MASTERARBEIT / MASTER'S THESIS

Titel der Masterarbeit / Title of the Master's Thesis

Navigating a world of constraints.

Developmentalism, industrial policy, and the limits to structural transformation in Ethiopia.

verfasst von / submitted by

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angestrebter akademischer Grad / in partial fulfilment of the requirements for the degree of

Master of Arts (MA)

Wien, 2023 / Vienna 2023

Studienkennzahl lt. Studienblatt / degree programme code as it appears on the student record sheet:	UA 066 589
Studienrichtung lt. Studienblatt / degree programme as it appears on the student record sheet:	Masterstudium Internationale Entwicklung
Betreut von / Supervisor:	Mag. Dr. Johannes Jäger

Acknowledgments

I would like to express my gratitude to my interlocutors in Addis Ababa, whose insights and cooperation greatly enriched my research. Their contributions were instrumental in shaping this thesis, and I am deeply grateful for their time and support.

The University of Vienna deserves special mention for generously funding my research stay in Ethiopia through the Short-term grants abroad (KWA) program.

I would also like to thank my supervisor, Johannes Jäger, for his invaluable insights and inspiration throughout my studies.

Thank you also to Miriam, Julia, and Felix for proofreading and for their constructive comments and feedback.

I also want to thank all my friends who accompanied me along parts of the way and with whom I spent countless days in the library.

To my parents, I owe a debt of gratitude for their unwavering support and the opportunities they provided that laid the foundation for all of this.

Finally, I would like to express my deep appreciation and gratitude to Wenke for her unwavering encouragement, understanding, and patience throughout this challenging endeavor. Her love and support kept me going through the most difficult times.

Abstract

This thesis investigates the challenges surrounding structural transformation and industrial policy in 21st century peripheral countries, with a special focus on the developmental journey of Ethiopia. It provides insights into the unequalizing workings of the world economy, highlighting global core-periphery polarization and the role of technological lagging and transfers of value. The thesis discusses developmental strategies that have historically been used by late industrializing countries, and examines the economic and political constraints that undermine peripheral attempts at structural transformation. Ethiopia, often hailed for its unconventional policies and impressive growth rates, serves as a case study to analyze how a poor country navigates the complexities of developmental constraints in its quest for economic development. Based on an in-depth literature review and 12 semi-structured interviews conducted in Ethiopia and online between October and December 2022, the thesis finds that, despite targeted efforts and remarkable progress, structural transformation in Ethiopia has been hindered by a complex interplay of internal and external pressures and constraints. These include a lack of credit for the manufacturing sector, difficulties in acquiring technological capabilities, limited success in creating linkages and fostering import substitution and export growth, political and ethnic grievances, foreign exchange shortages, external debt, and pressure from international financial institutions. Ultimately, the thesis discussed how Ethiopia's economic struggles and the failure to achieve structural transformation have led to the adoption of neoliberal policies, raising questions about the future of interventionist industrial policy in the country.

Kurzfassung

Diese Masterarbeit befasst sich mit den Herausforderungen und Schwierigkeiten, die mit Strukturwandel und Industriepolitik in peripheren Ländern des 21. Jahrhunderts verbunden sind, mit besonderem Fokus auf die Entwicklung Äthiopiens. Sie bietet Einblicke in die Funktionsweisen des kapitalistischen Weltsystems und skizziert Dynamiken globaler Kern-Peripherie-Polarisierung sowie die Rolle von technologischen Rückständen und Werttransfers. Die Arbeit diskutiert Entwicklungsstrategien, die in historischen Fällen nachholender Industrialisierung angewandt wurden und untersucht die wirtschaftlichen und politischen Hindernisse, die die Bemühungen der Peripherie um strukturelle Transformation untergraben. Äthiopien, das lange für seine unkonventionelle Politik und seine hohen Wachstumsraten gelobt wurde, dient als Fallstudie, um zu analysieren, wie ein peripheres Land versucht, solche Entwicklungshindernisse zu überwinden. Aufbauend auf einer umfassenden Literaturrecherche und zwölf semi-strukturierten

Interviews, die zwischen Oktober und Dezember 2022 in Äthiopien und online durchgeführt wurden, kommt die Arbeit zu dem Schluss, dass der Strukturwandel in Äthiopien trotz gezielter Bemühungen und bemerkenswerter Fortschritte durch ein komplexes Zusammenspiel interner und externer Faktoren behindert wurde. Dazu zählen ein Mangel an Krediten für den Industriesektor, Schwierigkeiten bei der Aneignung technologischer Fähigkeiten, begrenzte Erfolge bezüglich Linkages, Importsubstitution und Exportwachstum, politische und ethnische Widrigkeiten, Fremdwährungsknappheit, Auslandsverschuldung und Druck seitens internationaler Finanzinstitutionen. Die Arbeit diskutiert abschließend, wie die wirtschaftlichen Probleme des Landes und das Scheitern der strukturellen Transformation zu einer neoliberalen Wende geführt haben, was Fragen nach der Zukunft interventionistischer Industriepolitik in Äthiopien aufwirft.

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List of abbreviations

AAU	Addis Ababa University
ADLI	Agricultural Development Led Industrialization
AfCFTA	African Continental Free Trade Area
AGOA	African Growth and Opportunity Act
ANDM	Amhara National Democratic Movement
BIT	Bilateral Investment Treaty
CBE	Commercial Bank of Ethiopia
CIPE	Critical International Political Economy
COMESA	Common Market for Eastern and Southern Africa
COVID-19	Coronavirus Disease 2019
DAC	Development Assistance Committee
DBE	Development Bank of Ethiopia
EBA	Everything But Arms
ECCSA	Ethiopian Chamber of Commerce and Sectoral Associations
EFFORT	Endowment Fund for the Rehabilitation of Tigray
EHDA	Ethiopian Horticultural Development Agency
EIC	Ethiopian Investment Commission
EIH	Ethiopian Investment Holdings
ENA	Ethiopian News Agency
EOI	Export-oriented Industrialization
EPRDF	Ethiopian People's Revolutionary Democratic Front
ESAF	Enhanced Structural Adjustment Facility
EU	European Union
FDI	Foreign Direct Investment
FDRE	Federal Democratic Republic of Ethiopia
FTA	Free Trade Agreement
G20	Group of 20
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GERD	Grand Ethiopian Renaissance Dam
GTP	Growth and Transformation Plan
GVC	Global Value Chain
HERA	Homegrown Economic Reform Agenda
HIPC	Heavily Indebted Poor Country
IDS	Industrial Development Strategy
IFI	International Financial Institution
IMF	International Monetary Fund
IPDC	Industrial Parks Development Corporation
IPR(s)	Intellectual Property Right(s)
ISDS	Investor-State Dispute Settlement
ISI	Import Substitution Industrialization

LDC	Least Developed Country
MDRI	Multilateral Debt Relief Initiative
METEC	Metals and Engineering Corporation
MoF	Ministry of Finance
MoI	Ministry of Industry
MoPD	Ministry of Planning and Development
NBE	National Bank of Ethiopia
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
OPDO	Oromo People's Democratic Organization
PASDEP	Plan for Accelerated and Sustained Development to End Poverty
PP	Prosperity Party
PRSP	Poverty Reduction Strategy Paper
PTA	Preferential Trade Agreement
SAF	Structural Adjustment Facility
SAP	Structural Adjustment Program
SCM	Agreement on Subsidies and Countervailing Measures
SEPDM	Southern Ethiopian People's Democratic Movement
SOE	State-owned Enterprise
TIDI	Textile Industry Development Institute
TNC	Transnational Corporation
TPLF	Tigray People's Liberation Front
TRIMS	Agreement on Trade-Related Aspects of Investment Measures
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
TYDP	Ten Years Development Plan
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNECA	United Nations Economic Commission for Africa
UNIDO	United Nations Industrial Development Organization
US	United States of America
USD	United States Dollar
VSI	Vertically Specialized Industrialization
WTO	World Trade Organization

Part I.

Foundations

1. Introduction

After being discredited by the proponents of neoliberal development for decades, structural transformation and industrial policy are back on the agenda. However, while there is a growing consensus that state intervention plays a crucial role in the process of economic development, there are still few signs of structural transformation and industrialization throughout the world's poorest regions. Since the middle of the 20th century, only a small number of countries (with the exception of those particularly rich in natural resources) have truly escaped the shackles of poverty and achieved high-income status. This remarkable achievement is epitomized by the famous "East Asian Tigers", including South Korea and Taiwan. Their success begs the question: if these late industrializing countries were able to achieve rapid economic development, why do so many other impoverished countries seem to be trapped in cycles of stagnation? What is holding back structural transformation in these struggling regions?

Ethiopia, a country that has garnered global recognition for its unconventional policy strategies and impressive growth rates, lends itself as a prominent case study for answering these questions. My aim in this thesis is therefore to shed light on the intricate dynamics of structural transformation and industrial policy in the 21st century, using Ethiopia as an example to assess the challenges poor countries face on their path to development. I am particularly interested in the constraints to development that result from Ethiopia's subordinate position in global economic relations, and in the developmental strategies employed by the Ethiopian state to navigate this difficult terrain in its pursuit of structural transformation. Drawing on a wide range of scholarly perspectives, and supplemented by 12 semi-structured expert interviews conducted in Ethiopia and online between October and December 2022, I aim to uncover the complex interplay of internal and external pressures and constraints that have conditioned Ethiopia's experience of state-led economic development. My main research questions are therefore as follows:

1. Which obstacles to structural transformation arise from the subordinate position of peripheral countries in global economic relations?

2. Which strategies has the Ethiopian state adopted in its pursuit of structural transformation?
3. What are the limitations to structural transformation in Ethiopia, particularly with regards to the country's peripheral position in global economic relations?

This thesis is divided into three parts. Part I. lays the ontological, epistemological, and methodological groundwork, establishing the critical realist perspective as the foundation for this analysis.

In Part II., I turn to the global context in which Ethiopian developmentalism operates. In order to gain deeper understanding of Ethiopia's journey, it is necessary to grasp the unequalizing dynamics of the imperialist world system as a whole, the developmental constraints this entails, and the strategies that have historically been used to escape from subordination.

Part III. shifts the focus to the Ethiopian experience of state-led developmentalism and interventionist industrial policy, particularly under the leadership of the Ethiopian People's Revolutionary Democratic Front (EPRDF) between 1991 and 2019. From the EPRDF's early years marked by a commitment to agricultural transformation and the retention of state control over the economy, to its later – ultimately futile – efforts to accelerate industrialization, to the eventual demise of developmentalism in the country, I analyze the successes and shortcomings of Ethiopia's state-led approach to structural transformation.

Ultimately, the thesis concludes by reflecting on the overall failure to achieve industrialization in Ethiopia, the vulnerabilities of developmentalism in the face of persistent internal and external constraints, and the uncertain future of interventionist industrial policy in the country.

Through this comprehensive exploration, I aim to contribute to the ongoing discourse on economic development and the challenges faced by poor countries striving to break free from exploitation and subjugation. Ethiopia's developmental trajectory serves to illustrate the broader issues that impinge on the process of structural transformation in peripheral countries, offering valuable insights into the interplay of global forces and domestic agency in shaping developmental outcomes.

2. Ontological and theoretical foundations

Every interpretation of social phenomena (such as economic development) is necessarily based on fundamental assumptions about what exists in the world and how we can gain knowledge about it. In the philosophy of science, these two questions are referred to as ontology and epistemology, respectively. Methodology then builds on ontology and epistemology, and concerns the concrete ways (i.e., methods) used to acquire scientific knowledge about the world. In this chapter, I discuss some of the ontological and theoretical grounding on which this thesis builds, before turning to epistemological and methodological questions in the next chapter.

2.1. Critical realism

This thesis is underpinned by critical realism, an approach originally developed by Roy Bhaskar (1975) that is characterized by ontological realism, epistemological relativism, and judgmental rationality. In short, this means that critical realists assume a reality "out there" that is independent of how we (as researchers) conceive of it, that our knowledge of this reality is socially produced and thus fallible, and that certain explanations of the world can be rationally chosen over others (Buch-Hansen and Nielsen 2020: 39-40). Critical realism upholds a strict separation between ontology and epistemology, and since ontology precedes epistemology, the former is seen as more fundamental. Reducing what is real (ontology) to what we know of reality (epistemology) means committing what is known as an epistemic fallacy (Fletcher 2017: 182).

Critical realism posits that reality can be analytically divided into three distinct ontological levels or domains. On the surface is the empirical, which consists of human experiences, observations, and measurements. Beneath that is the domain of the actual where events and phenomena take place, irrespective of whether they are observed by humans or not. The "deepest" level is the real. This is the realm of structures and mechanisms, which cause (or prevent) events in the actual level but which are not directly observable. For critical realists, science should be primarily focused on understanding the interplay of structures and their causal mechanisms in the real domain, and how these shape the events taking place at the actual level, which are then experienced at the empirical level (Buch-Hansen and Nielsen 2020: 29-30).

However, structures are not the only entities that possess causal powers, and human agency is equally as important in understanding social phenomena. In critical realism, structure and agency are considered interdependent but ontologically distinct. Both are seen as having unique causal powers and liabilities that enable them to generate mechanisms in the real domain, i.e., to influence or be influenced. As human beings are always confronted with already existing structures, structure precedes agency (Wigger and Horn 2016: 44). As Marx (2001 [1852]: 7) famously noted, humans "make their own history, but they do not […] make it under circumstances chosen by themselves, but under circumstances directly encountered, given and transmitted from the past". Structures at any given time (themselves the result of past social activity) thus constitute the context in which agency takes place, enabling or constraining the scope for action. Agency, in turn, reproduces or transforms social structures at a later point in time, which then provides the basis for future agency (Jäger et al. 2016: 111). In critical realism, it is therefore the dialectical interplay of structure and agency that determines the course of history (Wigger and Horn 2016: 44).

While very abstract, such questions of structure and agency are highly relevant to this thesis. On a fundamental level, this work is concerned with the interactions of an agent, the Ethiopian state, with the structures of the world economy and the actions of other, often more powerful agents, both of which constrain the scope for action of the former. The central question of this thesis is whether and how a state with limited economic and political power can effectively navigate these global dynamics, and how it could exploit or change such (external) structures to its advantage, particularly for the purpose of industrialization. As will be shown, both the structural features of the world economy and the actions of powerful state and non-state agents severely hamper the ability of the Ethiopian state in achieving its goals.

2.2. Critical (international) political economy

The insight that the global economy is structured in such hierarchical ways is a crucial aspect of what forms the theoretical bedrock of this thesis: critical international political economy (CIPE). Historically, CIPE has ontologically and epistemologically been underpinned by historical materialism. Today, many CIPE scholars operate on the basis of a critical realist framework, and critical realism itself has been heavily influenced by historical materialism (Jäger et al. 2016: 102; Jäger 2020: 250). While CIPE is a diverse field, most scholars share the basic understanding that capitalism develops unevenly across the globe, resulting in asymmetric relationships between countries (Jäger 2020: 255). Within the discipline, more specialized approaches such as dependency theory or other heterodox development theories can offer useful frameworks for analyzing "the interrelated dialectics of external and internal economic and political forces and processes" (Jäger et al. 2016: 111), making it possible to understand the dynamic interplay of structure and agency in the context of Ethiopian developmentalism.

As the name suggests, CIPE chiefly focuses on global processes. Critical political economy, as a broader approach, is aimed at the analysis of the capitalist mode of production more generally, both globally and within individual countries. Marx's *Capital* (1990 [1867]), for example, primarily examined the development of capitalism in Great Britain, but this was understood to be embedded in the interactions of the British Empire with the world. In critical political economy, most human societies are considered to be constituted by different classes, characterized by their relative roles in the productive system, and thus antagonistic to each other. Within the contemporary mode of production – capitalism – there are two main classes, although many sub-divisions or class fractions can be identified. These are the working class (or proletariat) on the one hand, which has to sell its labor power (i.e., engage in wage labor) to earn the means of survival, and the ruling capitalist class (or bourgeoisie) on the other, which accrues wealth through the exploitation of workers and the accumulation of capital. With these distinct standpoints come specific class interests that are related to a class's position in the economy (Grumiller and Raza 2019: 9). In this context, the state in capitalist societies can be understood as the historical product of earlier class conflicts, and, as Jessop (1999: 74) puts it, as "a strategic site of organization of the dominant class in its relationship to the dominated classes". Among other things, critical political economy is interested in how classes struggle over the conditions of production and distribution, and how the development of productive forces (i.e., technologies) influences such class relations. In the context of global disparities, productive forces are particularly important, as technologically more advanced countries are generally able to exert power over countries with less developed productive forces (Carchedi and Roberts 2021).

In summary, this thesis is underpinned by certain key assumptions about the nature of (social) reality, as is any attempt at explaining parts of the world. Critical realism forms the metatheoretical (i.e., ontological and epistemological) soil on which this thesis rests. In this perspective, ontology is seen as both distinct from and more fundamental than epistemology. Critical realists understand reality as existing independently of our knowledge, and as being layered into three domains: the empirical, the actual, and the real. The goal of science, then, is to understand how mechanisms that operate on the "deepest" level (the real) interact and how these may or may not lead to events in the actual domain. Importantly, such outcomes are understood as the product of the reciprocal relationship between already existing structures and human agency. For this thesis, the interplay between the Ethiopian state and global structures and agents is of particular concern. On a less abstract level, this work is grounded in critical international political economy (CIPE), a broad social science field rooted in historical materialism and critical realism. CIPE rests on the assumption that the globally uneven development of capitalism leads to complex inter-state relations of dominance and exploitation. This perspective, along with more specific approaches within the field of CIPE, provides a valuable theoretical framework for analyzing the interconnected dynamics of capitalist development, both within individual countries and globally. The next chapter takes a closer look at how and under which conditions such knowledge production takes place, i.e., at epistemological and methodological questions.

3. Epistemological and methodological considerations

As noted in the previous chapter, critical realism is characterized by a commitment to epistemological relativism and judgmental rationality. Explanations of the world are understood to be situated in a specific historical context and are seen as always potentially fallible and therefore contestable (Wigger and Horn 2016: 39). However, this does not mean that every knowledge claim is equally valid. Different theories or explanations can be more or less helpful for identifying and understanding the causal mechanisms that form the basis for social phenomena (Fletcher 2017: 182). As researchers, we do not have direct access to reality. Critical realism therefore "opposes any notion that knowledge follows directly from being as if it was possible to read reality like an open book" (Buch-Hansen and Nielsen 2020: 29). Rather, our understanding of the world is mediated by (historically contingent) theories, ideas, and concepts, which function analogous to a lens through which we view reality (Jäger et al. 2016: 108). Dependency theory, for example, is one such lens. Through abstraction, theories allow us to move from the empirical observation and mere description of social phenomena to the identification of possible causes in the real domain (Wigger and Horn 2016: 47). The starting point of critical realist knowledge production may thus be a concrete phenomenon, which is analyzed through the lens of theory. Concepts at different levels of abstraction (e.g., the notion of the international division of labor or theories of the state) are used to make sense of empirical observations, which in turn can help modify or develop theoretical concepts (Jäger et al. 2016: 109).

Methodology, as it refers to the procedures and principles guiding the process of knowledge production, is more fundamental than methods (Jäger et al. 2016: 101). In critical realism, dialectical reasoning and theoretically grounded analysis, as described above, form the core of methodology. When it comes to understanding social phenomena, mainstream approaches typically place great emphasis on the use of scientific methods to identify regularities and, ostensibly, discover quasi-universal truths (Wigger and Horn 2016: 45). In grounded theory, for example, qualitative data is coded inductively to generate theories that are grounded in the data. By contrast, critical realist research seeks to provide the most appropriate explanation of reality by explicitly engaging with pre-existing theories about that reality (Fletcher 2017: 186). Critical realist methodology places less emphasis on methods and, as Jäger (2020: 252) emphasizes, "more so on the adequate combination of theories and abstractions which fits with the subject matter of the analysis". This is not to say that scientific methods are not important for critical realists, but they should not be given primacy over epistemology, and are not a substitute for a more fundamental analytical strategy (Wigger and Horn 2016: 47). As with theoretical lenses, methods should be selected and combined in a way that is appropriate to the subject, thus helping to uncover "hidden" mechanisms, rather than being applied for their own sake. As Wigger and Horn (ibid.) note, "[o]nly when this methodological dimension is clear can the actual choice of methods for how to go about the concrete process of gathering empirical data be made".

Given this epistemological and methodological background, this thesis primarily builds on already existing explanations about the topic at hand. It thus critically engages – through judgmental rationality – with literatures on dependency, developmentalism, economic development, industrial policy etc., in order to identify the underlying structures, agents, and mechanisms that shape the process of structural transformation in Ethiopia. An extensive literature review and theoretically informed analysis thus form the basis of this thesis. However, in order to gain deeper insight, I also conducted 12 semi-structured expert interviews with officials from Ethiopian ministries and state agencies, one academic economist, and representatives from the trade union confederation, the chamber of commerce, and international organizations.

Semi-structured interviews, in particular, are often used in qualitative research to supplement existing knowledge about the field of study with insights from experts (Froschauer and Lueger 2020: 59). Furthermore, interviews were chosen as a method of inquiry because there are limitations to purely relying on existing accounts, especially concerning more recent developments. For example, there is still very little academic research on the changes in Ethiopia's economic policy since 2018. These interviews helped generate first-hand information of the prospects and limitations of industrial policy in Ethiopia. They enabled me to gain access to the knowledge and opinions of people directly involved in Ethiopian economic policymaking (i.e., the ones identified by Grumiller and Raza (2019: 10) as the main social groups relevant to industrial policy) as well as those researching it "on the ground".

11 of the 12 interviews were conducted in person in Addis Ababa, Ethiopia, in October and November 2022, with one interview conducted online in December 2022. These ranged in length from 34 to 81 minutes, with an average of around 55 minutes. Interlocutors were selected using theoretical sampling and through a "snowball" system, with interviewees helping to contact potential further research participants (Froschauer and Lueger 2020: 25). The interviews were anonymized and then transcribed and coded using software, my coding procedure being similar to that of Fletcher (2017: 186):

> I used a primarily deductive yet flexible […] coding process […] that drew on existing theory and literature. A list of codes was drawn from the literature review, theoretical framework, and key [critical realist] concepts; however, these codes were changed, eliminated, and supplemented with new codes during the process until every piece of text was coded

The empirical data was then used to augment or contrast explanations found in the literature or to provide insight into recent developments.

However, given the tumultuous times Ethiopia found itself in in late 2022, there were some limitations to this approach. For example, it proved impossible to secure interviews with officials from Ethiopia's ruling Prosperity Party or certain international organizations, despite several attempts. Due to the tense political climate in the country, some interviewees also felt uncomfortable answering some of my questions and therefore refrained from doing so.

In the spirit of epistemological relativism, all explanations are treated as potentially fallible, including those offered by interlocutors (Fletcher 2017: 188). The way in which interviewees interpret the world is thus not taken at face value but contextualized with regards to existing explanations. In critical realism, this is the analytical task of the researcher. However, this does not mean that my interpretations of reality offered in this thesis can provide definitive answers to the puzzles of Ethiopian economic development, or even that they are necessarily more accurate than opposing knowledge claims. Any explanation presented in this work may well be refuted by more appropriate accounts in the future. Despite this limitation, this thesis aims to at least offer tentative answers.

Finally, critical realists reject the notion that there is a neutral and value-free way of looking at the world, especially in the social sciences. Any interpretation of reality is inevitably influenced by historical circumstances, societal norms and institutions, and political and economic interests (Jäger 2020: 250). Whether or not researchers reflect on this, they can never be objective observers. This insight does not undermine the possibility of science in a critical realist understanding. One can uncover causal mechanisms that shape social phenomena, while also having an ethical standpoint on them. However, it is important to be aware of one's biases and convictions, and, contrary to feigning value-neutrality, to be explicit about the underlying values and norms that inform one's research (Wigger and Horn 2016: 41). For critical realist research, this means being openly committed to striving for a more just and equitable world. The goal, then, is not only to produce knowledge but to use this knowledge in order to overcome exploitative and oppressive social relations. In the tradition of CIPE, this involves identifying – and critiquing – the causal mechanisms that perpetuate structures of global inequality and working to change or abolish them.

Overall, the epistemological and methodological tenets of critical realism inform the proceedings of this thesis. Because our knowledge of the world does not simply follow from observation, we must engage with reality through the lenses of theories. They allow us to make sense of empirical data, which, in turn, can lead to an enhanced theoretical understanding. This dialectical cycle forms the methodological core of critical realist research, and scientific methods should be employed in accordance with these considerations. For this thesis, a primarily theoretical approach, based on an extensive literature review and supplemented by semi-structured expert interviews, was chosen as the most promising avenue for understanding the topic at hand and the mechanisms that constitute it. Understanding, however, is only one aspect of critical realist research. Since social scientists can never be neutral, they should instead be open about the ethical, normative, and political standpoints that determine their view of the world. For CIPE, and for this thesis, this means not only explaining reality but working to overcome global relations of exploitation and exclusion.

Part II.

Capitalist development in an imperialist world

4. Dependency relations and the economics of modern imperialism

Before addressing the question of how a country can change its position in the global hierarchy of wealth and power, one must first define what such position specifically entails. What does it mean to be a poor country in this world? Theories of dependency and imperialism, discussed in this chapter, offer a good starting point for answering such questions. In Section 4.1., I first introduce dependency theory and how it conceptualizes global core-periphery relations manifested in the international division of labor and unequal patterns of productivity and specialization. The dependency understanding is then connected to insights from Marxist theories of imperialism before introducing some key mechanisms of the reproduction of dependency relations and of imperialist value transfer in Section 4.2. This section also discusses some contemporary aspects of dependency in the neoliberal era, embodied by the proliferation of global value chains and subordinate financialization. In Section 4.3., another emphasis is laid on the question of constraints and how the interactions of internal and external factors, as well as peripheral struggles against exploitation and exclusion, shape the process of global wealth polarization. Section 4.4. concludes the chapter.

4.1. Dependency theory: global capitalism and the periphery

At its core, dependency theory tries to explain the persistence of global wealth inequalities, asymmetric power relations and enduring underdevelopment (Kvangraven 2020: 81). The historical emergence of the dependency approach from the 1960s onwards must be understood in the context of the perceived failure of Latin American structuralism. The latter was developed in Latin America in the mid-20th century and sought to explain the lack of dynamic capitalist development on the continent. Structuralists such as Raúl Prebisch (1950) and Hans Singer (1950) conceptualized hierarchical relationships between rich countries (i.e., those belonging to the so-called core (or center) of the world economy) and poor countries (located at its periphery). Structuralists identified both the economic structures within peripheral countries and their economic relations to core countries as the main barriers to self-centered development (Tomkinson 2019: 39). However, when structuralist strategies for economic development failed to deliver on their promises, the paradigm and its proponents came under attack.

Dependency theorists critiqued both assumptions and policy prescriptions of structuralist economics. They showed that capitalism in the periphery did not follow the same path as it had earlier in the core of the world system. Instead, theorists of dependency assessed that capitalist development in the periphery was an illusion that could never be reached, at least not for all countries equally and simultaneously (Arrighi 1990: 16). In light of the demise of structuralism, they developed a more critical understanding of the nature of global capitalism and the (limited) possibilities for peripheral countries within it. Dependency theorists did, however, retain structuralism's relational framework to understand the hierarchical links between prosperous core countries and poorer peripheral regions. Indeed, despite being more skeptical about the chances for economic development, dependency theory arguably shares much of the structuralist analysis regarding the root problems of global core-periphery polarization.

Theotonio Dos Santos, one of the founding figures of the theory, understood dependency as "a situation in which the economy of certain countries is conditioned by the development and expansion of another economy to which the former is subjected" (Dos Santos 1970: 231). This implies an unequal relationship in which the economic development of some – peripheral – countries is impeded by their connections to other – core – countries. Some conceptualizations, particularly within world systems theory, introduce semiperipheral countries as intermediate cases falling in between these two extremes (Arrighi 1990: 11). Through various mechanisms (to which I will return shortly), countries at the core benefit disproportionately from their relationships with peripheral (and, to a lesser extent, semiperipheral) countries, at the expense of the latter. Frank (2008 [1966]) popularized the notion the development of underdevelopment to describe the ways in which the development of one is only possible through the underdevelopment of another. The extremes of core and periphery positions are understood to be merely two different sides of the same coin of capitalist expansion on a world scale. Core countries, in other words, "would not exist but for their symbiotic relationship with so-called underdeveloped economies" (Martins and Sotelo Valencia, cited in Treacy 2022: 221). In the dependency understanding, it is thus not only (or even primarily) endogenous factors within the periphery that cause chronic poverty and underdevelopment but rather the kind of integration into global economic relations and the exploitation of the periphery by the core. More specifically, different modalities of integration and participation are understood to lead to an unequal distribution of value on a world scale and to transfers of value from the periphery to the core, and thus, to underdevelopment and development, respectively (Weissenbacher 2018: 34).

The analysis of such issues, however, is not unique to dependency theory but has a long intellectual history, going back at least to the work of Lenin (2001 [1917]) and subsequent Marxist analyses of imperialism. Carchedi and Roberts (2021: 23), who operate in such a Marxist-Leninist framework, define economic imperialism as "the persistent and long-term net appropriation of surplus value by the high-technology imperialist countries from the low-technology dominated countries", an understanding that is compatible with most dependency theories. Four things are of note in this definition of imperialism: first, imperialism is understood as a relation between two countries, or two blocs of countries: imperialist countries and dominated countries, corresponding with dependency theory's account of core and peripheral countries, respectively; second, the economic relation between such core and peripheral countries is determined by an appropriation of (surplus) value by the former from the latter, meaning that there is a transfer of monetary resources from peripheral countries to core countries; third, this flow of value towards the core is not a singular event but a long-lasting dynamic inherent to the functioning of the imperialist world system; and fourth, technology plays a vital role in these value transfers, as value generally flows from peripheral countries with less developed productive forces, i.e., lower technological capabilities, to core countries with higher ones. These insights compound the theory of dependency by highlighting the crucial elements of value transfer and the role of technological discrepancies.

Differences in productive structures between countries (which are themselves an expression of the respective modalities of integration into global capitalism) are among the key determinants of either a core or peripheral position. The economic structure of a country, which depends on the technological capabilities of firms and workers, determines the kinds of goods the country can produce, thus resulting in varying levels of productivity and specific product specializations among different countries (Kvangraven 2020: 85). Whereas core countries generally have diversified economies with many firms at the technological frontier, the periphery is typically marked by the extraction of natural resources or the production of agricultural commodities or low-complexity manufactures, as well as by a dependence on (technologically complex) imports from the core and by persistent trade deficits. (Perez 2021: 103). In core countries' fields of specialization, firms face less intense competition and are therefore able to extract higher shares of value on the basis of their technological superiority, allowing for higher wages while maintaining profitability. Capital in the periphery, on the other hand, is exposed to cut-throat, low-cost competition which necessitates low wages for firms to survive (Macheda and Nadalini 2021: 122). Due to their firms' technological advantages, core countries also have persistently higher levels of productivity than those at the periphery – a key driver of economic polarization between countries, as theorists of imperialism also argue (Carchedi and Roberts 2021: 30). On a global level, these differences manifest in the international division of labor, a term which describes the uneven distribution of economic activities around the globe, whereby peripheral countries are relegated to unfavorable activities, to the benefit of the core.

Different economic activities carry different possibilities for development, and, as Amin (1976: 136) notes, "the one that agrees to specialize in the less dynamic branches of production will lose by doing so, in the long run". What makes economic activities dynamic in this sense is not necessarily mechanization per se, as Arrighi (1990: 24) emphasizes in his notion of the "peripheralization of industrial activities". Instead, what counts are higher barriers to entry and imperfect competition (i.e., oligopolistic markets) within sectors, which allows for so-called technological rents or superprofits. Whitfield et al. (2015: 4) stress that these are the factors that have made manufacturing historically stand out from other sectors such as agriculture, as opposed to any inherent properties of the manufacturing process itself. Oqubay (2015: 20), on the other hand, emphasizes the sector specificity of growth, meaning that certain activities have an inherent propensity to drive economic development more than others. This is understood to apply particularly to the manufacturing sector where, as output grows, so do gross domestic product (GDP) and productivity both within the sector and throughout the economy (Ashman et al. 2020: 182). In any case, whether because of barriers to entry or the unique characteristics of the sector, high-complexity manufacturing has historically exhibited, and continues to exhibit, certain characteristics that other economic activities often lack, making it a particular driver of development and identifier of core status.

From a historical perspective, core and peripheral positions in the international division of labor are a result of the uneven global expansion of the capitalist mode of production. Lenin's (2001 [1917]) theory of imperialism describes the way European companies expanded beyond the continent in order to resolve faltering capital accumulation at home. The rise of monopolies and the fusion of industrial and finance capital, underpinned by problems of domestic capital realization, led to this expansion of the capitalist mode of production into the hitherto non-capitalist parts of the globe. The newly incorporated regions had thereby become dependent parts of the world market, subject to the accumulation needs of imperialist capital (Cardoso 1972: 84-85). Their role had become to "provide imperialist capital with an outlet for direct or portfolio investment or with cheap agricultural products, minerals or labour, in various combinations at different times" (Perez 2021: 104). With the advent of industrial capitalism in 18th century Europe and subsequent processes of colonial and imperial expansion thus came a divergence of productive structures between countries and with it increased global polarization. Contemporary core-periphery relations and corresponding patterns of productivity and specialization must therefore be understood as going back to the specific form of any given country's integration into global capitalism (Brewer 1990: 183).

4.2. Mechanisms of core-periphery polarization

The flow of value from the periphery to the core prevents capital reinvestments in the former, contributing to the lack of dynamic capitalist development in peripheral countries. As dependency theory and theories of imperialism therefore show, it is not simply a lack of domestic in peripheral societies that lead to their impoverishment but the uneven nature of global capitalism and the persistent flow of resources to the core.

One of the most influential ideas on how value is being transferred stems from Arghiri Emmanuel's theory of unequal exchange. Unequal exchange occurs when – assuming equal productivity – core countries pay relatively less for their imports from low-wage peripheral countries than they would if they imported from high-wage countries. Samir Amin, who further developed Emmanuel's idea and incorporated it into his own theory of unequal specialization, posits that "exchange is unequal whenever labor of the same productivity is rewarded at a lower rate in the periphery" (Amin 1976: 148-149). The reason for this dynamic thus lies in the different wage levels of core and periphery. Because wages in the core are high, the products of core labor are correspondingly expensive for peripheral countries to import. The inverse is true for peripheral exports. Low peripheral wages lead to relatively cheap products on world markets. Under these conditions, when a core country and a peripheral country exchange their products, the former receives goods that embody a relatively higher amount of labor than the goods it exports. In this way, value is being transferred from the peripheral country to the core country (Brewer 1990: 200-203).

This problem is aggravated by a tendential worsening of the terms of trade, as Latin American structuralists Prebisch (1950) and Singer (1950) famously described. According to them, prices of peripheral countries' exports tend to decline relative to those from the core, a result of different income elasticities of demand for different kinds of goods. This hypothesis has since been heavily criticized, and there are indications that prices for raw materials and agricultural commodities (to which the argument originally referred) do not, in fact, decline continuously and linearly, but are subject to cyclical increases and decreases (Eder and Kaps 2020: 183). However, beyond demand elasticities, the sectors in which peripheral countries specialize – and this now includes low-complexity manufacturing – are typically characterized by lower barriers to entry and thus higher competition, which also pushes down prices (Whitfield et al. 2015: 56). Additionally, core-based transnational corporations (TNCs) have accrued immense price-setting power, contributing to a tendency of relative price declines as well (Chang et al. 2016: 151). As a result, the terms of trade of peripheral countries have in fact been decreasing, in the case of peripheral manufacturing exports specifically at an average rate of 1.1 percent per year between 1980 and 2014 (UNCTAD 2016: X).

Different positions in the international division of labor and their ramifications thus compound the dynamic of unequal exchange. Unequal exchange is indeed only detrimental to the periphery if the two trading partners specialize in different products, i.e.,

> only to the extent that the relationship in production and consumption between the two kinds of commodity is one of complementarity rather than of competition. If for any reason the relationship of complementarity weakens and that of competition becomes stronger, unequal exchange in this sense becomes the weapon of the "exploited" country to gain wealth, power, and welfare relative to, and possibly at the expense of, the "exploiting" country (Arrighi 1990: 13-14)

This insight leads back to the question of unequal specialization. If peripheral firms start engaging in the same high-technology activities in which core firms specialize, their ability to produce more cheaply would enhance competitiveness, which would benefit the peripheral country. An unequal international division of labor is thus a prerequisite for unequal exchange to occur. Crucially, the theory of unequal exchange does also not explain why peripheral wages are low in the first place. There must therefore be other mechanisms at play.

While accepting the concept's relevance, Arrighi (1990: 14) questions the notion that unequal exchange is mainly responsible for global polarization: "the assumption of a fundamental identity between core-periphery relations and relations of unequal exchange is unwarranted". Instead, he points to unilateral transfers of capital and labor from the periphery to the core and, more generally, to exploitation and exclusion as the main drivers in the creation and reproduction of global disparities. Arrighi distinguishes forced and voluntary transfers. The former include the slave trade and the monetary extortion of colonies, which are examples of forced unilateral transfers of labor and capital, respectively. Voluntary transfers, on the other hand, which have become the primary mode of transfer today, are "based exclusively on the self-interest of the owners of the resources that are being transferred, the most prominent examples being the emigration of workers and the 'flight of capital'" (Arrighi 1990: 13). These movements of labor and capital from the periphery to the core, incentivized by greater chances of either higher standards of living or profit realization, have greatly contributed to the disparities between poor and rich countries, and they continue to reproduce such inequalities. Today, key channels of unilateral transfers of capital include foreign debt and interest payments, the repatriation of profits by core-based TNCs, and payments related to intellectual property rights (IPRs) such as patents or royalties (Treacy 2022: 228-229). Direct flows of resources from peripheral to core countries thus constitute a key mechanism for explaining global wealth inequalities, and they seriously aggravate peripheral countries' problem of financial scarcity.

Besides direct channels of value transfer, one other central feature inherent to the imperialist world system needs to be considered. As already indicated, globally uneven patterns of specialization and productivity, and thus the international division of labor itself, can be seen as both origin and outcome of global core-periphery polarization. Both unequal exchange and unilateral transfers of capital are only possible because of the structural power of core countries and core-based companies, afforded to them by their technological superiority and their favorable position in the international division of labor. Carchedi and Roberts (2021: 34) thus maintain that "[p]ersistent unequal levels of technology are the necessary condition for the persistent appropriation of surplus value". This is because core capital is able to extract value from peripheral capital through its higher productivity. In line with Carchedi and Roberts (2021: 30), productivity is understood as "the price of assets divided by labour units". Companies with above-average productivity can therefore produce more efficiently than those with lower productivity. Core firms tend to be characterized by high productivity, which allows them to produce higher value goods in the same amount of time it takes a lower productivity firm to produce lower value goods. In this way, productivity differentials between core and periphery lead to a highly uneven distribution of value (Brewer 1990: 201). This, in turn, also functions as a key mechanism to explain the gap in wage levels between core and periphery, which forms the basis for unequal exchange (Treacy 2022: 222).

Since the original formulation of dependency theory over half a century ago, the imperialist world economy has undergone a series of fundamental shifts that can be associated with the rise of neoliberal ideology and a global neoliberal mode of capital accumulation. These transformations have altered the character of core-periphery relations, and thus of the difficulties facing peripheral countries. Perhaps most important among these changes are the internationalization of production and the proliferation of financialization (Fine and Mohamed 2022).

Beginning in the 1970s and increasingly since the 1990s, TNCs have outsourced large parts of their industrial production activities to supplier firms in peripheral and semiperipheral countries while retaining the most complex – and most profitable – activities at their core-based headquarters (Hauge 2020: 2070; Chang et al. 2016: 150-151). The global fragmentation of production into geographically dispersed manufacturing and assembly steps has manifested in a sharp increase of trade in intermediate goods, i.e., unfinished products that are traded between firms specializing in different activities (Milberg et al. 2014: 151). These transformations have given rise to globally integrated and vertically specialized global value chains (GVCs) under the control and governance of TNCs. As in earlier historical periods, the activities in which core-based firms specialize within GVCs are typically highly complex and thus have high barriers to entry (Treacy 2022: 227). These include research and development, branding, product design, software development, or high-technology production. Peripheral producers, on the other hand, are relegated to production or assembly activities that are relatively low in complexity, have low barriers to entry and are subject to more intense competition and tendentially falling prices (Whitfield et al. 2015: 4). Thus, the higher the barriers to entry, the better the opportunities for firms to capture higher shares of value from participation in GVCs. There are unique developmental challenges related to these dynamics, which will be discussed in Section 6.1.2.

The second relevant dynamic of neoliberal globalization concerns the process of financialization which can be understood as "not only the extraordinary proliferation and expansion of financial markets and instruments as such, both within and between countries, but also the penetration of financial processes and imperatives into ever more aspects of economic and social reproduction" (Fine and Saad Filho 2014: 156). Since the disintegration of the Bretton Woods system, financial deregulation in both core and peripheral countries has given rise to a heightened importance of financial accumulation and has exacerbated peripheral vulnerability to external financial shocks (Fritz et al. 2022: 725). Three modifications of the neoliberal era are of particular importance: increased global liquidity, much greater capital mobility beyond borders, and an increase in short-term speculative flows over long-term investments (Tomkinson 2019: 64). The way these developments influence the reproduction of global core-periphery polarization through subordinate financialization will be discussed in section 6.1.3.

4.3. Constraints and struggles

The question must then be why peripheral countries should remain locked in their current state of specialization and thus their standing in the global hierarchy of wealth. Blaming the remarkable persistence of dependency on technological lagging or transfers of value alone would constitute a rather mechanistic view on capitalist development. Indeed, the core-periphery divide in productivity and technology must itself be the result of other constraining factors. There must be additional mechanisms at work which prevent peripheral countries from altering their position in the international division of labor, i.e., additional constraints to autonomous development. Such barriers to development are one main focus of interest in this thesis, in particular those that are not solely located within peripheral countries, but which operate on a global or transnational scale. A more complete picture of these external developmental constraints will be provided in Chapter 6.

The constraints introduced in this chapter so far have focused mostly on economic mechanisms of dependency based on global circuits of capital accumulation and the workings of the international division of labor (e.g., unequal exchange, unequal specialization, or more recently, GVC dynamics and subordinate financialization). This is only one side of the story, as Arrighi reminds us. Alongside processes of exploitation (as he summarizes the effects of the participation in global capitalism on unfavorable terms), processes of exclusion hint at the political dimensions of imperialism.

> Processes of exclusion are as important as processes of exploitation. As used here, the latter refers to the fact that the absolute or relative poverty of peripheral and semiperipheral states continually induces their rulers and subjects to participate in the world division of labor for marginal rewards that leave the bulk of the benefits to the rulers and subjects of core states. Processes of exclusion, in contrast, refer to the fact that the oligarchic wealth of core states provides their rulers and subjects with the means necessary to exclude or crowd out the rulers and subjects of peripheral and semiperipheral state from the use and enjoyment of resources that are scarce or subject to congestion. (Arrighi 1990: 16-17)

For Arrighi, these two processes of exploitation and exclusion are *the* fundamental mechanisms of core-periphery polarization, and both can be conceptualized as constraints to autonomous development. As will be shown in depth in Chapter 6 and in the discussion of Ethiopian developmentalism in Part III. of this thesis, core countries and core-based actors actively engage in what Chang (2002) calls "kicking away the ladder", that is, in deliberate acts of exclusion that have the effect of keeping peripheral countries in their position of subordination. Besides transfers of value based on unequal exchange and patterns of specialization and productivity, such processes of exclusion thus constitute an inherent element of dependency and pose significant challenges for economic development in the periphery. In this sense, economic development could be understood as a continuous struggle against these twin processes. Concerning the moderate wealth of semiperipheral countries, Arrighi stresses that it is "precisely their capability to wage successfully these struggles that keeps semiperipheral states from falling into the abysmal poverty of peripheral states" (Arrighi 1990: 18). Waging such struggles is what this thesis is about.

However, it is necessary to understand external difficulties to development not as uniformly impeding peripheral countries from the outside but as dynamically evolving in relation with forces of production and social formations in the domestic realm. In other words, the way transnational constraints manifest themselves depends on the reciprocal interactions of external and internal factors. Thus, on the one hand, dependency theory rejects methodological nationalism, i.e., the notion that (under)development can be understood simply by examining internal conditions within the confines of a country. The insight that peripheral economies are adversely affected by dynamics in core countries is indeed a central tenet of dependency theory. On the other hand, however, it is important to uphold a non-deterministic view on the dynamics of global core-periphery polarization. Peripheral countries are not passive objects of foreign control, not puppets on the string of core capital accumulation. Focusing only on how the external unidirectionally shapes the internal does not do justice to the complexity of the problem. Instead, such thinking denies peripheral states, capitalists, and workers any agency. As Tomkinson (2019: 29) succinctly summarizes,

> the modality of a country's insertion into the global division of labour (and therefore the challenges this poses for development pathways) is not simply the product of global forces […] but is rather the context-specific product of both that nation's development strategy and the shifting functioning of the global capitalist system in a specific moment of global accumulation.

Domestic class relations and the political orientation of a peripheral state are thus equally as important as the workings of the international division of labor. Only by looking at the reciprocity of global and national dynamics is it possible to grasp "how the pressures unleashed by imperialism impress themselves" (Amsden, cited in Perez 2021: 109).

4.4. Conclusion: the persistence of uneven development

In summary, this chapter has explored the complex relations of dependency, global core-periphery polarization, and the economics of modern imperialism. Through the theoretical lens of dependency theory, Section 4.1. began addressing the fundamental question of what it means to be a poor country in global capitalism. Rooted in the critique of (but also building on) Latin American structuralism, dependency theory can offer useful perspectives for understanding the unequal patterns of productivity, specialization, and power that persist in the international division of labor. The section also linked dependency theory to Marxist theories of imperialism, which emphasize the critical role of value transfers and technological disparities in perpetuating global wealth polarization. It highlighted the historical origins of core-periphery relations and how differences in productive structures contribute to countries' core or peripheral positions.

Mechanisms of value transfer and the globally uneven distribution of value were examined in Section 4.2., including the concept of unequal exchange, the tendential worsening of terms of trade, unilateral transfers of capital and labor, and productivity differentials. These dynamics are based to a considerable extent on the persistence of a technological divide between periphery and core. Together, they allow core countries to appropriate value from peripheral countries, leaving the latter woefully deprived of resources. The section also discussed the shifts brought about by neoliberal globalization, particularly the internationalization of production through the rise of GVCs and the proliferation of (subordinate) financialization.

However, as emphasized in Section 4.3. these mechanisms are not the only drivers of dependency. Rather, they are themselves the result of other constraints at the global level, as well as domestic factors within the periphery. Developmental difficulties and the persistence of uneven development must be understood as neither solely external nor internal, but as dynamically evolving outcomes of structure and agency at different spatial scales. Class relations, statehood, and agency within peripheral countries must thus be seen as equally crucial factors in understanding the complexities of global core-periphery polarization.

Finally, the section underscored the importance of processes of exclusion alongside exploitation in perpetuating core-periphery polarization. These twin processes, as identified by Arrighi (1990: 16-17), shape the dynamics of development and underdevelopment and constitute a continuous struggle for peripheral countries trying to break free of the stranglehold of dependency.

How then do countries successfully wage these struggles? What is necessary for a peripheral country to escape its subordinate position and to become less dependent on core countries? These questions and how different theoretical approaches answer them are the subjects of the next chapter.

5. Avenues for emancipation? Structural transformation, developmentalism, and industrial policy

To escape such subordination means to change one's position in the international division of labor by moving towards higher-complexity activities and improving productivity in order to retain more of the value that is now mostly captured by core firms and countries. Carchedi and Roberts (2021: 59) contend that "for an emerging capitalist nation there is no other way to 'development' than by raising productivity through more efficient technologies". If conducted on a grand scale, this process can be regarded as the structural transformation of an economy, a term which will be used roughly synonymously with the notions of economic development and industrialization. Broadly speaking, structural transformation can be understood as "the shift of resources from low to high productivity sectors and activities" (Oqubay 2015: 19). This is not to say that any kind of industrial activity will bring about structural transformation (or that industrialization will necessarily result in human development). As noted, low-complexity and easily replaceable manufacturing activities have become peripheralized and do not bear the same fruits as those with high barriers to entry and potential for technological rents or super-profits. Therefore, the goal of structural transformation is not to industrialize for the sake of industrialization but "to build industrial modern systems which are geared towards the penetration of oligopolistic technology markets and the appropriation of a share of technological rents that nowadays are fully appropriated by the centre" (Macheda and Nadalini 2021: 120).

Typically, such transformation does not happen on its own but requires state intervention. This is what industrial policy is concerned with (Eder et al. 2018: 8). In line with the CIPE perspective of this thesis, this chapter will discuss and integrate some of the most influential heterodox concepts on industrial policy and structural transformation. In Section 5.1., I discuss the concepts of delinking and developmentalism as political orientations towards autocentric development and state-led structural transformation. In the following Section 5.2., I address the conditions necessary for such orientation of the state to emerge and persist, as well as some additional political-institutional foundations of developmentalism. I then introduce developmental state theory as one possible (and perhaps the most influential) developmentalist approach in Section 5.3. Different pathways to industrialization and corresponding industrial policy strategies are the focus of Section 5.4., where I discuss import substitution industrialization (ISI), export-oriented industrialization (EOI), and vertically specialized industrialization (VSI) approaches. In Section 5.5., I briefly introduce two important developmental aspects which facilitate and accompany the process of structural transformation, namely linkage effects and agricultural development. Finally, in Section 5.6., I discuss the financial side of industrial policy, focusing on the mobilization of domestic savings and the management of external finance, before concluding the chapter in Section 5.7.

5.1. The will to break free: delinking and developmentalist industrial policy

If we understand peripherality as generated and reproduced mainly through the meta-processes of exploitation (mediated through the international division of labor) and exclusion (active interference), as Arrighi (1990) suggests, economic development must combat and overcome both of these. In line with the dependency understanding of unequal specialization, Samir Amin (1987) introduced the concept of delinking to offer a possible pathway out of peripherality. Delinking can be understood as "the *active management* of foreign trade and finance to change international specialisation, instead of passively accepting the current international division of labour" (Perez 2021: 104, emphasis added). Despite the name evoking a sense of autarky, delinking is not about cutting all ties to the rest of the world (or even to the imperialist core) but about *actively managing* external economic relations and submitting them to the needs of domestic development (Amin 1987: 442). This orientation towards prioritizing the domestic realm is necessary for what Amin calls an autocentric (as opposed to dependent) accumulation of capital, and thus for structural transformation within capitalism. For Amin, such orientation was indeed one of only two choices for the periphery: either to conform to the needs of core capital or to delink and embark on a process of autonomous development (Amin 1976: 382). Pursuing a strategy of delinking, i.e., one towards autocentric development, is thus first and foremost a political choice of governments in peripheral countries and social forces acting upon them.

Delinking may therefore be considered a form of what is commonly called developmentalism, understood here as state-led efforts targeted at the accumulation of technological capabilities and hence at economic development (Hauge 2019: 2073). Developmentalism, like delinking, primarily constitutes a broad political orientation, including strategic choices derived from it, rather than a concrete set of instruments. In this regard, what counts is not policy but political will. This idea of developmentalism points to the central role of the state in propelling and mediating structural transformation. In a world characterized by inter-state exploitation and exclusion, the peripheral state can act as a "major countervailing force against the unequalising tendencies of the global economy" (Tomkinson 2019: 54). Indeed, most heterodox development theories widely accept state intervention in the form of industrial policy to be an absolute necessity (see, for instance, Amsden 1989: 13; Chang 2002: 65; Whitfield et al. 2015: 6). As Oqubay (2015: 15) notes, "[a]ll advanced capitalist nations have used industrial policies and state interventions to establish their first mover status, to consolidate their advantages, or to force the pace in catching up on those ahead of them".

Such emphasis on the centrality of state intervention deviates from mainstream approaches to industrial policy as they have long been propagated by core states, international financial institutions (IFIs), and other agents of neoliberal globalization (Fine and Mohamed 2022: 2). Orthodox economists and policymakers forcefully argue against active state involvement (although core countries have themselves done so in the past and continue to do so (Chang 2002)), which they see not only as ineffective but indeed damaging to economic development. At most, what is considered desirable is so-called horizontal industrial policy, which is chiefly concerned with competition policy, i.e., maintaining a level playing field between economic agents (Warwick 2013: 4). Accordingly, such policy orientation does not favor certain economic activities over others, as it is assumed that governments cannot know which sectors or firms to support in order to drive industrialization.

In contrast, a developmentalist approach to industrial policy, referred to in the literature as interventionist, vertical, or selective industrial policy, "is based on targeted strategies which support specific activities, sectors or technologies while discriminating others" (Eder et al. 2018: 8). For Chang et al. (2016: 28), such industrial policy is "a policy that deliberately favours particular industries – or even firms – over others, against market signals, usually to enhance efficiency and to promote productivity growth for the targeted industries as well as for the whole economy". On a more abstract level, an understanding of such industrial policy as "the infusion of goal-oriented strategic thinking into public economic policy" (Johnson, cited in Oqubay 2015: 17) resonates with the ideas of developmentalism and delinking as broad political orientations towards state-led industrial development and economic autonomy. Interventionist industrial policy thus implies actively guiding the development of an economy in order to change a country's position in the international division of labor. Before discussing how these goals can be achieved, however, it is important to address the question of how such a developmentalist orientation emerges within a state in the first place.

5.2. Class relations, the state, and the foundations of developmentalism

On a fundamental level, for a state to pursue any strategy at all, it needs to be in the interest of social forces powerful enough to influence policy in their desired direction. Classes, class fractions, or other groups may have conflicting economic interests. Jessop's (1999) concept of strategic selectivity helps analyze the way such interests translate into state policy. In this understanding, the capitalist state is not a neutral actor but "must be understood as a strategic field formed through intersecting power networks" (Jessop 1999: 48). As such, the concrete manifestations of the state (including which policies it implements) must be seen as the historic result of struggles between competing social forces, and thus as "the material condensation of a relationship of forces" (Grumiller and Raza 2019: 10).

The notion of strategic selectivity pertains to how a state prioritizes the interests of specific groups over those of others as well as the strategies employed by social forces to pursue their objectives through state policies. In capitalist societies, the state necessarily favors the interests of the bourgeoisie over those of the proletariat, at least insofar as the continued reproduction of capitalist relations is concerned. Within the bourgeois class, however, exist different fractions of capital with competing material interests and varying success in influencing the state in their favor. At the same time, working classes can also have significant influence over the direction of state policy. Therefore, any state structure is characterized by a particular constellation of strategic selectivity, reflecting the balance of power among competing social forces. This, in turn, determines whose interests are prioritized and which policies are pursued (Jessop 1999: 54-55).

With regards to a developmentalist orientation of the state, this implies the existence of class fractions with material interests in structural transformation, i.e., (nascent) industrial capitalists, who are influential enough to drive state policy towards industrialization. However, as with nearly any policy orientation, there may be opposing social forces, both inside and outside a country, contesting these processes. Active industrial policy inevitably reshapes the distribution of wealth by redirecting resources from non-developmental activities towards industrial endeavors. For instance, class fractions accumulating capital through import trading will typically oppose measures such as tariffs, import restrictions, or other policies that the state may employ to protect nascent industries (Whitfield et al. 2015: 19). Only when social classes with vested interests in fostering the manufacturing sector (or other sectors conducive to structural transformation) successfully form alliances with state elites can a developmentalist orientation take root.

The ability to initiate and sustain such developmentalist projects thus hinges on the power dynamics between competing social forces, especially between what is known as the national bourgeoisie and its comprador counterpart (Perez 2021: 104). The former describes an emerging domestic capitalist class involved in strategic activities (primarily manufacturing), while the latter accumulates capital primarily through low-complexity activities and, critically, aligns itself with dominant forces from core countries. Comprador class fractions "help to organise the extraction of natural resources and exploitation of local labour on behalf of foreign capitalists but are never in control of the domestic accumulation process and therefore cannot develop technological and financial autonomy" (ibid.). Collaborating with ruling classes from the core (i.e., imperialist capital, which benefits from ongoing exploitation and exclusion of peripheral regions), comprador bourgeoisies typically oppose comprehensive state-led developmental endeavors. The struggle between these competing fractions and the degree to which they manage to influence or take control of the state apparatus are thus closely linked to how a developmentalist orientation emerges and how resistant it is to both internal and external pressures.

Strategic selectivity towards developmentalism implies that political elites and government and bureaucratic officials must favor the interests of industrialists over others. State officials might have various reasons for privileging the interests of these social forces above others, including their own ideological motivations as well as reaping legitimacy gains from successful economic development and the resulting rise in living standards. Indeed, in the Gramscian notion of hegemony, the stability of social formations (such as a state's developmentalist orientation and the social forces involved in it) is understood as underpinned not only by material benefits but ideological aspects as well:

> Only the combination of both material and ideational elements can lead to a form of social cohesion uniting a bloc of social forces to support a project of late industrialization over a longer period, which can be conceived as a hegemonic project in the Gramscian sense. (Grumiller and Raza 2019: 9)

The ideological radiance of development and economic sovereignty thus acts as the glue that holds together hegemonic projects of state-led developmentalism. Durable political alliances between developmentalist state elites and fractions of industrial capital are therefore based on their shared interest in structural transformation. Such collaboration is one of three institutional preconditions for successful industrial policy, as suggested by Whitfield et al. (2015: 17), who also emphasize the importance of pockets of efficiency and learning for productivity.

Pockets of efficiency are segments within the state apparatus, typically concentrated in individual ministries or agencies, that work towards industrialization (ibid.). As bureaucratic government bodies are often the ones designing and implementing policies "on the ground", they have historically played important roles in most processes of industrialization, including in East Asia (Ashman et al. 2020: 200). Such institutions include development banks, export promotion agencies or investment commissions (Grumiller and Raza 2019: 18). For the state and its entities to fulfill their developmental roles, they must exhibit what Evans (1995) calls embedded autonomy. They must be imbedded in strategic sectors (i.e., have a thorough understanding of how a particular industry works and the specific challenges it faces), but at the same time maintain a degree of autonomy and avoid being susceptible to individual demands (Eder et al. 2018: 6; Whitfield et al. 2015: 20). As Grumiller and Raza (2019: 12) summarize, "[t]he embeddedness of the state reflects a connection to particular social groups with whom the state shares a joint project of transformation, while the autonomy allows the state to act with some independence in relation to particularistic societal pressures".

Finally, learning for productivity refers to the need for domestic firms to make effective use of (financial) assistance from the state to enhance their technological capabilities and transition towards higher-value production, i.e., "linking policy-generated rents to increases in productivity" (Grumiller and Raza 2019: 8). This is where a so-called "carrots and sticks" approach to industrial policy becomes relevant (Grumiller and Raza 2019: 13). On one hand, monetary incentives should encourage firms to invest in technological learning and increase productivity. On the other hand, however, any government support should be withdrawn if firms do not achieve the expected results. In this context, embedded autonomy is again crucial, because state officials need to understand how to strengthen an industry or individual firm while also ensuring that the principle of "letting losers go" (Eder et al. 2018: 6) is not undermined by influential actors.

For structural transformation to occur, there is thus a need for a conducive balance of power between capitalist class fractions, i.e., one in which the state curbs the influence of comprador forces and instead acts on the behalf of an emergent industrialist class. Such constellations are held together by mutual interests and developmentalist ideology, and they rely on effective bureaucratic bodies (characterized by pockets of efficiency) that can ensure that domestic companies use the support they receive to raise productivity and move towards more sophisticated production. These conditions were part and parcel of East Asian late industrialization, as it was captured by developmental state theory.

5.3. Carrots, sticks, and developmental state theory

First introduced by Chalmers Johnson in his seminal work on Japanese industrial policy (Johnson 1982), the concept of a developmental state originally referred to the special kind of "strong interventionist policies implemented by Japan that led to sustained, rapid industrialisation and long-term economic development" (Nem Singh and Ovadia 2018: 1035). Further foundational studies were conducted by Amsden (1989) and Wade (2004 [1990]), analyzing South Korean and Taiwanese industrial policy, respectively. As such, the rise of developmental state theory is inextricably linked with the remarkable processes of structural transformation in these countries. It must be emphasized, however, that the trajectories of South Korea and Taiwan took place under the highly unusual circumstances of United States (US) patronage during the Cold War, as will be discussed throughout Chapters 5 and 6. While there are undoubtedly lessons to be learned by today's late-industrializing countries, the East Asian experiences are thus not directly replicable.

Developmental state theory emerged not only as an analytical lens for understanding East Asian development but also as "the major ideological rallying point for those who wish to contest the appropriateness of neoliberalism and the Washington Consensus as a framework for effective governance and economic development in the global South" (Radice 2008: 1153). In tandem with the rise of neoliberalism and the formulation of developmental state theory, dependency theory saw a significant decline in popularity (Treacy 2022: 223). The industrialization of East Asia had supposedly disproven dependency theory, and the gap it left behind in heterodox development thinking was filled by developmental state theory. Rather than resisting market forces and striving for an alternative social mode of production (as most dependency theorists had advocated), developmental state theory now argued in favor of actively – but selectively – engaging the market in pursuit of rapid capitalist industrialization (Radice 2008: 1154). Here, the goal lay firmly in catching up with the advanced core countries, not in socialism.

Developmental state theorists were further occupied with disproving the neoliberal narratives of state failure and the inappropriateness of industrial policy. They showed how East Asian state intervention had driven structural transformation by helping domestic firms acquire technological capabilities "through financial inducement and, sometimes, market-distorting coercions and picking national champions" (Yeung 2016: 188). By engaging in a "carrots and sticks" approach (Grumiller and Raza 2019: 13), i.e., through incentivizing and disciplining capital, these states channeled investment into strategic sectors such as modern manufacturing, where it otherwise might not have gone to due to high costs or uncertainty (Whitfield et al. 2015: 52). In East Asian development, therefore, "[t]he state protected and supported domestic business [...] yet by disciplining capital ensured that the rents from this were reinvested in investment, upgrading, and expansion" (Ashman et al. 2020: 200). Such developmental states thus combined state planning and oversight with the profit motive of private capital in order to drive technological learning and hence structural transformation.

5.4. Industrial and trade policy strategies

Developmentalist industrial policy, as pursued by East Asian developmental states, aims to enhance the technological capabilities of domestic firms in order to challenge adverse international specialization and relations of dependency. Historically, two general strategies to such policy have been most prominent: import substitution industrialization (ISI) and export-oriented industrialization (EOI). Since the rise of GVCs, a third approach has entered the stage: vertically specialized industrialization (VSI). These strategic orientations will be discussed in the following sections.

5.4.1. Import substitution industrialization

Import substitution industrialization (ISI) typically aims at the formation of a broad industrial sector in pursuit of comprehensive structural transformation (Morris and Staritz 2019: 508) As the name suggests, ISI primarily seeks to replace imports with domestically produced goods by developing a potent manufacturing sector for the production first of simple consumer goods and later of more technologically complex capital goods. This is aimed at not only reducing the structural dependence on imports from core countries but also at easing a peripheral country's trade deficit. Scarce foreign exchange earnings (e.g., in US dollars) – no longer needed for buying foreign-made consumer goods – can then be used to import capital goods that peripheral firms are not yet able to produce (Francis 2017: 7). ISI is thus both an argument for the centrality of industrial development for reducing dependency and a proposed strategy for achieving it.

However, in the early phases of ISI, the need to buy expensive foreign machinery (necessary for the production of the consumer goods that are being substituted) means that imports increase while exports typically do not. Thus, somewhat paradoxically, ISI may actually aggravate import dependency and trade imbalances, at least initially (Fischer 2018: 3363). Because of this, Latin American economies engaging in ISI were seen as having failed at reducing their subordination to core countries (particularly the US), an observation that was central to dependency theorists' critique of Latin American structuralism and its policy advice. Nevertheless, ISI strategies have been an essential element of nearly all historic processes of structural transformation, as Cypher and Dietz (2009: 176) note: "With the exception of Great Britain, the first modern industrializing nation, all subsequent successful efforts by nations to modernize have involved elements of import substitution industrialization (ISI) as a means to promote the expansion of a domestic industrial sector". Indeed, the very nature of structural transformation through the growth of the manufacturing sector implies that at least some manufactured imports will eventually be replaced by domestically produced goods, thus making ISI an inherent element of industrialization (Fischer 2018: 3363-3364).

ISI strategies are strongly related to the argument for infant industry protection. Since domestic peripheral firms do not possess the necessary technological capabilities to compete with advanced core-based companies (not in consumer goods and much less in complex machinery), protective measures are deemed crucial (Nem Singh and Ovadia 2018: 1038). Such perspective is thus fundamentally opposed to unrestricted trade flows since "under conditions of free trade, the country with weak productive capabilities would never be able to develop new industries, and to create new comparative advantages, but would rather be stuck in its existing comparative advantage" (Whitfield et al.: 2015: 48-49). Most heterodox approaches to structural transformation indeed consider infant industry protection "an absolute necessity" (Oqubay 2015: 27). Consequently, advocates of both delinking and developmental state theory thus call for tariffs, import duties or import bans on substitutable goods in order to restrict their import and strengthen domestic infant industries (Perez 2021: 105).

For ISI, and for economic development more generally, the role of the state need not be confined to protectionist policy but may include active market participation through state-owned enterprises (SOEs). In this way, the state can control the "commanding heights" of the economy (Tomkinson 2019: 2), thereby more directly driving the establishment of infant industries and the structural transformation process, rather than having to rely on the investment decisions of private companies which might not be aligned with state policy (Grumiller and Raza 2019: 21). In many cases, this is indeed necessary as the high risk associated with large-scale developmental projects can deter private firms from investing:

> Especially when it comes to backward economies entering industries that require large capital outlays and a large amount of technological and organizational learning, the risk is incalculable and thus turns into uncertainty. In such cases, establishing state-owned enterprises (SOEs) may be the only solution. (Chang et al. 2016: 45)

SOEs also play a critical role in providing services that may not be profitable but are considered either strategically necessary or important social goods, such as rural infrastructure or providing healthcare to remote populations (Tomkinson 2019: 58). In the financial sector, state-owned development banks, which Oqubay (2015: 38) considers "the flagships of developmental states", can provide finance where commercial banks might not. Before coming under attack for supposed inefficiency in the neoliberal era, SOEs have historically been, and continue to be, key instruments for economic development, including in many of today's richest countries (Chang et al. 2016: 61). Indeed, in the early stages of Taiwan's industrialization, the SOE sector was responsible for more than 50 percent of the country's industrial output and for the establishment of infant industries in strategic sectors such as cement, steel, fertilizers, and heavy machinery (Amsden 1989: 162), illustrating the potential efficacy of state control over the "commanding heights" and SOE-driven ISI policies.

5.4.2. Export-oriented industrialization

Often presented as a distinct counterpart to the extensive scope of ISI, export-oriented industrialization (EOI) is instead "aimed at narrower intensive sectoral development" (Morris and Staritz 2019: 508) and "aims to speed up the industrialisation of a country through exports" (Hauge 2020: 2072). EOI strategies can be further divided into either conforming to or defying the “laws” of comparative advantage. Oqubay (2015: 24) refers to these divergent approaches as Ricardian and Kaldorian strategies, which roughly correspond to passive (horizontal) and interventionist (vertical) industrial policy orientations, respectively. While Ricardians generally urge countries to focus only on the products they can produce and export most efficiently (i.e., primarily low-complexity goods in the case of peripheral countries), Kaldorians see such pursuit of current comparative advantages as perpetuating unequal patterns of specialization. In this view, only the development of new comparative advantages through the acquisition of technological capabilities can result in structural transformation and a more advantageous position in the international division of labor.

Similar to ISI, the goal of such interventionist EOI strategy is thus to strengthen domestic firms vis-à-vis foreign competition and to help them move into higher-complexity activities. Unlike ISI, however, it seeks to do so by strategically exposing domestic firms to international competition, rather than shielding them from it. From this perspective, competing – although not “freely” – on world markets is considered conducive for domestic firms to improve productivity, acquire new technology, establish market relations, and meet international quality standards (Oqubay 2015: 42). Crucially, exports are also necessary to generate sufficient foreign exchange earnings in order to pay for imports.

Whereas ISI has historically been associated with Latin American development strategy, EOI is said to explain the “miracle” of East Asian industrialization. Although proponents of neoliberal capitalism (i.e., Ricardians) argue that market forces alone were responsible for the rapid growth of these countries, developmental state theorists instead showed how large-scale state intervention drove the growth and diversification of East Asian manufacturing exports (Amsden 1989: 139; Wade 2004 [1990]: 53). The developmental states of South Korea and Taiwan pushed domestic firms to participate and become competitive in international export markets. Exporters were financially supported through export subsidies or tax exemptions, but these benefits were withdrawn if firms failed to meet stringent performance requirements, often using export targets as an indicator:

> The capacity to export and to expand exporting over time provided the yardstick for determining which firms had become efficient. Firms that attained international levels of efficiency […] and met their export targets were rewarded with continued access to state assistance and special treatment (Cypher and Dietz 2009: 327)

East Asian developmental states were thus strongly characterized by such interventionist approach to EOI industrial policy, a key idea being that comparative advantages needed to be deliberately distorted through targeted subsidies, selective tariffs, and preferential access to finance (Radice 2008: 1154). Contrary to Ricardian advice, the export-oriented policies of East

Asian developmentalism, particularly in strategic manufacturing sectors, were thus fundamentally based on the principle of "getting the prices wrong", as Amsden (1989: 139) famously noted. This is not to say that peripheral countries should under no circumstances follow comparative advantage. But exporting primary commodities, for example, must be tied into a developmentalist plan to climb the hierarchy of production and break free from dependency.

5.4.3. Vertically specialized industrialization

Although already part of East Asian development to a lesser extent (Chang et al. 2016: 143), the further fragmentation of production into GVCs since the 1990s has led to a third strategic industrial policy orientation alongside ISI and EOI: vertically specialized industrialization (VSI) (Morris and Staritz 2019). Proponents of the VSI approach argue that this new international division of labor, as embodied in GVCs, means that more traditional industrial policy approaches have become outdated and that new strategies for the pursuit of structural transformation are thus required (Yeung 2016: 217).

Due to its focus on GVCs, the VSI orientation differs markedly from both ISI and EOI strategies, although it shares with the latter its focus on export growth through active participation in international trade. However, whereas traditional EOI had prioritized final goods exports to core markets, VSI entails a narrower focus on trade in intermediate goods, increasingly also between peripheral and semiperipheral firms and countries (Milberg et al. 2014: 153-154). Milberg et al. (2014: 155) summarize further defining characteristics that distinguish ISI, EOI and VSI: "Whereas under ISI, developing countries tried to restrict imports and under EOI, developing economies focused on promoting exports, with VSI the main emphasis is on how to use traded intermediates to capture more value in GVCs". A VSI strategy thus shifts from trying to substitute imports or exporting finished manufactures to specializing in individual production steps and activities (i.e., vertical specialization) where most value can be retained (Hauge 2020: 2072). In contrast to ISI or EOI, such GVC-driven industrialization may also offer better opportunities for achieving economies of scale (due to its narrower focus), improving productivity, and generating technology transfers to the domestic economy (Morris and Staritz 2019: 507, 509). Crucially, participating in GVCs is also important for earning foreign exchange.

Proponents of the VSI strategy thus argue that industrial policy in the 21st century should no longer be concerned with broad, cross-sectoral industrialization but rather focus on how to position domestic firms in GVCs in order to maximize developmental outcomes (Whitfield et al. 2015: 5). It is now widely considered more feasible for firms (and countries) to initially specialize in narrow activities and then move – or "upgrade" – into higher-complexity activities

(Eder et al. 2018: 7). Upgrading is "[t]he process by which countries, regions or firms improve their position in the international hierarchy of value-added activities, moving from low- to high-value activities to increase the benefits (security, value added, profits, wages) from participating in GVCs" (Morris and Staritz 2019: 510-511.). Engaging in activities with higher barriers to entry, i.e., where competition is more limited, allows for higher profits and thus better potentials for value to remain in peripheral countries. While the goal of acquiring technological capabilities thus remains the essentially same as in ISI and EOI, the way of doing so has changed in the context of globally dispersed production. From this perspective, the key imperative of VSI industrial policy must thus be to support domestic firms first in entering GVCs and then in their pursuit of upgrading opportunities, including by incentivizing or forcing lead firms to increase technology transfers to their peripheral suppliers. Initial GVC integration can be supported by gaining preferential access to targeted markets, by developing infrastructure and improving trade facilitation to reduce the costs of imports and exports, and by attracting foreign direct investment (FDI) (Morris and Staritz 2019: 513-514).

FDI plays an important role for VSI strategies, as it can provide domestic firms with access to both technology and export markets (Francis 2017: 8). TNCs establishing production facilities in peripheral countries and sourcing from local suppliers can foster the integration of these local firms into GVCs and generate spill-over effects to the domestic economy. Such effects can occur in various ways, including through the imitation of superior production techniques by local firms, through the movement of workers from foreign to domestic firms, or through the creation of linkages (Chang et al. 2016: 146). In this way, peripheral firms can develop manufacturing capabilities themselves and potentially upgrade towards higher-complexity activities. Attracting FDI into strategic sectors and ensuring technology transfers to domestic firms is can thus be a crucial component of industrial policy (Milberg et al. 2014). However, the impact of FDI regarding structural transformation depends on the capacity of the state and peripheral firms to generate such spill-over effects to the local economy, without which there may be little prospect for technological learning (Akyüz 2015: 3). Ultimately, as Oqubay (2015: 44) argues:

> What matters is less the level and amount of FDI than its composition, where it is directed, whether states succeed in maximizing domestic gains from FDI, and how transfer pricing, employment generation, training, and technical and know-how transfers are managed.

Industrial policy can maximize the developmental potential of FDI through performance requirements, such as mandating that TNCs use domestically produced inputs and employ local labor or forcing them to form joint ventures with domestic firms or SOEs (Chang et al. 2016: 125). Beyond FDI, policy instruments aimed at benefitting from GVC participation include selective import tariffs, export taxes, preferential access to finance (including priority foreign exchange allocation) and capacity-building to assist upgrading at domestic firms (Morris and Staritz 2019: 512). In many cases, VSI strategies thus resemble the policy prescriptions of developmental state theory and other heterodox approaches.

While the business strategies of global lead firms can vary greatly, their interests (e.g., low labor costs in peripheral countries) are often not aligned with those of peripheral firms and countries – not to mention those of workers. GVCs often engender extreme forms of labor exploitation (Selwyn 2019), which is clearly detrimental to genuine development and which, beyond industrial policy, calls for progressive labor standards and potent trade unions. Moreover, interfirm relations within GVCs are anything but harmonious as lead firms try to secure their superior position vis-à-vis peripheral suppliers which might try to escape subordination. Although it has become increasingly unlikely for peripheral countries to attain structural transformation fully independent from or outside of GVCs, participation alone will therefore not bring about the desired results. A developmentalist industrial policy aimed at building domestic technological capabilities and reducing dependency from core countries requires challenging the subordinate integration of peripheral firms into GVCs and thus the lead roles of core-based TNCs. As Amin (cited in Perez 2021: 112) reminds us, if an interventionist state "resorts to multinational corporations and their technologies, it does so in accordance with the imperatives of a plan that outlines the stages of a rise through the hierarchy of production". The fact that such developmental processes usually go against the interests of powerful actors gives a first indication that structural transformation via upgrading in GVCs faces a myriad of challenges. I will return to these GVC-related constraints and power relations in Section 6.1.2.

5.4.4. Combined approaches and the role of exchange rate policy

Schmitz (2007: 419) illustrates how these strategic orientations of ISI, Ricardian/passive EOI and Kaldorian/active EOI, and, I would add, VSI, embody different combinations of supporting (e.g., through subsidies or protection) and challenging (e.g., through export targets or exposure to international competition) domestic firms. While ISI strongly supports companies by protecting them from superior foreign competitors, it often does not challenge them to acquire technological capabilities. Passive EOI, on the other hand, argues against any market-distorting support for individual sectors or firms, while at the same time severely challenging these firms by exposing them to free international trade. Finally, active EOI and VSI strategies combine high levels of state support for firms with high challenges both in the form of government-imposed performance targets and world market competition, or more specifically in the case of

VSI, GVC participation. In the Kaldorian perspective, this particular combination of support and challenge is regarded as most the conducive for driving rapid structural transformation.

On a more abstract level, these strategies of active EOI and VSI on the one hand, and ISI on the other, also correspond to Arrighi's struggles against exclusion and exploitation, respectively:

> A struggle against exclusion is a struggle for a comparatively secure niche in the world division of labor. [...]. Struggles against exploitation move in the opposite direction. They are struggles aimed at the creation of divisions of labor as autonomous as possible from the axial division of labor of the capitalist world-economy. (Arrighi 1990: 17)

While EOI and VSI focus on sectoral or product specialization and thus (controlled) world market integration, ISI strategies aim at creating independent and self-sufficient industrial economies. To Arrighi, successful struggles against exclusion and exploitation are what characterize semiperipheral (i.e., middle-income) countries, some of which "rely more on one than on the other, but most alternate or combine the two" (ibid.). Such combined approaches of ISI, EOI, and VSI also resonate with the notion of delinking and autocentric development: "An autocentric strategy always entails active state intervention aiming at a favorable position in the international division of labor through a mixture of association and dissociation" (Amin 1994: 167; emphasis added). A developmentalist orientation may thus require simultaneous association (i.e., struggle against exclusion) in the form of strategic participation in international trade and finance, and dissociation (i.e., struggle against exploitation) through protectionism and infant industry protection, and thus strategic combinations of ISI, EOI, and VSI policy orientations.

Indeed, although often portrayed as mutually exclusive, successful industrializers around the world have engaged in all types of industrial policy strategies, either simultaneously or sequentially (Whitfield 2015: 50). In many historic cases, ISI preceded EOI to some extent, as technological capabilities first had to be developed through infant industry protection before firms could compete in export markets. In South Korea, among other places, the two strategic orientations were also used at the same time. While certain sectors were incentivized and disciplined to export as well as given easy access to imported inputs, others were nurtured and protected from international competition (Morris and Staritz 2019: 508). Since EOI strategies generally require cheap imports, trade policy had to be carefully managed. As Hauge (2020: 2077) argues, South Korean policymakers thus "had to balance the need for importing certain goods that were needed for the export strategy, while at the same time not eroding the possibilities for developing a domestic supplier base". Attributing East Asian industrialization to "carrots and sticks" EOI policies alone is thus inappropriate.

Ultimately, what matters is the acquisition of technological capabilities by peripheral firms and thus their ability to capture relatively more value from core firms than in the current moment. Whether this is achieved by restricting imports and developing infant industries, by raising output and productivity growth through export exposition, or by entering and upgrading in GVCs, depends on the concrete historic moment a peripheral country finds itself in. As Wade (2004 [1990]: I) notes, “[s]trategic economic policy does not, as is commonly assumed, favor protection universally […]; it prescribes free trade, protection, and subsidies in various combinations depending on a country’s circumstances and levels of industrialization”. Which industrial policy strategy to follow, how to manage trade-offs between them, and when and how to switch between these approaches are thus highly context-specific questions that can only be answered by looking closely at individual country cases.

Finally, this also applies to the exchange rate, a key policy instrument that needs to be considered when pursuing any such strategic orientation. The exchange rate determines, among other things, the competitiveness of exports on international markets and the cost of imports and debt servicing (Amsden 1989: 13). Through the activity of central banks, exchange rates can be overvalued or undervalued relative to what they would be if they were determined solely by market forces. An overvalued exchange rate makes exports more expensive on world markets (i.e., less competitive) and is therefore not conducive to primarily export-oriented strategies. However, it also means that imports are cheaper than they would otherwise be, and this may be beneficial if the industrialization strategy is very dependent on imported capital goods, which is often the case. Overvaluation also reduces the cost of external debt servicing (Haile 2019: 17). Currency undervaluation, by contrast, boosts the international competitiveness of exports, but also raises the cost of imports. While the latter can be beneficial for infant industry protection and ISI efforts, it may hurt import-dependent industries, including those that are export-oriented and that otherwise benefit from an undervalued exchange rate. There is thus no definitive answer to which exchange rate policy is most conducive to structural transformation. As with the pursuit of different policy strategies in general, there are always trade-offs involved.

5.5. Nurturing transformation: linkages and agricultural development

Regardless of the specific application of strategic orientations, there are certain dynamics and thus policy considerations that are essential for any process of structural transformation. Two of these concern the creation of linkages and agricultural development.

The idea of linkages was developed by Albert Hirschman to describe the process by which economic activities, or their expansion, trigger the emergence of other activities. According to Hirschman (cited in Oqubay 2015: 46), “a linkage exists whenever an on-going activity gives rise to economic or other pressures that lead to the taking up of a new activity”. When an industry grows (e.g., as a consequence of the state channeling investments into it), it needs more input from other sectors to be able to produce. Initially, there would typically be a shortage of inputs as suppliers are unable to meet the increased demand. Over time, however, these bottlenecks are expected to induce investment in the expansion of input production, thereby strengthening and expanding these input-supplying industries. At the same time, the greater output of the original sector may initially create a situation of oversupply but then stimulate the expansion of other sectors that process its product. These two dynamics are referred to as backward and forward linkages. While backward linkages facilitate the creation or growth of input-producing activities, forward linkages entail the creation of new activities that depend on the output of the original industry as an input for further production (Ashman et al. 2020: 188; Cypher and Dietz 2009: 148-149). Physical infrastructure, for example, requires inputs (i.e., backward linkages) from the engineering and construction sectors, while also creating strong forward linkages to the economy as a whole, and manufacturing in particular (Gottschalk and Gehl Sampath 2021).

In the context of GVCs, the creation of domestic linkages between sectors implies that peripheral firms expand the scope of their activities towards tasks further up or down the value chain that are currently performed by firms outside the country (Morris and Staritz 2019: 514-515). It also means that FDI inflows should bring forth new domestic activities that supply inputs to, or use outputs from, TNCs setting up new production facilities. These dynamics can also have significant import substitution effects, as less inputs need to be imported. Such linkage creation can be facilitated through concerted efforts by the state, aimed at establishing relations between TNCs and peripheral firms and creating new domestic sourcing or processing opportunities, hence strengthening nascent local industries (Cypher and Dietz 2009: 472).

The importance of linkages for economic development applies not only to changing the mode of participation in GVCs but to all investments aimed at industrialization. These ripple effects are indeed essential for a dynamic process of structural transformation to take place, as Oqubay (2015: 46) argues: “successful industrialization may involve the selection of, and targeting of support to, those sectors and activities likely to have the most, or strongest, linkage effects”. Investments should thus be directed not only to those sectors that have the best chance of capturing more value but also those where linkages to other important activities can be created.

Important connections of this kind exist between manufacturing and agriculture as a whole, making rural development and agricultural productivity growth key components of structural transformation. In terms of backward linkages from agriculture to manufacturing, higher rural household income usually leads to higher demand for domestically produced goods. At the same time, an increase in agricultural productivity means cheaper food and higher supply of raw materials for further production, thus also constituting strong forward linkages to manufacturing (Vogel 1994: 137). The processes of manufacturing development and agricultural productivity growth thus reinforce one another through linkages. Beyond this, rising agricultural productivity means that less labor power will be needed for agriculture, and rural workers will eventually migrate to other activities, including industrial sectors. As Whitfield et al. (2015: 58) note, "[e]conomic transformation necessarily means that some smallholders will not remain farmers, but rather become wage laborers". It is for these reasons that the transformation of agriculture has historically been, and continues to be, a prerequisite for industrialization.

Two processes are of particular importance for such rural development: besides increasing productivity through a greater utilization of technology and public investments into "schools and health clinics, roads, dams and irrigation canals, crop storage facilities, farm extension services, agricultural research, and farm credit programmes" (Cypher and Dietz 2009: 346), redistributive land reform must change rural land ownership structures in favor of smallholder farmers. This is important both to ensure a more equitable allocation of rural incomes (which in turn strengthens linkages to the consumer goods and farm equipment industries) and for political reasons. As noted with regards to the strategic selectivity of the state, large landowners and (transnational) agricultural corporations are typically not aligned with state-led efforts towards industrialization. Undermining their economic base through expropriation and redistribution of parts of their holdings (as was done in South Korea and Taiwan, among other places) may be a necessary component of weakening the political influence of "forces maintaining the preindustrial status quo" (Oqubay 2015: 33). Additionally, such policy orientation can secure the support of rural populations and strengthen the legitimacy of a developmental state.

To sum up, while favorable linkage patterns and corresponding public investment decisions determine the dynamism and scope of industrialization, rural transformation is necessary both for economic and political reason. This makes linkage dynamics and agricultural development indispensable components of the structural transformation process and thus crucial considerations for interventionist industrial policy.

5.6. Financing development: mobilizing domestic resources and managing foreign capital

As noted, developmentalist industrial policy actively channels investment into strategic sectors, i.e., into modern manufacturing activities with higher barriers to entry and better opportunities for domestic firms to capture more value. In general, “developmentalism will depend upon taking command of financial resources in order to guarantee appropriate levels of investment in appropriate directions in conformity with targeted policy” (Fine and Mohamed 2022: 27). But where do these funds come from? Seen from the perspective of development finance, the state must somehow mobilize such financial resources, i.e., increase domestic savings and investment and manage external finance, and put them to productive use.

5.6.1. Domestic development finance

An important mechanism for such state-directed resource allocation lies in the strategic management of domestic sources of finance. This typically involves the redistribution of income from certain social groups to others. In the context of a developmentalist agenda, the state thus captures incomes (e.g., through taxation) from unproductive or otherwise non-developmental sources and uses them for strategic purposes, which Clapham (2018: 1162) calls “long-horizon centralised rent management”. In summarizing the proposals of Finnish economist Ragnar Nurkse, Cypher and Dietz (2009: 146) describe one such possible approach to developmentalist financial policy:

> Nurkse advocated forced savings through an increase in taxes on upper-income recipients. The government, then, could repress the level of consumption out of national income, thereby increasing the level of overall savings. Then, the increased investment funds generated could be allocated to the most promising industrial sectors, possibly via government-operated development banks

In other words, by suppressing consumption in favor of investment, developmental states can redistribute resources towards strategic goals. For this purpose, state-owned development banks (which are a type of SOE) have historically played a crucial role in earlier processes of structural transformation (Oqubay 2015: 38-39). Since they are not primarily driven by the profit motive, development banks can provide preferential loans to companies engaged in risky activities, which commercial banks might not do because of the high level of uncertainty. Beyond development banking, domestic financial regulation should ensure that credit is available to manufacturing industries at low cost by setting appropriate interest rates (Mayer 2009: 383). Direct resource allocation and appropriately regulating the domestic banking sector can thus go hand in hand.

As noted, financial state support can then manifest as performance-based subsidies ("carrots") that serve as monetary incentives for improving export performance. In the context of GVCs, developmentalist governments can also assist domestic firms in upgrading by subsidizing some of the costs of entering new activities, for example by financing research and development activities or vocational trainings (Whitfield et al. 2015: 18). Ultimately, these measures of targeted preferential lending, prudential financial regulation, and fiscal expenditure all serve to mobilize domestic savings for developmental purposes.

5.6.2. Managing foreign capital

However, managing domestic resources is typically not sufficient to reach the levels of investment necessary for structural transformation. In neoclassical economics, this condition is called the savings gap (Dim and Ezenekwe 2014: 75). Moreover, even if there were abundant domestic savings denominated in local currency, late industrialization is heavily dependent on imports, in many cases both of consumer goods and of machinery needed to fuel the transformation process, and thus on foreign exchange earnings to pay for them. As Fischer (2018: 3375) notes, "late development engenders an intensive demand for external finance, which has to be met if development strategies are not to be stymied, no matter how wisely and effectively domestic strategies are conceived and implemented". Given peripheral countries' adverse patterns of specialization, exports alone are typically not sufficient for this, especially in early phases of ISI (Whitfield et al. 2015: 49), contributing to chronic trade deficits. And since peripheral governments and firms cannot borrow in their own currency to pay in international markets, they must acquire foreign exchange by different means (Bougrine and Seccareccia 2009: 44). In other words, the subordinate position of peripheral countries and the resulting unequal distribution and transfers of value to the core thus lead to a structural shortage of foreign exchange, a condition that is perhaps the most binding financial constraint to economic development. An additional inflow of funds from abroad is therefore needed in order to allow peripheral countries to run trade deficits, i.e., to consume and invest more than they produce domestically.

These flows of external finance come primarily in the form of loans, investments, grants, and remittances (Francis 2017: 8). Borrowing from international lenders, both private and public, is a widely used source of foreign exchange and has been used extensively in most cases of late industrialization. South Korean policymakers, for instance, relied heavily on the accumulation of external debt over other capital inflows (avoiding foreign investments in particular) to fuel the country's EOI strategy (Amsden 1989: 92).

Besides borrowing, grants by geopolitical allies were a second important source of external finance for South Korea (Fischer 2018: 3366). Still today, development aid, which includes grants and concessional loans – what the Organisation for Economic Cooperation and Development (OECD) calls official development assistance (ODA) – plays a crucial role in financing the current account deficits of many peripheral countries. Between 2010 and 2019, so-called Least Developed Countries (LDCs), i.e., those at the extreme periphery of the global economy, received 94 percent of their financial inflows in the form of ODA (World Bank 2021: 32). This immense aid dependence is a stark reminder of how peripheral countries are in many ways at the whim of those in the core, who can freely decide whether and how much ODA they provide. While private capital flows (investments and private loans) to peripheral countries increased by 10 percent annually between 2010 and 2019, ODA rose by only 2 percent per year (ibid.), which points to the increased international mobility of capital versus more or less stagnating levels of public flows from core countries.

This surge in private foreign capital is partly reflected in the spectacular growth of cross-border investment, with FDI as share of global GDP having tripled between 1990 and 2017 (Hauge 2020: 2070). From a developmental perspective, portfolio investments (e.g., core-based companies buying shares in a peripheral firm) do not seem to play a significant positive role and can indeed contribute to financial volatility, as will be discussed in Section 6.1.3. While they can provide liquidity, structural transformation typically requires long-term financing rather than potentially short-lived surges of capital. Thus, attracting portfolio investment is generally not considered a priority of interventionist industrial policy, which should instead carefully manage such flows through the use of capital controls (Tomkinson 2019: 56, 64). The significance of FDI, on the other hand, can go beyond merely offsetting current account deficits, as already noted in Section 5.4.3. However, as also discussed, FDI is only beneficial if states manage its impact accordingly through the use of targeted policy.

This applies to some extent to all forms of external finance. As noted, development as delinking depends on "the active management of foreign trade and finance to change international specialisation" (Perez 2021: 104). Without such active approach, foreign capital entering a peripheral country may end up, for instance, financing an increase in import-dependent consumption, thus further aggravating current account deficits (Bresser-Pereira and Gala 2009: 61). Instead, to the extent possible, these financial inflows must be channeled into the most promising and strategically important activities, while excessive outflows must be prevented through capital controls. This requires the state to be in control of the financial system and the direction of capital accumulation towards developmental goals (Perez 2021: 105). An interventionist approach to finance, both of domestic and foreign origin, is thus a crucial prerequisite for any process of structural transformation.

5.7. Conclusion: pathways to industrialization

In this chapter, I introduced and discussed several key insights from heterodox development theory regarding the process of structural transformation in peripheral countries and the policies typically considered necessary to achieve it. Based on the finding that dependency is manifested in an unequal international division of labor, value transfers, and processes of exploitation and exclusion, as discussed in Chapter 4, this present chapter assessed possible pathways for breaking the shackles of imperialist domination. I argued that structural transformation of peripheral economies through the accumulation of technological capabilities is necessary in order to retain greater shares of value within these countries.

In Section 5.1., I argued that not policy but political will is the primary prerequisite for such process to take place. I introduced Samir Amin's concept of delinking as a broad political orientation towards economic sovereignty and linked it to the idea of developmentalism as state-led efforts economic development, whereby interventionist industrial policy plays a crucial role.

The importance of the state's political orientation and the power dynamics between social forces were discussed in Section 5.2. Key institutional preconditions, which were also explored, include mutual interests between state elites and industrial capital, efficient bureaucratic agencies, and productivity-focused learning at domestic firms. Together, these dynamics allow the state to ensure – through the use of "carrots and sticks" – that firms use the support they receive to actually build technological capabilities and climb the ladder of production.

In Section 5.3., I turned to one of the most historically influential approaches to such developmentalist agenda: developmental state theory. Originally formulated in the context of structural transformation in East Asian economies, its proponents argued that these countries engaged in extensive state planning and strategic use of SEOs, while simultaneously harboring market forces and the private sector in order to channel investment into priority sectors.

Three broad strategic orientations to interventionist industrial and trade policy, ISI, EOI, and VSI, were discussed in Section 5.4. Whereas ISI aims to develop autonomous industrial sectors through protectionist trade policy and infant industry promotion, EOI – in its interventionist variant – focuses on rapid export growth and raising the productivity of firms through controlled exposure to international competition. VSI, finally, is focused on trade in intermediate goods and on how to position local firms in GVCs to retain more value in the country. FDI also plays a central role in VSI strategies, and its impacts should be carefully managed through targeted industrial policy. Depending on the context of a country, these strategies may need to be combined or employed sequentially, as has been the case in many late industrializing countries.

In the following Section 5.5., I highlighted the importance of two dynamics that condition and accompany the structural transformation process. While linkages shape the dynamism of structural industrialization through backward and forward ripple effects, agricultural development is crucial both for its linkages to manufacturing and for political reasons.

In the last section of this chapter, Section 5.5., I turned to the financial side of industrial policy and argued that peripheral states must be in control of financial flows in order to steer the direction of accumulation towards developmentalist goals. This includes the domestic sphere, where development banking and financial regulation must ensure that savings are invested where they are needed. However, due to peripheral structures of production, high import dependency, and capital outflows, there is often a shortage of foreign exchange, and thus a need for additional inflows of foreign capital. I argued that developmental states need to carefully monitor cross-border flows and, similar to domestic finance, steer them in strategic directions.

To summarize the developmentalist policy agenda, I would like to refer to Tomkinson (2019: 56-57), who provides a broad overview of some of its most important aspects, as discussed throughout this chapter:

> [H]eterodox trade and industrial policies should broadly seek to eschew free trade. Instead protection and selective industrial promotion (mixing infant industry protection of domestic industries and export promotion) should be deployed, attached to appropriate performance requirements. Privatisation, meanwhile, should be resisted for its own sake in order to utilise state enterprises for development objectives […]. Innovation and technological adoption should be promoted over the protection of intellectual property rights. International private capital flows should be carefully managed, through the use of capital controls, ceilings on foreign loans, careful management of portfolio inflows and FDI management strategies, all targeted at employment creation, living standard improvements and knowledge transfer. Domestic financial regulation should seek to provide credit at appropriate prices for investments likely to yield stable, sustainable and equitable investment. Financial liberalisation should therefore be secondary to these more important goals. Finally, macroeconomic policies and institutions may entail restricted currency convertibility, adjustable exchange rate pegs, central banks integrated with the wider development strategy, growth-enhancing rather than inflation targeting oriented monetary policies, and growth-promoting public investment underpinned by expanded tax revenues.

Without such policy orientation, industrial development is unlikely to happen. However, as shown in Chapter 4, the imperialist world system is a source of relentless struggle for poor countries. Thus, even if we assume a "perfect" developmental state, one whose political elites and bureaucrats are genuinely committed to structural transformation, one that handles policy in a flexible and context-specific way, one that incentivizes and disciplines capital, etc. – what then? History has shown that this alone is rarely enough for structural transformation. The central questions must then be: what external factors are holding development in the periphery back? What external challenges and pressures does a peripheral state face in its pursuit of structural transformation? I will now turn to these issues.

6. Transnational constraints to industrial policy and structural transformation

Having now laid out the foundations of developmentalism and industrial policy as pathways out of peripherality, the following chapter focuses on the specific transnational constraints that peripheral developmental states face in their pursuit of structural transformation. These external barriers to industrialization and industrial policy will be grouped into, first, economic constraints, which relate to the economic structure of peripheral countries, their integration into and role within the circuits of global capital accumulation, both productive and financial, including constraints arising from capital outflows and the developmental need for additional external finance; and, second, policy space constraints – i.e., what Chang (2002) calls "kicking away the ladder" – which operate in the realm of geopolitics and international relations and concern global rules and regulations, international (financial) institutions and the social forces they represent, as well as open hostility against developmentalism. To some extent, this division is in line both with Arrighi's (1990: 17) notion of exploitation and exclusion, as discussed in Section 4.2., and with Tomkinson (2019: 57), who highlights

> two categories of shifts which demand attention in any study of contemporary late development: the neoliberal architecture of global rules and institutions (the IFIs and WTO and broader trade and investment regime); and shifts in patterns of global accumulation (specifically effecting global production and finance)

It must be stressed, however, that such categorization into "economic" and "political" constraints is only of an analytical nature. In the real world, no such clear-cut distinction exists. As will thus be shown throughout the chapter, the developmental constraints arising from economic and political dynamics are deeply intertwined. For example, chronic shortages of foreign exchange and a resulting accumulation of external debt can bring about a host of political dynamics related to the power of private creditors and IFIs and which constrain the policy space of peripheral countries. Despite such inherent interconnectedness of economic and political constraints to industrial policy, I argue that a meaningful analytical difference can be drawn between the uneven dynamics of capital accumulation on the one hand, and the "rules of the game" imposed by globally dominant social forces to which peripheral countries must succumb on the other. While economic hurdles thus constrain the outcomes of industrial policy, political constraints affect the policymaking process itself by determining which measures can or cannot be taken. Although the latter typically reinforce the conditions necessary for the former to function, they are nonetheless distinct from one another.

By bringing together these various sources of constraint in this chapter, I try to paint a broad picture of the global political economy of developmentalism under the conditions of neoliberal imperialism. However, I do not claim to offer an exhaustive account of the obstacles to industrialization. As dependency relations continuously evolve over time, so do the constraints that emanate from them. Any analysis of external obstacles to development can thus only be preliminary and tendentially incomplete. Moreover, there may hindering factors that lie squarely within the confines of peripheral countries and are, at most, only indirectly a result of core-periphery relations. The interest of this chapter, however, and this thesis in general, lies in the question of which constraints would remain, even if peripheral governments were able to overcome most internal difficulties in the way of structural transformation.

6.1. Economic constraints to development: peripheral integration and global patterns of accumulation

This section reviews some of the key difficulties that arise from the subordinate position of peripheral countries in global economic relations. Above all, these concern the structural shortage of foreign exchange, the position of peripheral firms and countries vis-à-vis TNCs, and the impact of financialization. First, uneven specialization means that peripheral countries tend to generate little foreign exchange through exports, while being structurally dependent on imports. This situation, which is exacerbated by a tendency of worsening terms of trade and capital outflows (e.g., in the form of interest payments), is examined in Section 6.1.1. Second, the internationalization of production and the rise of vertically integrated value chains spanning the globe have reinforced these uneven patterns of specialization. Hierarchical GVC relations may render the process of transforming to higher-complexity activities extremely difficult. In addition, foreign ownership of key industrial sectors through FDI can lead to enclave economies and a loss of agency over the process of structural transformation. These dynamics are the topic of Section 6.1.2. Third, the global proliferation of financialization and financial liberalization impacts peripheral countries in specific ways. A rise in global liquidity, increased capital mobility and the growing importance of short-term flows have reduced state control over resource allocation and increased the risk of volatilities, which is discussed in Section 6.1.3. Together, these dynamics severely curtail the prospects for structural transformation in the periphery.

6.1.1. The foreign exchange constraint

The peripheral problem of a structural lack of foreign currency has been central to the analysis of developmental constraints since the heyday of Latin American structuralism and dependency theory (Prebisch 1950: 4-5; Dos Santos 1970: 232). For interventionist industrial policy, which depends on imports of capital goods or licenses (and especially when following a VSI strategy which relies on imports of intermediate goods), a shortage of foreign exchange poses a fundamental challenge: "[i]f imports, say of capital equipment or materials, are essential for growth, the growth of the whole economy can be limited by the balance of payments constraint" (Brewer 1990: 172). The need to import complex machinery is itself a reflection of the periphery's dependence on technology from core countries – but importing is often the only feasible way towards eventually overcoming this gap in technological capabilities. Therefore, the peripheral structure of production (reflected in unfavorable specialization) in a way hinders its own transformation by not generating enough foreign exchange.

Since trade deficits are an immediate manifestation of foreign exchange shortage, an obvious solution to the problem would be to increase the value of exports. However, as noted in Section 4.2., prices for traditional peripheral exports (i.e., commodities and low-complexity manufactures) often tend to decline relative to the prices of imports from core countries. Peripheral countries therefore need to steadily increase the amount of goods they export to even be able to maintain stable levels of imports. With worsening terms of trade, achieving a trade surplus (and thus earning more foreign exchange than is spent on world markets) would be only feasible by reducing imports which is generally detrimental to both living standards and prospects for structural transformation (Fischer 2018: 3364). In the long term, industrialization through import substitution and export growth are the only way to overcome foreign exchange shortages, as both Latin American structuralists and dependency theorists already argued.

Another way of sustaining a trade deficit (i.e., being able to pay for imports in the face of low export earnings) is to attract external sources of finance, as discussed in Section 5.6.2. Although perhaps an indispensable component of an interventionist industrial policy, relying on foreign capital to pay for imports is a double-edged sword. In contrast to income remittances and grants, concessional loans and commercial forms of capital inflows generally lead to outflows of resources at later points, constituting a central mechanism of the value transfers described in Section 4.2. As a result, interest payments on foreign debt and the repatriation of TNC profits become the main channels of foreign exchange outflows from peripheral countries.

Between 1982 and the mid-2000s, peripheral countries paid an estimated USD 4.2 trillion to service their debts to core creditors (Roos 2019: 2). These extractions of value may currently even be accelerating, as the external debt of Sub-Saharan Africa doubled throughout the 2010s (Zajontz 2022: 177). The scale of profit repatriation may, however, be even more significant. As Kvangraven et al. (2020: 9) note:

> between 2000 and 2016, 28 African countries representing 85 per cent of sub-Saharan Africa's GDP, cumulated annual flows of FDI income of 500 billion USD, compared to 100 billion USD for the cumulated annual flows of interest payments on external debt.

Although not all FDI income leaves peripheral countries in Africa and elsewhere (as some of it is reinvested), the capital outflows associated with FDI and profit repatriation can nevertheless be assumed to be substantial. While FDI initially makes a positive contribution to the balance of payments, this is often reversed in the longer term by the high import intensity typical of foreign firms and by profit remittances (Akyüz 2015: 3). TNCs also routinely engage in the practice of transfer pricing, which allows them to shift profits between corporate entities in different countries, thus avoiding taxation or restrictions on profit repatriation (UNCTAD 2022: 214). Payments for licenses or royalties have long been another method of circumventing financial regulations and siphoning off value from peripheral countries (Cardoso 1972: 91; Treacy 2022: 223). Large-scale capital flight, i.e., sudden outflows of resources in times of economic or political turmoil, can be another critical drain on the scarce foreign exchange supplies of peripheral countries, often leading to sharp currency depreciation, debt distress and financial crises (Cypher and Dietz 2009: 227). Moreover, the accumulation of large foreign exchange reserves for the purpose of currency stabilization poses an additional constraint, as these resources cannot be allocated to productive investment either (Musthaq 2021: 20).

Ultimately, what matters is what foreign exchange is used for. If most of it goes into debt servicing, is repatriated by TNCs, or used for luxury consumption, little will be left for essential imports (e.g., of capital goods) and investments. And when outflows exceed inflows due to rising debt or in times of crisis, this inevitably leads to a decline in imports and thus austerity. While external finance may indeed be necessary to drive import-dependent industrialization, it leads to vicious circles of borrowing and attracting investment on the one hand, and repayment and repatriation on the other. This condition is indeed a central feature of peripherality, as

Treacy (2022: 223) notes: “dependent capitalist development is characterized by the transfer of value in the form of profits, interest payments, patents, royalties, and deterioration of the terms of trade – a surplus thus not realized internally”.

When trying to learn from the development experiences of the past, one has to keep such dynamics of value transfer and foreign exchange shortage in mind. During the industrialization processes of South Korea and Taiwan, their foreign exchange constraints were eased considerably for geopolitical reasons. Both were strategic allies of the US in its Cold War containment policy and benefited from generous American support (Radice 2008: 1154). US aid and preferential loans indeed allowed South Korea to run significant trade deficits throughout the 1960s and 1970s (Macrotrends 2023); and even amidst the 1980s debt crisis:

> the surge in official lending in the years preceding and following the 1982 international debt crisis appears to have been crucial to maintaining the solvency of the country in the midst of its deep trade deficits that persisted through these years, which under normal circumstances would have given financial markets cause for concern (Fischer 2018: 3374)

The process of structural transformation in South Korea, which depended heavily on the adoption of foreign technology through imported licenses (Amsden 1989: 20), would hardly have been possible without the US easing the foreign exchange constraint normally faced by peripheral economies. It is therefore important to emphasize that “US foreign policy did not simply facilitate Taiwan and Korea’s development; it *allowed* it to happen” (Perez 2021: 112, emphasis in original). These conditions, unfortunately, were nothing less than extraordinary. In most cases of late industrialization, foreign exchange is a notoriously scarce resource, a fact that makes any attempt to simply emulate the East Asian experience inherently problematic.

Without extensive concessional foreign financing – as in the case of South Korea and other US allies – the periphery faces a relentless uphill battle against the workings of the international division of labor and the immense transfers of value to the core. Foreign exchange shortages are a direct consequence of this, thus constituting a severe constraint to industrial policy and limiting the prospects for structural transformation.

6.1.2. The internationalization of production: adverse dynamics of global value chains and foreign direct investment

As shown in Sections 4.2 and 5.4.3, the production of all kinds of goods is now internationally dispersed and predominantly organized in GVCs, providing peripheral countries with different industrial policy options than in the past. However, the proliferation of GVCs, accompanied by a global surge in FDI, and the specific form of peripheral firms’ (non-)participation in these networks have also created distinct difficulties for the process of structural transformation.

These problems arise primarily from the dominance of TNCs and the intense competition between peripheral firms and countries on the one hand, and the loss of domestic control over the industrialization process through denationalization and enclave economies on the other.

Over the past decades, TNCs have been able to establish dominance over large segments of many GVCs, leading to a situation where "the winner takes most" (UNCTAD 2017: 125). Having achieved oligopolistic market control in many sectors, these lead firms exercise power by determining the allocation of resources and risks among actors, setting (quality) standards, and controlling logistics and marketing (Whitfield et al. 2015: 56; Morris and Staritz 2019: 506). A small number of TNCs now make decisions for entire industries, thereby severely affecting the prospects and room for maneuver of peripheral firms trying to catch up (Jackson 2021: 4).

This degree of market control has resulted in increased price-setting power of TNCs vis-à-vis subordinate firms in peripheral countries. TNCs can therefore increase their profits by squeezing costs, i.e., by lowering the prices of inputs sourced from supplier firms (Selwyn 2019: 81). Moreover, the TNC-driven extraction of large shares of value from GVCs has intensified in the context of financialization and the increased intrusion of financial imperatives into corporate decision-making processes. This is because financial capital presses TNCs for short-term returns on investment, which in turn exerts further downward pressure on supplier firms (Fine and Mohamed 2022: 21). These factors have led to a deepening of the "smile curve", whereby the often intangible activities at the beginning and end of production (e.g., design or marketing) have become more and more profitable, while the actual production process has provided increasingly less opportunity for value capture (Hauge 2020: 2086). Peripheral GVC participants thus face shrinking income shares relative to TNCs. The price-setting power of lead firms is indeed a significant driver of the deteriorating terms of trade of peripheral exports, exacerbating the foreign exchange constraints discussed in the previous section.

Because of the intense competition between peripheral firms, TNCs also find themselves in a privileged bargaining position against subordinate participants. In sectors characterized by globally available standardized manufacturing activities, these lead firms can often simply remove individual suppliers from their networks and replace them with cheaper – or more subservient – alternatives (Chang et al. 2016: 152). This weak bargaining position can make upgrading towards higher-complexity activities extremely difficult. Lead firms may have an interest in preventing peripheral firms from engaging in more advanced parts of the production process, especially if this would challenge their dominance, or if it involves activities that TNCs consider their core competencies (Morris and Staritz 2019: 511). For this reason, knowledge flows and technological spill-over may be very limited. Upgrading is further constrained by the fact that some of today's most profitable activities are protected by tightly enforced IPRs which inhibit knowledge transfers and prevent peripheral producers from emulating the activities of lead firms (Fischer 2015: 714). Additionally, the very measures designed to attract FDI and foster GVC integration can have a negative impact on upgrading prospects. By prioritizing the needs of TNCs, transfers of technology and other spill-over and linkage effects (e.g., local procurement) may be neglected (Tomkinson 2019: 61, 63).

By contrast, during the time of East Asian industrialization, South Korean and Taiwanese manufacturing firms were in a much better bargaining position vis-à-vis TNCs due to higher global demand, less competition among producers, a less constrained legal environment, and a privileged geopolitical position. This allowed for considerably higher rates of technology transfer and better opportunities for upgrading, which spurred the structural transformation process (Hauge 2020: 2088). Today, the difficulties to upgrading pose serious challenges to industrial development, meaning that peripheral countries may remain stuck in subordinate positions with little developmental prospects.

The fierce competition among peripheral countries has led to a "race to the bottom" in many sectors, with countries having to continually devalue their currencies or suppress wage levels in order to gain or secure market share against others (Cypher and Dietz 2009: 474). At the heart of this problem is the fallacy of composition, which describes the fact that what might be true for one (e.g., structural transformation being possible via an EOI or VSI light manufacturing strategy) is not necessarily true for all. In this context, this means that if all peripheral countries pursued the same industrial policy strategy at the same time, doing so would increase competition to such an extent that, combined with a lack of sufficient demand, the benefits for all would be greatly diminished (UNCTAD 2016: 132). Although this does not undermine all possibility for structural transformation in individual countries, it does imply that the development of one peripheral country may come at the expense of another. This is what Wallerstein (1988: 2022) meant when he famously described the world economy as a zero-sum game and thus the development of the periphery at large as an illusion.

Another crucial developmental obstacle related to the internationalization of production is the problem of losing control over the industrialization process. This can happen through the denationalization of industry and the proliferation of enclave economies, resulting from uncontrolled FDI inflows. Thus, while subordinate GVC integration may be detrimental to industrialization, domestic non-participation and total foreign control may indeed be worse. As Akyüz (2015: 2) notes, FDI is often less about actual capital movements and more about the transfer of control over assets from domestic to foreign actors. In this manner, an excessive reliance on FDI can lead to an effective denationalization of key sectors and thus to a lack of domestic influence over the process of structural transformation (Bougrine and Seccareccia 2009: 59-60, 62).

The problem with foreign ownership of industry is twofold. First, TNCs are not as embedded in a peripheral country as domestic firms and are therefore more likely to leave when conditions change (Morris and Staritz 2019: 517). While rising wages may pressure a domestic capitalist to move into new activities, they may cause a much more mobile TNC to exit a country and relocate its operations. Second, the relationships between developmental states and foreign capital are less likely to allow for the conditions of mutual interests and embedded autonomy to emerge, resulting in diminished state leverage over capital (Whitfield et al. 2015: 19). Brazil is an example of a country experiencing such loss of domestic control. Whereas East Asia could rely on concessional loans and aid (which did not change the ownership structure of national industries), Brazil was heavily dependent on FDI and soon faced the denationalization of strategic sectors. This was exemplified by the automotive industry, where foreign companies accounted for over 90 percent of sales by 1995 (Fischer 2018: 3372).

It is precisely because of this threat of denationalization that capital controls on the one hand, and technology transfers and indigenous learning on the other, are needed to break the cycle of technological dependence and TNC leverage. The diffusion of technology to local firms, however, crucially depends not only on upgrading when participating in GVCs, as discussed above but also on the creation of linkages between TNCs (and their suppliers) and the wider domestic economy, i.e., on entering GVCs in the first place. If states do not actively encourage the emergence of such linkage dynamics through measures such as local content requirements or mandatory joint ventures, FDI inflows to peripheral countries and the resulting industrial activity may instead happen in an enclave manner (Francis 2017: 16). This means that peripheral firms may have minimal prospects for any kind of GVC participation, thus inhibiting linkage creation and technological learning. This is especially true in export-oriented manufacturing, which is often highly productive but largely disconnected from the rest of the economy. Such absence of linkages may result in a stark duality: "ultramodern TNCs operating in a nearly autonomous transnationalized sphere and a domestic economy mired in low productivity, poverty, social decomposition, capital flight, and massive unemployment" (Cypher and Dietz 2009: 473).

Overall, an industrial policy strategy that relies excessively on FDI inflows, resulting in either subordinate GVC participation or loss of domestic control, can further deepen the dynamics of core-periphery polarization. Given the unfavorable conditions under which peripheral firms typically engage in GVCs, there are often very few opportunities, both in terms of foreign exchange earnings and for the purpose of upgrading. The increasing dominance of TNCs eager to protect their positions and the competition between peripheral producers of low-complexity goods means that the latter find themselves in a global "race to the bottom". Moreover, unfettered FDI inflows can lead to the denationalization of entire sectors and thus to the transfer of control over the economy to TNCs that are neither entrenched in the domestic economy nor subject to the same degree of state pressure to comply with developmental imperatives. As with the question of external finance discussed in Section 6.1.1., the developmental states of East Asia faced far fewer constraints related to TNCs and GVCs than peripheral countries do today. With economies dominated by TNCs and characterized by subordinate GVC integration, peripheral countries may now be in a considerably worse position for conducting interventionist industrial policy, thus greatly reducing their prospects for structural transformation.

6.1.3. Subordinate financialization and financial dependency

Since the collapse of the Bretton Woods system of fixed exchange rates in the early 1970s, the world economy has undergone a shift towards a neoliberal phase of capitalism characterized by financialization (Fine and Mohamed 2022: 1). As noted in Section 4.2., financialization can be understood as the expansion of financial markets, instruments, and imperatives around the world and into ever more aspects of society (Fine and Saad Filho 2014: 156). In this section, I will discuss some of the most important implications of these dynamics for peripheral countries.

An important enabler of financialization on a world scale has been the process of financial liberalization in both core and peripheral countries, which can be interpreted as a strategy to restore faltering capital accumulation in the productive sphere (Becker et al. 2010: 227). In much of the periphery, the liberalization agenda has been driven by the International Monetary Fund (IMF) and the World Bank since the 1980s. This has led, among other things, to the expansion of cross-border financial flows through capital account deregulation and the removal of capital controls, and to the transformation of peripheral financial systems through privatization, easier access for foreign banks, and the creation and expansion of stock markets (Kvangraven et al. 2020: 5; Fine and Mohamed 2022: 23).

This deregulated global financial environment impacts peripheral countries and their prospects for industrialization in unique ways, captured by the notions of subordinate financialization and financial dependency. Financial dependency means that peripheral countries are adversely affected by, and therefore have to respond and adapt to, financial dynamics that either result from their dependent position in global financial relations or emanate from the core of the imperialist world economy (Musthaq 2021: 15; Kvangraven et al. 2020: 3). Subordinate financialization, on the other hand, can be understood as the distinctive form in which peripheral countries experience the global phenomenon of financialization and thus as the process by which financial dependency has evolved and deepened in the neoliberal era (Powell 2013: 144). While financial dependency existed long before the disintegration of the Bretton Woods system (and indeed before its inception), the proliferation of financialization and financial liberalization since then has led to three major interlocking evolutions that have significantly altered the conditions for peripheral countries: greater global liquidity, increased capital mobility, and the upsurge of short-term speculative flows over longer-term movements of capital (Tomkinson 2019: 64).

Since the abandonment of the gold standard, financial capital has become increasingly liquid. This is especially the case in times of expansionary monetary policy in core countries, where central banks reduce interest rates and may resort to further measures such as quantitative easing to spur growth, as was done in the wake of the global financial crisis in the late 2000s (Kvangraven et al. 2020: 3). Together with the increase in capital mobility, i.e., the unimpeded flow of finance across borders due to liberalization, such waves of global liquidity can lead to surges of capital inflows to peripheral countries. An important reason for the entry of financial capital is the often higher interest rates offered in the periphery to compensate for the higher credit risk. These interest rate differentials between core and periphery allow financial capital to borrow cheaply in one country and lend dearly in another (Fischer 2015: 718). The resulting flows of capital and other forms of speculative financial movements seeking short-term returns, e.g., portfolio investments, deeply influence the economies of peripheral countries and their prospects for structural transformation in at least three ways.

First, the preference of capital for short-term speculative profitmaking over longer-term loans or investments is detrimental to industrialization by decreasing the funds available for productive activity (Tomkinson 2019: 64). Manufacturing development is a lengthy process that requires stable funding, the availability of which is compromised when other, potentially more profitable, and less risky avenues for accumulation exist. This problem is often exacerbated in the case of a large presence of foreign institutions in peripheral financial systems. Foreign bank entry, enabled and encouraged through financial liberalization, tends to lead to a low prioritization of the needs of domestic firms (Kvangraven et al. 2020: 15-16).

Second, increased cross-border capital flows can lead to volatile exchange rate movements to which peripheral countries must adapt. In periods of expansion and net capital inflows, peripheral currencies appreciate, while net outflows put downward pressure on the exchange rate (Fritz et al. 2022: 730). As these effects can happen in erratic ways, they can undermine predictability and thus hurt the performance of peripheral manufacturing sectors. In order to keep such exchange rate fluctuations under control, peripheral countries must resort to the accumulation of foreign exchange reserves in order to stabilize their currencies against others (Bougrine and Seccareccia 2009: 51). However, this comes at a price. Cruz and Walters (2008: 665) estimated the opportunity cost of reserve accumulation to be around 1 percent of GDP, a significant sum which consequently cannot be used for productive investment. This containment of exchange rate fluctuations resulting from financialization thus imposes a heavy cost on peripheral countries which aggravates the foreign exchange constraint discussed in Section 6.1.1.

Third, unrestricted capital flows can result in boom-and-bust cycles with potentially far-reaching repercussions beyond mere exchange rate effects. While peripheral countries often experience net capital inflows in times of liquidity and financial market optimism, the direction of these movements can quickly reverse when conditions change, either inside or outside the country (Fritz et al. 2022: 730). A rise in US interest rates, for instance, can result in a sell-off of peripheral assets, as capital flows towards the US in search of higher yields. Likewise, when peripheral countries experience a deterioration in economic or political conditions, or if they seek to implement policies undesirable to capital, optimism may wane, and massive capital outflows often follow (Musthaq 2021: 24). Without capital controls in place, sudden capital flight leads not only to sharp currency depreciation but may result in acute financial and foreign exchange crises. These knock-on effects of financial liberalization could be witnessed in the 1997 Asian financial crisis. South Korea, for example, almost fully relinquished state control over capital inflows and over the direction of resource allocation (UNCTAD 1998: 76). The result was ballooning short-term external debt and asset price inflation, until the bubble finally burst, sending East Asia into turmoil (Chang et al. 1998: 738-739). Such crises often leave peripheral countries unable to service their external debt and thus open the door for the demands of IFIs and the social forces they represent (Tomkinson 2019: 66). Besides the danger of financial crisis, debt distress, and structural adjustment, to which I will return in Section 6.2.1., capital flight makes peripheral countries dependent on further injections of foreign capital, resulting in a vicious circle of refinancing and thus ever more vulnerability to changes in external financial conditions (Fischer 2015: 727).

In sum, subordinate financialization and the financial dependency on volatile cross-border flows reinforce the constraints to structural transformation in peripheral countries. In the neoliberal era, higher global liquidity, the increasingly unimpeded movement of capital between countries, and the rise of short-term flows have resulted in a reduction of peripheral state control over the direction of resource allocation and to deep financial vulnerability. The liberalization of financial systems around the world has led to a surge in speculative flows, whose effects on the exchange rate need to be contained at great cost and whose direction can suddenly reverse, leading to financial crisis and debt distress, and reducing the prospects for industrialization.

6.2. Policy space and the limits to peripheral sovereignty

In addition to the economic constraints discussed in the previous section, there are other developmental obstacles that are more political in nature. While the problems of foreign exchange shortage, GVC (non-)integration, and financialization undermine the success of interventionist policy *outcomes*, political constraints impinge directly on policymaking sovereignty by limiting which measures can be pursued in the first place. In this regard, the notion of policy space describes "the boundaries within which decision-makers can create policies" (Jackson 2021: 1). For developmentalist industrial policy, such limits to policymaking sovereignty essentially mean that peripheral countries are prevented – through political pressure, legal contracts, or force – from implementing appropriate measures. Echoing the notion of shrinking policy space, Chang (2002) refers to these obstructive practices as "kicking away the ladder". This describes the hypocrisy of core countries and core-based organizations in preventing peripheral countries from pursuing essentially the same policy strategies they themselves have employed in their historical processes of structural transformation. Policy space constraints thus arise primarily from the influence and pressure of powerful actors such as core states or international (financial) organizations or from peripheral countries' commitments to multilateral or bilateral agreements (Mayer 2009: 377; Kentikelenis et al. 2016: 547). In theory, peripheral states could choose not to give in to the demands of external actors or not to enter into such agreements. In practice, however, they often have little alternative, as will be shown throughout this section (Bradshaw and Huang 1991: 324; Roos 2019: 16; Mayer 2009: 389).

The different mechanisms that constrain peripheral policy space will guide the structure of this section. First, as noted in the previous section, financial crises and episodes of debt distress can make peripheral countries susceptible to the demands of IFIs and the forces they represent. The influence of these actors and their practices on policy space is discussed in Section 6.2.1. Second, and related to the first point, the reliance of some peripheral countries on aid can result in the danger of strong donor influence on policy, which I briefly outline in Section 6.2.2. Third, the rules and regulations of the global trade and investment regime, which are discussed in Section 6.2.3., now effectively outlaw many (industrial) policies that have historically been used for achieving structural transformation. Fourth and finally, powerful states may resort to more aggressive methods if they see their interests threatened by peripheral policymaking. This kind of military hostility, which impinges on policy space in the most brutal way, is outlined in Section 6.2.4.

6.2.1. International financial institutions and structural adjustment programs

Beyond the problems of foreign exchange outflows and the financial vulnerabilities associated with short-term capital flows, the accumulation of large external debts can constrain industrialization in additional ways that are related to the power of international financial institutions (IFIs) and the measures they can impose on indebted peripheral countries. Since the 1980s debt crisis, IFIs such as the IMF and the World Bank, have engaged in conditional lending and implemented structural adjustment programs (SAPs), leading to substantial restrictions of peripheral policy space (Kentikelenis et al. 2016). As Reinsberg et al. (2019: 1228) note, "the practice of conditionality gives creditors – the high-income countries controlling IFI operations – unparalleled leverage to alter the political economies of borrowing countries in the interests of the West". Such dynamics usually start in episodes of debt distress when sovereign borrowers become unable to service their outstanding liabilities and thus susceptible to outside influence.

From the perspective of peripheral states, one obvious solution to this problem would be to simply default on their external debt, i.e., to choose non-repayment. However, as Roos (2019: 10) illustrates, this option has become nearly inconceivable, as private and public lenders can subject a defaulting country to intense pressure by refusing to extend further short-term credit (on which most governments and companies rely), triggering a series of debilitating spill-over effects that may cause deep crisis and widespread popular unrest. Continued debt repayment is of paramount interest to international creditors, and their structural power and influence over the IFIs provide them with the necessary means to ensure the realization of their profits one way or another. The immediate motivation for conditional lending and the implementation of SAPs is thus to uphold the liquidity of debtor countries, enabling them to continue servicing their debts, as well as to preserve the stability of the international financial system, as disorderly defaults could trigger contagion to core countries and international financial crises (Roos 2019: 13). In this environment, debtor compliance and repayment, rather than unilateral default, become the norm. This was the case, for example, in Ghana in the spring of 2023, as Sauvage

(2023) writes in *France 24*: “To prevent Accra from defaulting on its debt, the International Monetary Fund (IMF) on Wednesday approved a $3 billion loan in exchange for austerity measures”. Thus, in lieu of other options, distressed borrowers must comply with the conditions imposed on them in exchange for “rescue” loans (Reinsberg et al. 2019: 1224).

The IMF distinguishes between stabilization conditions, which set broad macroeconomic targets and allow state greater policy space in choosing how to achieve them, and structural conditions, which impinge directly on policymaking sovereignty by mandating sweeping changes to the structure of the domestic economy (Kentikelenis et al. 2016: 555). These far-reaching policy reforms are designed to address what the IFIs consider to be the root causes of economic distress, including “excessive” government spending, trade deficits and lackluster export performance. Accordingly, the core tenets of such SAPs are austerity, deregulation, liberalization, and privatization. More specifically, they often include government budget cuts, tax hikes, ceilings on government debt, elimination of subsidies, price deregulation, removal of tariffs and other import restrictions, currency devaluation, financial sector deregulation (including capital account liberalization, liquidation of development banks, and easier entry for foreign banks), SOE-related conditions (up to and including full privatization), and deregulation of labor markets (Roos 2019: 14; Reinsberg et al. 2019: 1231-1232; Kentikelenis et al. 2016: 548, 557; Kvangraven et al. 2020: 15; Bradshaw and Huang 1991: 322). In short, the mandatory policy reforms associated with SAPs are diametrically opposed to what heterodox development theory considers conducive to structural transformation. Although the IMF has slightly changed its view on financial deregulation in the wake of the 1997 Asian crisis and more recently has even accepted the “occasional need for pre-emptive use of capital controls” (Loungani et al. 2022), the SAP policy package today remains firmly neoliberal and anti-developmental.

As such, the effects of these programs can be devastating for peripheral economies. Not only do they lead to increases in unemployment and poverty (Biglaiser and McGauvran 2022: 806), as well as higher inequality and negative health outcomes (Kentikelenis et al. 2016: 550), SAPs also severely undermine the prospects for industrialization. The elimination of subsidies and tariffs, for example, makes both export promotion and import substitution much more difficult, while financial deregulation and privatization undermine the state’s ability to direct investment into strategic sectors. Currency devaluation leads to a higher external debt burden and reduced purchasing power, and thus sharp reductions in imports on which industrialization depends.

For the IFIs and the social forces they represent, on the other hand, these measures fulfil their purpose, as they alleviate the foreign exchange constraint and free up resources for continued debt service, while at the same time opening up peripheral economies to international capital. In the 1980s, peripheral countries that underwent SAPs were thus often able to repay their external debts rather quickly, albeit while causing severe damage to their manufacturing capabilities (Fischer 2009: 861). These programs essentially force peripheral countries to implement reforms that favor the interests of core countries and international capital over their domestic economies. They serve not only to perpetuate value transfers through continued debt servicing but also to dismantle developmentalism through reducing policy space and the role of the state in in the development process. As Bougrine and Seccareccia (2009: 52) therefore argue, "the idea behind the recommendations regarding the 'abandonment of the interventionist strategy' being sold to poor and developing countries is to strip the state of its power and sovereignty". The result is a consolidation of core-periphery relations at the hands of the IFIs. Acting as agents of neoliberal imperialism, these organizations have forcefully "kicked away the ladder" for many poor countries. Recurrent cycles of debt distress and IFI-driven structural adjustment must therefore be understood as systemic manifestations of the adverse incorporation of peripheral regions into the imperialist world economy (Zajontz 2022: 174). The dangers posed by this dynamic loom over peripheral projects of developmentalism like the sword of Damocles and can constitute one of the fiercest constraints to structural transformation.

6.2.2. Aid conditionalities and donor influence

Developmental constraints related to aid conditionalities and donor influence in many ways mirror the problems illustrated in the previous section and will therefore be discussed only briefly. Both lending from international creditors and receiving aid from bilateral or multilateral donors are forms of external finance on which developmentalism often relies. They differ, however, in that concessional grants do not have to be repaid and therefore do not contribute to capital outflows at later points in time, as loans do.

Being deemed at the bottom of the creditworthiness scale the very poorest countries in the world are often unable to access cheap foreign loans and are thus particularly reliant on aid. As noted, between 2010 and 2019, these LDCs received 94 percent of their total financial inflows in the form of ODA, i.e., grants or concessional loans from OECD bilateral donors in the OECD's Development Assistance Committee (DAC) or from "traditional" multilateral donors and IFIs (World Bank 2021: 32). This dependence means that core countries and IFIs may find themselves in powerful positions to influence policies in peripheral countries in their own interests. Similar to the practice of conditional lending, the continuation of aid flows can be made contingent on recipient countries' compliance with political conditionalities. Prominent among these are stipulations on democracy and human rights, the violation of which can lead to sanctions in the form of aid withdrawal.

For example, both the US and many European Union (EU) countries, which are among the largest unilateral donors in the OECD-DAC group, have provisions for aid sanctions in the case of military coups or perceived authoritarian regression. In this way, aid functions as a "carrot", while its suspension is the "stick" with which to discipline peripheral governments. However, these large bilateral donors, particularly the US, have applied such aid conditionalities selectively and inconsistently (Masaki 2016: 51). This is because, in addition to ostensible moral convictions, some of the most important reasons for core countries to provide ODA include economic and national security concerns (Kragelund 2015: 245), including the desire to maintain "stability" in recipient regions, for example through counterterrorism assistance (Crawford and Kacarska 2019: 189). If any of these objectives are threatened to a sufficient degree, bilateral aid will either be provided or suspended to achieve the donor's interests – even if this means authoritarian consolidation, contrary to the purported goal of advancing democracy around the globe (Crawford and Kacarska 2019: 186, 198, 200).

Multilateral donors and lenders, on the other hand, have come to put their emphasis on the implicitly neoliberal notion of good governance. Although the concept is vague, good governance almost always "implies a minimal state" (Sadie 2002: 58), which is at odds with any chance of industrialization. In case of "bad" (e.g., interventionist) governance or perceived autocratization, donors and lenders can simply withhold aid flows. From the 1980s onward, IFIs (most notably the World Bank) have thus often made the continuation of aid contingent on policy reforms in line with SAPs. Non-compliance with an IMF program can indeed lead to the suspension of other aid programs by the World Bank or bilateral donors (Wade 2001: 69). These actors have the ability to withhold financial flows to aid dependent countries if they see their interests threatened by the policy choices of peripheral governments and thus have significant influence on their policy space. As Whitfield and Fraser (2009: 1) note, "Western aid agencies have constrained the policymaking options of aid-receiving governments […] by insisting that, in return for much needed finance, recipient governments change their economic and social policies".

However, peripheral states are not necessarily powerless receivers of such dynamics. The ability of donors to influence policymaking relies to a significant extent on the negotiation strength of both donors and the peripheral state. Clear policy visions, the capacity to design and implement (industrial) policies while keeping donors out of the administrative system (Whitfield and

Fraser 2009: 20), the ability to internally finance strategic developmental projects if external finance is not forthcoming, and to play competing donors off against each other (Kragelund 2015: 246-247), as well as being of strategic importance to donors (e.g., as a guarantor of regional stability) all contribute to increased peripheral leverage in aid negotiations and thus to higher degrees of policy space. Only through such interventionist approach to aid can peripheral states hope to resist the influence and power of core states and IFIs, and prevent them from using aid conditionalities to "kick away the ladder" of structural transformation.

6.2.3. Rules and regulations of the global trade and investment regime

Since the creation of the World Trade Organization (WTO) in 1995 and the later proliferation of bilateral and plurilateral trade and investment agreements, there has been a proliferation of rules and regulations governing the movement of goods, services, and capital around the globe. In addition to the WTO's predecessor, the General Agreement on Tariffs and Trade (GATT), there are now a plethora of agreements that fall under the WTO banner, including on issues such as trade in services (GATS), investment (TRIMS), intellectual property rights (TRIPS), and subsidies and countervailing measures (SCM) (Andreoni et al. 2019: 117). With the exception of LDCs (which are exempted from some of the most stringent rules), these treaties impose binding and legally enforceable obligations that severely reduce the policy space of peripheral countries (Mayer 2009: 374).

WTO members are, for example, required to set a ceiling on tariffs, beyond which they cannot be increased. In many peripheral countries, tariffs on manufactured imports are already exceptionally low compared to earlier historical periods, which is partly a result of previous SAPs (Chang et al. 2016: 117). This is problematic because it makes import substitution and the promotion of infant industries much more difficult. Subsidies are another contentious issue, as the WTO considers direct government support for strategic activities and companies to be a trade-distorting measure. Sector-specific subsidies, particularly those designed to promote exports through performance requirements, are thus prohibited (Mayer 2009: 377). For the "carrots and sticks" approach that is critical to interventionist industrial policy, this presents an enormous difficulty. Performance targets for FDI, such as local content requirements aimed at creating linkages and technological spill-overs, are also prohibited (Jackson 2021: 4). In the absence of such measures, it is much more likely for FDI to lead to limited upgrading opportunities and enclave economies, as discussed in Section 6.1.2. The contemporary multilateral trading system also includes much stricter protection of IPRs than in the past. Whereas earlier industrializing countries could imitate and reverse-engineer existing technologies, this has become almost impossible under WTO rules. This further entrenchment of barriers to entry has "tilted the balance between technology creation and technology diffusion in favour of established knowledge exporters in the developed countries, disadvantaging follower developing countries who are net technology importers" (Francis 2017: 25). While it is possible to circumvent some WTO rules, these arrangements nonetheless severely limit the policy options of peripheral countries.

Trade and investment agreements between individual countries, however, are often even more restrictive. Since the failure of the Doha Round of WTO trade negotiations, these have become more widespread. As it became increasingly difficult for core countries to achieve further trade liberalization through multilateral negotiations, they turned to bilateral and plurilateral agreements where they could exert greater leverage to secure more far-reaching commitments (Francis 2017: 17). Such free trade agreements (FTAs) or bilateral investment treaties (BITs) are "targeted at eliminating all remaining barriers to trade and capital flows, open new areas to corporate profit through privatisation, and push through deregulation and flexibility in labour markets" (Tomkinson 2019: 61). The constraints that FTAs and BITs impose on the policy space of participating countries therefore typically go beyond WTO rules and encompass much broader policy areas (Francis 2017: 28). A common feature of BITs is the Investor-State Dispute Settlement (ISDS) mechanism, which allows foreign corporations to sue governments if regulations reduce their profits. This severely limits the ability of governments to change their policies along the way (e.g., towards a more interventionist orientation) and codifies the dominance of TNCs over peripheral countries (Andreoni et al. 2019: 114). Preferential trade agreements (PTAs), in which core countries unilaterally offer privileged market access to peripheral countries, are usually less restrictive but can still influence the policy choices of recipient governments and carry the constant threat of withdrawal (Chang et al. 2016: 131-132).

While peripheral countries can choose not to join the WTO or enter into other agreements, this may be a costly choice. Trade integration is a crucial consideration for export-oriented industrialization. If non-participation in these international arrangements means a complete loss of competitiveness in export markets, this may ultimately be even more detrimental to structural transformation than the restrictions imposed. As Mayer (2009: 378) therefore notes, the "weakening of sovereignty […] must be weighed against the gains from integration into international markets and participation in the system of multilateral rules and disciplines". Whether and how to participate in such agreements must thus be a strategic choice of developmental states.

In summary, the contemporary global trade and investment regime confronts peripheral countries with a much more restrictive environment for pursuing developmentalist strategies. WTO rules and bilateral and plurilateral agreements prohibit some of the most important policy instruments, thus reducing the policy space of peripheral countries and their prospects for structural transformation. In contrast, East Asian late industrializers were not only bound by less restrictive rules on tariffs and subsidies (Hauge 2020: 2088). They also encountered much weaker IPR protection and were even supported in their technological learning efforts (Yeung 2016: 207-208), again suggesting that the East Asian experience is no longer replicable.

6.2.4. Military interventionism

Although effective mechanisms for preventing structural transformation in peripheral countries, the aforementioned issues of conditional lending, selective aid disbursements, and legal obligations are arguably among the gentler forms of constraining policy space. When these measures fail to fully achieve their goal of dismantling interventionist development strategies, violence may become – in the most literal sense – the weapon of choice. History is replete with countless examples of powerful core countries intervening in the affairs of poor countries in the most brutal ways. As Cope (2019: 31) argues, "[w]hen any country threatens to make a decisive break in the imperialist chain of value creation and distribution, they are forcibly pushed back into line, as the history of foreign interventions over the past century and more amply attests". In many cases, one goal of such interventions lies in the installation of subservient governments willing to forgo industrialization (or other measures that are against imperialist interests) and accept the subordinate (re)integration of their economies into the world system (Wai 2014: 484). In tandem with domestic comprador class fractions, such military invasions, coups d'état, or foreign-sponsored insurgencies thus typically aim to achieve pro-imperialist regime change.

There is no industrial policy strategy that can mitigate the effects of invasion, no developmentalist project that can withstand the wrath of some of the largest military powers on earth. Imperialist hostility is the most powerful constraint to structural transformation and, if other measures prove insufficient, ultimately ensures the continuation of core-periphery polarization and global patterns of exploitation: "force majeure was and remains the ultimate guarantor for the continued siphoning of wealth from the weak to the powerful countries" (Cope 2019: 31).

6.3. Conclusion: state-led developmentalism and its obstacles

The aim of this chapter was to review and discuss some of the most pressing issues that peripheral countries face in the pursuit of structural transformation, in particular the difficulties that result from their peripheral position in the world economy. For analytical purposes, these were divided into economic and political constraints, although it must be maintained that, in the real world, these are highly interrelated dynamics. While economic constraints are understood as structural consequences of the subordinate integration of peripheral countries into global relations of production and finance, political constraints concern the policy space, i.e., the room for maneuver, of peripheral states in implementing specific (industrial) policies.

Chronic shortages of foreign exchange, which were discussed in Section 6.1.1., constitute one of the most pressing economic constraints to structural transformation. They are a direct result of peripheral patterns of specialization, reflected in weak and volatile export earnings, high import bills, and value transfers through debt service, profit repatriation, and capital flight. In order to balance their trade deficits, peripheral countries become dependent on additional flows of external finance, which only exacerbate the problem. Since foreign exchange shortages significantly reinforce other developmental constraints (e.g., by inducing countries to rely on FDI and subordinate GVC integration, or by opening the door for external demands for liberalization through indebtedness), it is hard to overstate the importance of the foreign exchange constraint.

The internationalization of production and the heightened importance of FDI and GVC participation pose additional challenges to the periphery, as elaborated in Section 6.1.2. Within GVCs, TNCs have come to wield substantial power, controlling prices, setting standards, and determining resource allocation. This has intensified competition among peripheral producers, affecting their ability to ascend the technological ladder and leading to a global "race to the bottom". Moreover, excessive reliance on FDI can lead to a loss of control over the domestic manufacturing sector and to enclaves that are largely disconnected from the rest of the peripheral economy, undermining the effectiveness of state-led developmental projects.

The third economic constraint, discussed in Section 6.1.3., relates to the dynamics of financialization. Global financial deregulation, often under the influence of IFIs, has led to subordinate financialization and deepened the financial dependency of peripheral countries. Greater liquidity, increased capital mobility, and a surge in short-term speculative capital flows are among the most important transformations of this neoliberal era. For industrialization, these are problematic as they result in reduced financing for productive activities, exchange rate volatility, and the ever-present threat of boom-and-bust cycles. As a result, the potential for industrialization in peripheral countries remains constrained by their subjugation to global financial forces and the vulnerabilities this entails.

Concerning policy space constraints, Section 6.2.1. first underscored how the accumulation of external debt can strengthen the influence of IFIs over peripheral policymaking, often to the detriment of industrial policy efforts. By imposing SAPs in return for loans, IFIs often require debtor states to privatize, liberalize, and deregulate. These measures are intended primarily to ensure debt repayment and global financial stability, and they have detrimental effects on structural transformation. Besides often exacerbating issues like unemployment, poverty, inequality, and negative health outcomes, SAPs enshrine a neoliberal approach to economic policymaking and reduce the capacity of peripheral countries to implement interventionist industrial policies.

Relatedly, donor influence in the form of aid conditionalities, as discussed in Section 6.2.2., can also impinge on policy space. Grants and concessional loans are vital for many impoverished countries, but they often come with strings attached. Donor countries and IFIs can use these to shape policies in recipient countries, sometimes contradicting peripheral efforts at industrialization. Peripheral states can navigate and resist these pressures, but their ability to maintain policy space depends on factors such as their strategic importance to donors and their capacity to independently plan and implement development policies.

The global trade and investment regime, as embodied by the WTO and various bilateral and plurilateral agreements, imposes binding and legally enforceable obligations that severely restrict the room for maneuver of peripheral countries. These agreements, which were introduced in Section 6.2.3., cover policy areas such as tariffs, subsidies, and IPRs, and they often make it more difficult to pursue developmentalist strategies. While peripheral developmental states can choose not to participate in these agreements, this decision must be weighed against the potential gains from international market integration.

Finally, when SAPs, aid conditionalities, or legal obligations fail to undermine interventionist strategies in peripheral countries, powerful states may resort to violent interventions, as discussed in the last section of this chapter, Section 6.2.4. By forcefully ensuring the subordinate (re)integration of peripheral economies into the world system, military hostility serves as the ultimate means of perpetuating global exploitation and core-periphery polarization.

Overall, the web of economic and political constraints faced by peripheral countries underscores the profound challenges they encounter on their path to structural transformation. These constraints not only impede peripheral efforts to escape from dependency but also illuminate the enduring power dynamics that shape the imperialist world economy.

Some strands of dependency theory have long been criticized for focusing too much on such external constraints and thereby neglecting peripheral agency (Kvangraven 2020: 93). At its best, however, the dependency approach is indeed interested in the complex interplay between internal and external processes. There are many potential internal obstacles to economic development that have not been discussed so far (e.g., educational or infrastructural deficiencies), and these interact with and are reinforced by external constraints in more complex ways than can be explored here. The internal politics and problems of peripheral developmentalism must be seen as equally important as relations of international dependency. Only by understanding the interactions between external constraints and peripheral developmental efforts can one assess the prospects and limitations of industrialization in a given context. In the next part of this thesis, Part III., I will discuss how these transnational developmental difficulties have manifested themselves in the case of Ethiopia and how the Ethiopian state has attempted to navigate this challenging terrain in its pursuit of structural transformation.

Part III.

The Ethiopian experience of state-led developmentalism

7. Setting the scene: the EPRDF's resistance to neoliberalism and the emergence of the Ethiopian developmental state (1991-2005)

In 1991, the Ethiopian People's Revolutionary Democratic Front (EPRDF), an alliance of several regional militias, overthrew the previously ruling Derg regime, a Marxist-inspired military dictatorship that had ruled Ethiopia with great brutality since 1974. During its 17-year tenure, the Derg nationalized all land and most of the country's industry, expelled foreign capital, and largely eliminated the domestic capitalist class (Tomkinson 2019: 70-71). The period was also marked by little development in agriculture or manufacturing (Manyazewal and Shiferaw 2019: 142) and general stagnation (Oqubay 2018: 8). The deteriorating economic and political situation and the outbreak of an unprecedented famine in the early to mid-1980s led to an intensification of the country's long-running civil war, in which the Derg government was eventually defeated (Peterson 2020: 59).

Consisting of the dominant Tigray People's Liberation Front (TPLF), the Amhara National Democratic Movement (ANDM), the Oromo People's Democratic Organization (OPDO), and the Southern Ethiopian People's Democratic Movement (SEPDM), the EPRDF subsequently assumed the government of Ethiopia (Tomkinson 2019: 72). In contrast to the highly centralized political character of previous regimes, Ethiopia was now to become a federal state divided into nine ethno-linguistic regions. The constitution of 1995 granted each region the unconditional right to self-government and self-determination, up to and including secession from Ethiopia (Wayessa 2021: 91). Despite its federal nature, the new state remained characterized by a strong central government dominated by elites from certain ethnic groups, particularly those from the northern region of Tigray represented by the TPLF (Gebremariam 2018: 67). Meles Zenawi, an ethnic Tigrayan, became president of Ethiopia.

The first section of this chapter, Section 7.1., outlines the EPRDF's Agricultural Development Led Industrialization (ADLI) strategy and its approach to SOEs and private sector involvement.

In the following Section 7.2., the influence of IFIs on Ethiopia's reform agenda and the way the EPRDF handled external pressures for liberalization are discussed. Section 7.3. focuses on the chaotic events of the early to mid-2000s, which ultimately led to a more assertive phase of EPRDF rule and to the emergence of an Ethiopian developmental state. Finally, Section 7.4. concludes the chapter.

7.1. ADLI, market transition, and the preservation of state control

The EPRDF's most dominant constituent party – the TPLF – had emerged from a Maoist guerrilla movement and considered the impoverished peasantry its main constituency (Clapham 2018: 1153). The government thus laid its initial focus on improving the livelihoods of the rural population through agricultural development. Its ADLI strategy, which would become a guiding principle of Ethiopian development policy until at least the late 2000s, aimed to increase the productivity of smallholder agriculture through access to modern inputs, extension services, and infrastructure development (Manyazewal and Shiferaw 2019: 144). As the name suggests, the ultimate goal of ADLI was to promote the development of a hitherto very small industrial sector through fostering the potential linkages between agriculture and industry, particularly in the area of agro-processing. For the EPRDF, ADLI was not only a strategy for development but a means of state survival. The improvement of rural living conditions was to overcome the issue of regional separatism and achieve peaceful coexistence among Ethiopia's many ethnic groups (Dercon 2022: 252). Defending this quest for development and state survival against internal and external pressures was to become a defining feature of the EPRDF's politics in the 1990s and early 2000s.

The EPRDF came to power at a moment of global neoliberal hegemony, and the collapse of the Soviet Union further undermined the legitimacy of socialist development strategies that had previously shaped the TPLF's thinking. Despite officially embracing economic liberalization and overseeing the transition of Ethiopia from a centrally planned economy to one based on market principles, Ethiopian ruling elites did not undergo a fundamental ideological shift towards free market politics (Tomkinson 2019: 72). President Meles Zenawi was highly critical of the Washington consensus, which he considered a "dead end" for African development, "arguing that this simply bound developing countries into relations of subservience to already developed states, and that a strong state geared to a purposive development agenda was required in order to break the stranglehold of dependence" (Clapham 2018: 1154). Building on a foundation of Marxism-Leninism-Maoism, Latin American structuralism, and dependency theory, a commitment to state-centered developmentalism thus formed an ideological bedrock of the new Ethiopian government. This political orientation was also characterized by a remarkable degree of flexibility and pragmatism, tenets deemed necessary to navigate the developmental challenges of war-torn Ethiopia. The EPRDF saw the threat to its rule, and by extension to the development of Ethiopia, as being twofold: first, “rent-seeking” capitalists and liberal “anti-development” opposition parties inside the country, and second, imperialist forces from outside (Gebremariam 2018: 73-74). The ambition to curb the influence of these perceived enemies became a defining characteristic of the EPRDF regime until 2018.

The early economic difficulties faced by the EPRDF were steep. The war against the Derg had left the country’s infrastructure destroyed and its economy in shambles. Ethiopia was one of the poorest countries in the world, with a GDP per capita in 1991 that was lower than it had been in the 1960s (Oqubay 2018: 8). In addition to its efforts to foster agricultural development, the EPRDF sought to rebuild the economy mainly through the use of SOEs inherited from the Derg’s sweeping nationalization measures. Despite internal and external pressure to privatize, the government only cautiously did so. Between 1995 and 2000, a mere 200 SOEs were privatized, the majority of which were small enterprises in the retail and restaurant sectors, while most manufacturing activity remained under state control (Collins 2022: 611). The EPRDF also retained state ownership over all land and natural resources, fearing that privately-owned land would divert investment from productive use to land acquisition, while also creating unequal land ownership structures that would threaten to undermine the class basis of the EPRDF. SOEs were also used in sectors considered strategically important, such as finance, large-scale engineering, metallurgy, fertilizers, and pharmaceuticals (Tomkinson 2019: 80). In addition to enabling the government to steer economic activity, the resistance against privatization was also based on the EPRDF’s desire to keep policymaking largely independent of the demands of private capital, as Meles Zenawi argued:

> We could privatize our key economic assets and liberalize our land and food policies at any time […] but if we do that any time soon we will be the loser. Whoever buys up those assets […] will also buy a stake in our politics (Meles Zenawi, cited in de Waal 2018: 9)

While the EPRDF thus retained control over the “commanding heights” of production and finance, the private sector was again allowed at least some role in the economy (Weis 2016: 196). A new investment law in 1992 offered tax incentives to domestic and foreign capitalists, but their contribution was to remain marginal, with some sectors reserved for domestic investors only and many closed to private investment altogether (Manyazewal and Shiferaw 2019: 143). The lack of affiliation between the EPRDF and the domestic bourgeoisie stemmed from the party’s socialist heritage and their aforementioned wariness regarding the role of the private sector in economic development. The EPRDF preferred the local bourgeoisie to be small and fragmented, which made domestic demands for liberalization more manageable (Tomkinson 2019: 103). Foreign capital was only welcome in areas where neither the state nor domestic capitalists were able or willing to invest and especially in sectors aligned with ADLI, such as food and beverages, horticulture, cotton, or agro-processing (Tomkinson 2019: 95).

Overall, the EPRDF's early stance on state ownership and private sector involvement was one of considerable heterodoxy, especially considering the global neoliberal context. The extent to which the Ethiopian government was able to maintain its interventionist orientation is all the more remarkable given the pressure it faced from the IFIs, especially the IMF.

7.2. Handling pressure from international financial institutions

Post-war Ethiopia was in desperate need of international assistance. In 1991, the government secured a 600 million USD multi-donor aid package with no strings attached, which was mainly used for rebuilding infrastructure and to pay for essential imports (Manyazewal and Shiferaw 2019: 143). The following year, however, the World Bank announced that it would withhold further assistance until the Ethiopian government agreed to enter into an SAP, known as the Structural Adjustment Facility (SAF) (Feyissa 2011: 790). This program, to which the EPRDF subsequently agreed, included import liberalization through tariff reductions, the devaluation of the Ethiopian currency (the Birr), the elimination of subsidies, the introduction of the aforementioned investment law, and a commitment to privatization (which, as noted, was very slow to materialize) (Gebrehiwot 2019: 233).

For Tomkinson (2019: 98), the IFIs' acts of conditional support indicate "clear efforts to use Ethiopia's economic distress and need for external financing to induce policy reform in line with the neoliberal development agenda". In an effort to avoid confrontation with the IFIs, and left with little alternative anyway, the EPRDF grudgingly agreed. In terms of implementation, however, the government resisted as much as possible, or as the Ethiopian president put it: "We fought a rearguard war not to privatize too much. We sent delegations across Africa to ask, how to handle the IMF? They said, 'say what they want you to say and do what you can get away with'" (Meles Zenawi, cited in de Waal 2015: 161-162). This commitment to preserving some measure of state control is a testament to the developmental character of the early EPRDF regime.

The IFIs, however, were not happy with the speed and extent of the structural adjustment process. The most contentious issues were the liberalization of the financial sector (which was still closed to foreign investors and dominated by state-owned banks) and the privatization of land

and the telecommunications sector, all of which the EPRDF considered non-negotiable (Feyissa 2011: 800). As a result, the mid-1990s saw a gradual decline in ODA to Ethiopia. Despite the country's undisputed success in poverty reduction, aid flows roughly halved between 1992 and 1997, mainly due to multilateral donors, while bilateral assistance remained relatively stable (Borchgrevink 2008: 200-202).

The tense relationship between the Ethiopian government and some of the IFIs reached its peak in 1997. A year earlier, a new three-year arrangement, the Enhanced Structural Adjustment Facility (ESAF), had been launched. However, after the first tranche had been disbursed, the IMF suspended its lending program in 1997 because it considered the government to be a "reluctant reformer" and "off track" (Wade 2001: 72). With the IMF acting as an ODA gatekeeper, not only 127 million USD in concessional IMF loans were at stake but other multilateral flows as well (Stiglitz 2002: 27). The IMF did not like the way the EPRDF handled the economic transition process and especially not the extent to which the government was keen on preserving domestic policy ownership. However, as Wade (2001: 72) argues, the IMF's actions may not have been motivated by economic reasoning alone:

> Fund officials are not used to poor country governments, especially African ones, arguing with them and presenting counterproposals. The fact that the Ethiopian government did just this – and worse, the prime minister called himself a Marxist – made them determined to strike back.

Angered that it had not been consulted on key fiscal policy decisions, the IMF then demanded further reforms on top of those already agreed before the start of the program. This included dividing up Ethiopia's largest bank, the state-owned Commercial Bank of Ethiopia (CBE), opening up the country's banking sector to foreign competition, and allowing for the free determination of interest and exchange rates (Manyazewal 2019: 180; Wade 2001: 71). Despite the need for cheap loans, these conditions were too much for the EPRDF to accept. The intervention of then World Bank chief economist Joseph Stiglitz, who sympathized with Ethiopia's approach, eventually led the IMF to retract its demands and allow for the continuation of ESAF, but this outcome must also be seen in the context of the simultaneous outbreak of the Asian financial crisis, which delegitimized calls for financial liberalization (Stiglitz 2002). What also helped the EPRDF was that the Derg, being largely excluded from the international financial system, did not leave behind massive amounts of foreign debt, which meant that debt relief was not part of the negotiations with the IFIs, thus reducing the pressure on Ethiopia (Feyissa 2011: 800). According to Wade (2001: 74), the IMF nevertheless wanted to make an example of Ethiopia to show other African countries that they would be excluded from concessional finance if they did not comply with the Fund's neoliberal policy prescriptions, or even had the audacity to argue back. The 1997 episode showed Ethiopian policymakers that being overly dependent on IFIs and their conditional ODA would almost invariably lead to sweeping liberalization, eroding the prospects for structural transformation. For the EPRDF, development was an existential question. Accordingly, giving in to IFI demands was seen not only as undermining policymaking sovereignty but also as directly threatening the survival of Ethiopia as a country and the EPRDF as its ruling party. As Manyazewal (2019: 180) argues, "[t]he controversy signalled the ever-present fiscal risk that Ethiopia lives with as an aid-dependent country. It underlines the significance of enhancing domestic resource mobilization, which Ethiopia embarked upon as a matter of strategic importance". Avoiding the most damaging effects of conditional lending thus became a top priority for the EPRDF.

This was also reflected in the next round of SAP negotiations, which began in 2000. Like many other peripheral countries, Ethiopia was required by the IFIs to prepare a Poverty Reduction Strategy Paper (PRSP) as a prerequisite for later debt relief under the Heavily Indebted Poor Country (HIPC) initiative (Furtado and Smith 2009: 140). While Meles Zenawi described the HIPC scheme as just another "whip to enforce unquestioning acceptance of the economic orthodoxy" (cited in Tomkinson 2019: 101-102), his country once again managed to retain domestic sovereignty over policymaking. Ethiopia's PRSP markedly differed from those of other African countries and was largely a reaffirmation of its already existing ADLI strategy and other sectoral development plans (Furtado and Smith 2009: 140). The heterodoxy of the Ethiopian PRSP is also indicated by the IMF's alleged last-minute efforts to prevent Ethiopia from joining the HIPC initiative (Gill 2010: 90).

Ethiopia's ability to resist such IFI pressure was augmented by two dynamics. First, the EPRDF's strong sense of policy ownership, its unwillingness to compromise on certain strategic issues, and the fact that key policy decisions were made in closed party structures all helped to isolate policymaking from outside influence (Tomkinson 2019: 100). Second, the lack of unity and coordination between the IFIs, especially the IMF and World Bank, and bilateral donors on whether and how to support Ethiopia's heterodox development policies meant that the threat of aid withdrawal was not as intimidating as if they had acted in unison. Bilateral donors in particular were satisfied with the developmental progress Ethiopia had made in the early to mid-1990s, and were therefore happy to continue aid flows, or in the words of a British aid official cited in Feyissa (2011: 793), "it is good value for our money". Together, these factors meant that neither IFIs nor bilateral donors generally had much influence on the policy space of Ethiopia. According to a bilateral aid agency official cited in Brown and Fisher (2020:

196-197), discussions with the EPRDF on aid and development are in most cases “a joke”, “empty” and “meaningless”, and that it is “almost impossible to influence national officials”.

Overall, Ethiopia managed to retain a remarkable degree of policy space throughout the 1990s and early 2000s, despite the country being chronically short on foreign exchange and heavily dependent on ODA. The Ethiopian experience illustrates that “the conditionality pressures emanating from the IFIs can be subject to strong counter-tendencies from the national domain, suggesting that space exists for countries to exploit the global concessional financial architecture in service of alternative development strategies” (Tomkinson 2019: 312).

7.3. Ruptures and reinvigoration

The late 1990s and early 2000s were a tumultuous time for Ethiopia. In 1998, war broke out with neighboring Eritrea, leading to immense human suffering and developmental regressions. The war also contributed to a split in the central committee of the TPLF, the dominant party within the EPRDF. On an ideological level, the power struggle within the TPLF leadership revolved, among other things, around the question of whether the notion of revolutionary democracy, to which the EPRDF had committed itself in the early 1990s, was a transitional Marxist ideology or a strategy for the development of Ethiopian capitalism (Gebremariam 2018: 72). Former president Meles Zenawi, who had become prime minister in 1995, belonged to the faction of the party that held the latter view. In 2001, he managed to defeat his political opponents and emerge victorious from the leadership crisis. Having eliminated many of his most prominent internal critics, the prime minister was able to set the agenda for the future of Ethiopian economic policymaking (Brown and Fisher 2020: 191). It was around this time that the notion of an aspiring Ethiopian developmental state, drawing explicitly on East Asian strategies for structural transformation, began to take hold (Clapham 2018: 1155). Reflecting this new emphasis, and designed to complement ADLI, the 2002 Industrial Development Strategy (IDS) focused on the priority sectors of textiles and garments, meat processing and leather, agro-processing, and construction. These were selected for their prospective linkages to agriculture and their potential for earning foreign exchange (Tomkinson 2019: 111). Overall, economic policy shifted to push for agriculture-led, export-oriented, and labor-intensive industrialization (Vrolijk 2021: 256).

Early success, however, was limited, and the EPRDF soon began to feel it. Although the PRSP program, which ran from 2001 to 2005, made considerable progress in improving rural living standards, Ethiopia was still the poorest country in the world in terms of GDP per capita (Priewe

2016: 1). In 2005, the EPRDF was nearly defeated in the country's first democratic general election. This showed the ruling party that it had failed to win the support of a large section of the population. Discontent was particularly high in urban areas, which had been somewhat neglected in the EPRDF's ADLI efforts and where unemployment was rampant, especially among the many young people. While the EPRDF won a strong majority in the federal parliament, it was thoroughly defeated in the larger cities. Irregularities in the counting process eventually led to widespread protests, to which the government responded with extreme brutality and a crackdown on the media and opposition parties (Weis 2016: 265-266). The election and its aftermath became a defining moment for the EPRDF's trajectory. The ruling elites realized that they had to intensify their efforts if they wanted to secure legitimacy among the population. Stability in a Gramscian sense was to be achieved not through democratic means but through the benefits that accrued from Ethiopia's economic success (Clapham 2018: 1155). The commitment to building a developmental state and discourses of development and poverty reduction, including in urban centers, became cornerstones of the government's claim to legitimacy (Kelecha 2022: 3). In a bid to transform itself into a mass party, the EPRDF managed to increase its membership from 760,000 before the election to over 4 million in 2006 (Weis 2016: 276).

Ethiopia also entered its second PRSP program, leading to the creation of the country's first comprehensive five-year plan, the Plan for Accelerated and Sustained Development to End Poverty (PASDEP), which was to run from 2005 to 2010. Although the PRSP again began as a donor-led initiative, IFIs had little say in the eventual formulation of the program, indicating again the ability of the EPRDF to preserve policymaking ownership (Furtado and Smith 2009: 140). With the goal of turning Ethiopia into a middle-income (i.e., semiperipheral) country within the coming two to three decades, PASDEP embodied the government's new level of ambition and its developmental vision (Weis 2016: 234-235).

The ruptures of the 2001 leadership crisis and the 2005 electoral debacle thus paved the way for a more assertive (and increasingly authoritarian) phase of EPRDF rule, ushering in a distinctly proactive approach to industrial policy and state-led structural transformation. The way in which this push for an Ethiopian developmental state unfolded between the mid-2000s and the EPRDF's demise since 2018, as well as the accompanying processes of economic development and the constraints this project ultimately faced, will be the subject of the next chapter.

7.4. Conclusion: carving out Ethiopian developmentalism

When the EPRDF came to power in 1991, it inherited a war-ravaged country where extreme poverty prevailed. Ethiopia was in desperate need of assistance and the IFIs were ready to step in. However, despite the global momentum for rapid neoliberal reform, the Ethiopian government resisted to a considerable extent. Privatization and liberalization, especially in areas deemed crucial by the EPRDF (such as telecommunications or manufacturing), were gradual and slow, in stark contrast to the common experience of "shock therapy" that gripped much of the world in the early 1990s (Collins 2022: 611). The ruling party was able to retain state control over the "commanding heights" of the Ethiopian economy, while the role of the domestic private sector and especially of foreign capital, was to remain strictly limited. This was much to the displeasure of the IFIs, which tried to coerce the Ethiopian government into liberalization through conditional lending practices. Despite being short of foreign exchange and dependent on aid, the EPRDF refused, ultimately leading to an increasingly hostile relationship between Ethiopian leaders and parts of the IFIs. The EPRDF thus managed to contain the pressures for neoliberal reform in two ways. First, by keeping the domestic capitalist class weak and disorganized, the government managed to preserve a political economy that was unfavorable to "home-grown" neoliberalism (Tomkinson 2019: 103). Second, the party's strong sense of policy ownership and its unwillingness to compromise with outside demands enabled it to strategically navigate the international aid regime without abandoning its developmentalist agenda.

At the turn of the new millennium, the trajectory of the EPRDF's tenure changed significantly. In 2001, a leadership struggle occurred within the dominant TPLF, from which the EPRDF re-emerged as an unquestionably pro-capitalist ruling party, firmly committed to creating an Ethiopian developmental state. The outcomes of the 2005 elections, however, signaled an acute lack of hegemony and threatened to undermine the EPRDF's developmentalist agenda. This created a new sense of urgency for the party: either quickly win popular approval through economic development or risk the end of the party's rule. The outcome of this reinvigorated drive for developmentalism was PASDEP, an ambitious development plan that aimed at bringing Ethiopia out of peripherality. Through the preservation of state control over production and finance, the ability to withstand donor influence, and a growing commitment to interventionist industrial policy, the EPRDF had thus set the scene for what was to come over the next 15 years.

8. Rapid expansion, limited transformation: the heyday of Ethiopian developmentalism (2005-2018)

The period from the mid-2000s roughly until the beginning of Abiy Ahmed's tenure as prime minister in 2018 and the dissolution of the EPRDF in 2019 provides the clearest picture of Ethiopian developmentalism. This chapter traces the evolution, successes, and failures of Ethiopia's industrial policy efforts in pursuit of structural transformation.

Section 8.1. illustrates how the EPRDF intensified its efforts at building a developmental state by striving for hegemony, building a dedicated bureaucracy, and crafting economic policy geared towards rapid growth and infrastructural expansion. In Section 8.2., I examine in more detail this push for public investment into infrastructure, and the limited contribution of the private sector during this period. Section 8.3. turns to the financial side of economic policy and highlights how the state's heterodox approach to domestic development finance enabled it to propel this ambitious expansion. Section 8.4. then discusses Ethiopia's trade deficit and the resulting need for capital inflows, and how the EPRDF managed to preserve state control in the face of aid dependence. The section also examines the growing debt burden resulting from the import-dependent development model. In Section 8.5., the subsequent turn towards increasing GVC integration through FDI attraction and the construction of state-owned industrial parks is illustrated, before turning to sector-specific policies and outcomes in Section 8.6. Finally, Section 8.7. concludes the chapter by reviewing the successes and failures of the EPRDF's developmentalist agenda. Overall, the chapter shows how Ethiopia's interventionist industrial policy and control over resource allocation have led to rapid growth but only a limited degree of structural transformation.

8.1. Building the Ethiopian developmental state

After the disruptive experiences of the early 2000s, the EPRDF set out to transform Ethiopia into a developmental state. In the ruling party's understanding, this entailed three essential elements. First, the state had to remain largely in charge of the economy, while guiding the private sector. This had already been established in the 1990s and the government intended to keep it that way. Second, there had to be an obsession with development, which needed to be seen as a matter of national survival. Accordingly, the EPRDF began regarding economic development as "the major objective of our organization" and "the foundation and pillar of all our goals" (EPRDF, cited in Weis 2016: 283). And third, these developmental discourses needed to become hegemonic throughout the whole of Ethiopia, which entailed that the "norms and values of our society must be based on value-creation and growth" (Meles Zenawi, cited in de Waal 2018: 2). In its quest to establish such hegemony, the EPRDF-led government targeted the media, schools, universities, religious organizations, and other parts of civil society, all of which were identified as ideological battlegrounds in the fight against neoliberal thinking (Gebremariam 2018: 77). Besides an emphasis on state-directed "developmental journalism", these efforts also included mandatory trainings and workshops aimed at disseminating the EPRDF's ideology among teachers, students, military personnel, and civil servants throughout the country (Weis 2016: 286-287).

Building an effective and meritocratic bureaucracy, committed to the goals of the EPRDF, was another key objective of the emerging developmental state. Civil service reform, which had begun after the TPLF leadership struggle in 2001, was reinvigorated (Brautigam et al. 2018: 160) and the number of public officials more than doubled between 2005 and 2010 (Weis 2016: 313). Over the years, there was also an expansion of bureaucratic pockets of efficiency (as discussed in Section 5.2.), i.e., dedicated industrial policy institutions. This led to the creation of the Ethiopian Investment Commission (EIC), the Industrial Parks Development Corporation (IPDC), and several sector-specific research institutes (Hauge and Chang 2019: 833; Vrolijk 2021: 260), which overall managed to remain fairly autonomous from the influence of private sector demands (Grumiller 2021: 441). All levels of the state apparatus were brought on track to realize the common goal of structural transformation, in what Meles Zenawi called the "single-minded pursuit of accelerated development" (cited in Weis 2016: 294). The EPRDF was thus able to build, as well as maintain ideological and operational control over, a newly professionalized bureaucracy to serve this purpose.

The ruling party's aspirational agenda was captured in a series of five-year development plans, starting with PASDEP in 2005 and followed by two consecutive Growth and Transformation Plans (GTP I and GTP II), which ran from 2010 to 2015 and 2015 to 2020, respectively. Criticized by the IFIs for being too interventionist (Tomkinson 2019: 114), these plans became central to the developmental project of the EPRDF regime and provided focal points for coordinating the efforts of the ministries and agencies involved (Weis 2016: 90). Since PASDEP had been designed before the 2005 election, GTP I was the first plan to truly reflect the EPRDF's newfound ambition. The goal was now to move from mere economic growth to lasting structural transformation, focussing on massive infrastructure development, increasing agricultural productivity, and building manufacturing capabilities. In terms of priority sectors, GTP I and II were thus an affirmation and continuation of what had already been identified in the ADLI strategy and the 2002 IDS as the EPRDF's long-term plan for structural transformation: "agricultural-based, manufacturing sector-driven and export-led development" (Gebrehiwot 2019: 231). The two GTPs did, however, place much greater emphasis on export promotion, for example in the floriculture and apparel sectors, and on import substitution in the cement, metal, chemical, and pharmaceutical industries (Vrolijk 2021: 257; Oqubay 2015: 105). The EPRDF now also viewed parts of the private sector – those that were seen as engaged in developmental activity rather than rent-seeking – as potential partners in building Ethiopian capitalism, although distrust continued to characterize state-business relationships (Pellerin 2020: 589).

What followed between the mid-2000s and the late 2010s was an economic expansion the likes of which Ethiopia had not seen before. Between 2004 and 2015, GDP grew at an average annual rate of 10.9 percent (Priewe 2016: 1), and GDP per capita more than tripled between 2003 and 2019 (Dercon 2022: 240). Although there is disagreement about exact growth rates (Wayessa 2021: 89), Ethiopia is widely considered as one of the fastest growing economies in the world during this period (World Bank 2022: xi). This remarkable growth was based largely on a major state-directed investment offensive, particularly in infrastructure development and the expansion of the industrial sector. According to the Ethiopian government, investment as a share of GDP increased from around 25 percent in the early 2000s to a peak of 38 percent in the fiscal year of 2016/17 (FDRE 2020a: 5). Much of this was public investment or made via the use of SOEs and party-owned endowment funds (Gebreeyesus 2019: 693). The investment drive was fuelled by a heterodox approach to domestic development finance as well as selective and careful utilization of foreign capital (Clapham 2018: 1156-1157). In terms of industrial policy, the state not only participated directly in strategic markets but also sought to incentivize private capital to enter priority sectors, for example by offering subsidized access to land and duty-free imports of machinery and spare parts (Vrolijk 2021: 257). Among the most important policy instruments of this era were the state-directed allocation of financial resources to targeted sectors, various export promotion and import substitution measures, and, increasingly since GTP II, the attraction of FDI into labor-intensive manufacturing through the construction of industrial parks (Hauge and Chang 2019: 832).

In sum, between 2005 and 2018, the EPRDF aimed to transform Ethiopia into a developmental state and thus push for structural transformation through the use of interventionist industrial policy. It sought to base these efforts on a broad popular hegemony of developmental thought and to advance them through a disciplined and dedicated bureaucracy. This aspiring developmental state focused on large-scale (semi-)public investment in infrastructure and industry, financed by heterodox fiscal and monetary policies as well as strategic use of external finance. Since the mid-2010s an increased effort was also made to attract FDI and promote GVC integration. The agenda focused on agricultural development, import substitution, and export promotion and diversification in several key strategic sectors. Sections 8.2. to 8.7. will examine and evaluate these aspects of Ethiopian developmentalism in more detail.

8.2. Infrastructure, SOEs, and the role of the private sector

From the mid-2000s onward, public investment increased sharply, consistently exceeding 17 percent of GDP between 2010 and 2015 (Tomkinson 2019: 114, 117). In the mid-2010s, the country had the third highest rate of public investment on the one hand, and the sixth lowest rate of private investment in the world, on the other (Gebreeyesus 2019: 693), reflecting the exceptionality of the Ethiopian development model. This section reviews the way the state used SOEs for infrastructural and industrial expansion, while keeping the private sector weak and disorganized, and how this has led to some success, for instance in import substitution but limited structural transformation.

8.2.1. The infrastructure and (semi-)public investment boom

As noted in Section 8.1., the surge in public investment focused overwhelmingly on the expansion of physical infrastructure. In the mid-2010s, over 40 percent of the government budget was spent on infrastructure development, primarily in the areas of transport, power generation, and telecommunications (Hauge and Chang 2019: 837). These efforts were seen as a prerequisite for the goal of a subsequent structural transformation of the economy. Ethiopia was (and still is) considered one of Africa’s least developed countries in terms of infrastructure (van Wijk 2022: 95), which hampers the growth of domestic industrial sectors, especially export-oriented manufacturing.

Increased infrastructure spending kicked off under PASDEP, when the Ethiopian Telecommunications Corporation (later renamed Ethio Telecom) and the Ethiopian Electric Power Corporation each announced plans for multi-year expansion projects valued at close to USD 2.5 billion. Two newly created state-owned enterprises, the Ethiopian Railway Corporation and the Ethiopian Housing Development Corporation, were tasked with building a nationwide railway system and accelerating urban construction, respectively (Weis 2016: 296). Under GTP I and II, these efforts were intensified, resulting in a doubling of the size of the national road network, an increase in telecommunications users from 7.7 million to around 40 million, and an increase in the country's electricity coverage from 41 to 60 percent between roughly 2010 and 2015 (Tomkinson 2019: 114).

Most large-scale infrastructure projects were carried out by two types of companies: those owned by the Ethiopian state or one of the EPRDF's constituent parties, and Chinese SOEs. Ethiopia relied heavily on Chinese lending for financing its infrastructure development, and this also meant that Chinese companies were doing the construction work. A new railway line between Addis Ababa and the port of Djibouti (USD 4.5 billion), the expansion of public transport and roads in the capital (over USD 500 million), high-voltage power lines (USD 1.45 billion) and the expansion of mobile and internet coverage in rural areas (USD 2.3 billion) were financed and implemented with Chinese involvement (van Wijk 2022: 97). As one EIC official interviewed in late 2022 noted, the Ethiopian government was more than willing to make full use of its beneficial relationship with China:

> [T]hey are cheaper than the Western countries. When I say cheaper, with a good quality, you know what I'm saying? […]. Those advantages, those marketing schemes the Chinese have, get the Ethiopian government interested. […]. And also, there is also a long years of political and diplomatical relationship, better than other countries, from the Ethiopian government's side. So, China […] is preferred by the Ethiopian government for these reasons. (I-1)

In the energy sector, the output of Ethiopia's hydropower plants nearly tripled between 2005 and 2011. This is expected to be exceeded fivefold once the EPRDF's perhaps most prestigious (but now much delayed) mega-project, the Grand Ethiopian Renaissance Dam (GERD), becomes fully operational (Brautigam et al. 2018: 160). With a budget of nearly USD 6 billion, the GERD is the largest single project in Ethiopia's history. Since multilateral donors and even China were reluctant to fund the construction of the mega-dam, as noted by an MoF official interviewed for this thesis (I-11), the EPRDF committed to fully financing the project domestically (Hauge and Chang 2019: 834). Public sector workers were encouraged, some say forced, to contribute one month's salary to fund the GERD (Kelecha 2022: 10). The construction of the dam was awarded to the Metals and Engineering Corporation (METEC), an SOE with close ties to the military that was founded in 2010 (Weis 2016: 299).

METEC and other newly established (semi-)SOEs not only drove the infrastructure boom but also became involved in manufacturing. In this matter, the EPRDF's main goal was to use these companies to reduce the country's dependence on imports. Operating almost 100 factories across 15 sectors, METEC began assembling train cars for the expanded railway system, while also manufacturing everything from weapons to furniture, buses, and fashion accessories. The company was also utilized as a strategic vehicle for branching into new markets by establishing joint ventures with foreign companies and facilitating technology transfer to local firms. Two new public enterprises were tasked with the construction of ten sugar refinery plants and five fertilizer factories, respectively (Weis 2016: 297-300). The Endowment Fund for the Rehabilitation of Tigray (EFFORT), a TPLF-owned conglomerate, held several companies in sectors ranging from construction and industrial engineering to agro-processing and banking (Clapham 2018: 1159). In the textile and garments sector, three of the four largest vertically integrated firms were either state- or endowment-owned (Staritz et al. 2016: 9).

The reinvigorated developmentalism of the GTP era thus also characterized the public enterprise sector. In a complete reversal of the already slow trend towards privatization, the government established a range of new SOEs that were much bigger than any potential private sector equivalents (Weis 2016: 295, 297). Privatization was not, however, disregarded completely. Rather, the government selectively sold off individual enterprises in non-strategic sector in order to expand its tax base and diversify revenue sources for the state budget, which has historically been dependent on ODA flows. In the alcohol industry, for example, the sale of factories to TNCs led to an increase in production capacities and increased tax revenues (Collins 2022: 618). However, such decisions have generally not undermined the dominance of Ethiopia's SOEs, most notably the "big five" – Ethiopian Airlines, Ethio Telecom, Ethiopian Insurance Company, Ethiopian Electric Power Corporation, and CBE – which continued to function both as revenue generators across sectors and as steering mechanisms for developing priority industries (Tomkinson 2019: 123). The government justified this massive use of SOEs by arguing that the state needed to correct market failures and thus exercise its dominant economic role until, in the EPRDF's view, the emerging private sector was ready to take over (Feyissa 2011: 797). According to this view, in a country with low technological capabilities and weak competitiveness like Ethiopia, private capital would inevitably tend to engage in unproductive rent-seeking behavior (e.g., import trading), leaving the state to fill the gaps in productive activity that the private sector was unable or unwilling to fill (de Waal 2013: 153). With private capital seemingly incapable of driving structural transformation, SOEs instead played the leading role in the EPRDF's developmental project, thereby fueling both import substitution and export promotion measures.

However, by the late 2010s, Ethiopian SOEs had also recorded a number of failures. For example, by 2018, METEC had completed only 30 percent of its task in the construction of the GERD (which was originally scheduled for completion in 2014) (Meester et al. 2022: 64) and state-led plans for large-scale import substitution in sugar and fertilizers ultimately proved elusive (Tomkinson 2019: 126; Zikargie et al. 2022: 444). More pervasively, a number of corruption scandals in SOEs and party-affiliated companies threatened to undermine their contribution to structural transformation (Pellerin 2019: 607). Conglomerates such as METEC and EFFORT were also widely seen as both receiving ethnically motivated preferential treatment from the government, and themselves engaging in patronage practices that disproportionately benefited ethnic Tigrayans (Wayessa 2021: 93; Kelecha 2022: 7). Such ethnic divisions were also highlighted as key developmental constraints by several interlocutors interviewed for this thesis, noting that policy implementation was often based on regional and ethnic interests (I-1; I-4; I-8). In the words of an AAU economist, ruling elites mainly "wanted progress of the developmental state type to occur in their locality, in the Tigrayan region. […] Any investor comes, they were channeling it to that place" (I-4).

8.2.2. Disembedded autonomy: the private sector and the prevalence of rent-seeking

As noted, the EPRDF distinguished between developmental and rent-seeking private capital, based on its ability to contribute to the project of structural transformation. However, government efforts to incentivize capitalists to turn away from perceived rent-seeking and invest in agriculture and manufacturing have largely failed. Instead, the expansion of the service sector as well as the mining and construction industries have been the main private sector contributors to the high growth rates during the 2000s and 2010s (Melese and Whitfield 2023: 2). While industry expanded rapidly since the early 2010, this had mainly been due to the construction industry (Manyazewal and Shiferaw 2019: 138-139). In 2022, agriculture and services each accounted for roughly 37 percent of GDP, while the contribution of industry was around 23 percent, of which manufacturing accounted for a mere 4 percent (World Bank 2023).

Agriculture accounts for more than 80 percent of Ethiopia's exports and employs the vast majority of the population (Guteta and Worku 2023: 210-211). Despite this importance, and despite the fact that agricultural transformation has been a key strategic pillar of the EPRDF's development plans, average private investment in the sector between the early 1990s and the end of GTP II was far below that of the service sector. This indicates a disconnect between policy plans and what has actually happened in the economy (Debebe and Bessie 2022: 21). Although significant linkages are emerging between smallholders and large TNCs (with a single international beer company sourcing wheat from 80,000 farmers, as noted by an EIC official interviewed for this thesis (I-1)), such developments are little more than the proverbial drop in the ocean. The sector remains largely characterized by low fertilizer use and traditional, rainfed production methods, with less than 1 percent of agricultural land estimated to be irrigated. However, agricultural output has nonetheless increased sharply, and this is believed to be largely responsible for the successful reduction in poverty over the past two decades (Manyazewal and Shiferaw 2019: 145-146).

Manufacturing has faced similar headwinds, despite targeted industrial policy measures since the early 2000s and financial incentives directly targeting the sector, including reduced interest rates from the state-owned banks, subsidized salaries for hiring foreign experts, or tax exemptions (Hauge and Chang 2019: 833). During GTP II, even greater emphasis was placed on trying to redirect domestic investment from services and construction to export-oriented manufacturing but to no avail. In terms of the number of operational projects, the service sector increased by almost 50 percent in the early years of GTP II (driven primarily by real estate), while the number of manufacturing projects actually declined (Gebreeyesus 2019: 697). Although manufacturing output grew steadily – at an annual rate of 10 percent in the GTP I period and by 17.9 percent between 2015 and 2017 (Oqubay 2019: 631-632) – it did so from a very low base, and in relative terms, these outcomes were less impressive. Stagnating at a share of roughly 5 percent of GDP throughout the 2000s and 2010s (World Bank 2022: xi), manufacturing has in fact utterly missed the (arguably completely unrealistic) 20 percent target set in GTP II (van Wijk 2022: 99). The domestic manufacturing sector as a whole continues to be troubled by low productivity, high labor turnover and low competitiveness in international markets (EDRI 2018: 2). To the extent that there is private investment in manufacturing in Ethiopia, it is largely through foreign capital (Debebe and Bessie 2022: 21), especially since the government intensified its attempts to attract FDI since GTP II (Hauge and Chang 2019: 836). Thus, a structural transformation of the Ethiopian economy (i.e., domestic firms moving into higher-complexity activities), or delinking in the Aminian sense, has not taken place.

The reasons for the lack of dynamism in productive sectors, and thus for the slow pace of structural transformation, are manifold. For one, profit margins in sectors such as construction, trading, and finance are much higher than in manufacturing or commercial agriculture (Melese and Whitfield 2023: 2; Gebreeyesus 2019: 698). This is exemplified by the largest private business conglomerate in Ethiopia, MIDROC, which bought up numerous newly privatized companies in the 1990s (Weis 2016: 204) and now owns one of the largest private banks as well as the country’s most luxurious hotel and largest gold mine (Clapham 2018: 1159). This essentially matches the EPRDF’s rent-seeking argument: in a political economy in which productive investment is considered too risky or not profitable enough, capital will find other outlets. Industrial policy measures, such as subsidies, have apparently not been sufficient to incentivize investment in productive activity. An official from the United Nations Industrial Development

Organization (UNIDO) interviewed for this thesis echoed this sentiment, noting that private investors “don’t really venture to go into manufacturing. They want their return back quickly […]. [T]he government always tries to incentivize these investors, you see, but still those incentives are not good enough” (I-5).

Another reason for the lack of private investment in manufacturing and agriculture, which is related to the first one, is an acute shortage of finance, including of foreign exchange. This was also confirmed by several Ethiopian ministry and agency officials interviewed in late 2022 as the single largest constraint to industrialization in Ethiopia (I-1; I-3; I-7; I-10). Inadequate infrastructure, especially electricity and transportation, difficult access to land, and a lack of industry knowledge and technical and managerial skills are also key constraints to the growth and transformation of Ethiopia’s productive sectors (Debebe and Bessie 2022: 29, 48).

Some also argue that the excessive activity and dominance of SOEs has crowded out private sector involvement (Kelecha 2022: 7), although it is difficult for the author of this thesis to assess whether this is true. One Ministry of Finance (MoF) official interviewed captured this dynamic in the following way: “how do you see as a private sector if the government announces that it’s going to construct nine sugar factors. Do you think that you’ll join that sector or so, as a private sector? No.” (I-7). Oqubay (2018: 20), on the other hand, maintains that private investment in these sectors has simply not been forthcoming due to “a pervasive culture of ‘short-termism’ and quick gains” – thus making state involvement necessary in the first place.

One key political reason for the overall suppressed role of the domestic private sector, and perhaps for its reluctance to enter the manufacturing sector (although this is debatable), was the EPRDF’s fear of losing control. The party’s relationship with domestic capitalists was characterized by two equally important but at times contradictory goals: mobilizing the private sector’s developmental forces on the one hand, and limiting its influence in order to prevent challenges to the regime on the other (Pellerin 2020: 589). In combination with pervasive levels of mutual distrust (Oqubay 2018: 20), this has often resulted in “a focus on control at the expense of developmental objectives” (Pellerin 2020: 589). In the words of an Addis Ababa University (AAU) economist interviewed in October 2022, the “private sector is not strong enough because the government […] does not want it to be strong” (I-4). The Ethiopian state’s strategic selectivity, as discussed in Section 5.2., was thus aligned with the interests of industrial capitalists, but aimed to suppress the influence of other fractions of capital.

Illustrative of this relationship is the EPRDF's attitude towards the main representative body of the private sector, the Ethiopian Chamber of Commerce and Sectoral Associations (ECCSA). In response to the political activism of the former chamber of commerce, which openly advocated a more liberal approach to economic policy, the government disbanded the chamber and replaced it with ECCSA. New sectoral associations were established for manufacturing subsectors such as apparel and leather, and staffed with EPRDF loyalists. Meanwhile, groups representing the interests of trade and services were kept at arm's length and prevented from influencing policymakers (Pellerin 2019: 596-597, 606). The 2005 election further confirmed the EPRDF's distrust of domestic capitalists. The private sector was predominantly in favor of the liberal opposition party, which ended up winning the majority of seats in the larger cities (Clapham 2018: 1160). In the early to mid-2000s, the EPRDF thus became acutely aware that a united and politically influential class of rent-seeking capitalists, whose interests lie in economic liberalization, could spell the end of the party's rule. By reforming the chamber system, the party sought to contain such tendencies and limit the influence of these groups. In that way, it also strengthened its ability to resist outside pressure for liberalization (Tomkinson 2019: 312)

The EPRDF's prioritization of control over collaboration has meant that the kind of broad developmental state-bureaucracy-business alliance that characterized East Asian developmental states has largely failed to materialize in Ethiopia (Clapham 2018: 1159). Embedded autonomy on a substantial scale, historically a key component of the institutional fabric of these countries (Evans 1995), is essentially non-existent. While there is autonomy in the sense of the state's ability for independent developmental policymaking, there is little embeddedness. Its efforts in reorganizing ECCSA for the benefit of (agro-)industrial capitalists illustrate that the EPRDF at least attempted to forge cooperative relations with what it considered potential developmental forces. However, the small size of the manufacturing sector, versus the widespread persistence of rent-seeking activity, might in fact indicate that "[t]here is simply not much basis for an 'alliance' or 'symbiotic' relationship between the bureaucracy and the domestic private sector […] to exist" (Hauge and Chang 2019: 835) in the first place.

Overall, the EPRDF has not actively attempted to promote the emergence of a potent domestic capitalist class as collaborators in its developmental project, nor has it succeeded in encouraging private investment in productive sectors. Instead, it relied on the use of SOEs and party-affiliated companies, which invested massively in infrastructure development and import substitution manufacturing. Seen as a prerequisite for making industrialization possible, Ethiopia rapidly expanded its transport, energy, and telecommunications infrastructure, while the activity of SOEs in manufacturing was meant to fill the gaps that the private sector could not or would not fill. Despite government efforts, private investment instead focused on the service sector and, since GTP I, on construction. Due to the state's failure to cultivate collaborative relationships and to effectively motivate capitalists to enter the manufacturing sector, the Ethiopian economy has suffered from a lack of embedded autonomy and, despite important achievements, a sluggish rate of structural transformation.

8.3. Banking on development: macroeconomic policy and domestic financial regulation

In order to finance the surge in public investment and the rapid expansion of infrastructure between PASDEP and GTP II, the Ethiopian government employed a host of heterodox macroeconomic and financial policies, and heavily expanded its tax base to increase its spending capacity. Government income through taxes increased more than sevenfold between 2006 and 2012 (Weis 2016: 305) and by another 31 percent annually until the end of GTP I (Manyazewal 2019: 180), allowing for the sharply increased rates of public investment. The domestic financial system remained highly regulated and geared towards channeling resources to SOEs and priority sectors, while the interest rate was kept low, and the exchange rate overvalued to lower the cost of imports and debt service. As a whole, Clapham (2018: 1156) describes the government's efforts at financial regulation as characterized by "a relentless search for 'rents', […] any source of potential investment income that the government can lay its hands on, and that it is intent on removing from the control of anyone else".

8.3.1 Interest rate and exchange rate policy

To stimulate public and private investment, the government maintained very low interest rates. Real deposit interest rates (adjusted for inflation) were in fact negative, which further discouraged savings in favor of investment (Priewe 2016: 16-17). During GTP I, commercial banks were to set interest rates between 4 and 5 percent. These very low rates further depleted private savings while making credit abundantly available for government spending (Weis 2016: 302). This has been accompanied by strict capital controls, which prohibit the movement of deposits abroad (Priewe 2016: 18).

In terms of exchange rate policy, the Birr remained pegged to the US dollar (Haile 2019: 6), and strongly overvalued during the PASDEP to GTP II high-growth period, despite nominal devaluations in 2010 and 2017 (Oqubay 2015: 92; Tomkinson 2019: 289). Overvaluation means that the official price of the currency is lower than its value on the parallel (i.e., black) market

(Haile 2019: 27). This condition is maintained by the Ethiopian central bank, the National Bank of Ethiopia (NBE), which manages its reserves accordingly and does not allow free buying and selling of foreign exchange. The goal of this approach has primarily been to lower the cost of imports that are needed to build physical infrastructure, and to reduce the burden of servicing foreign debt (Priewe 2016: 21). The flipside of the currency overvaluation has been the diminished competitiveness of Ethiopian exports in international markets (Haile 2019: II). Given that primary commodity exports, on which Ethiopia depends, are largely unresponsive to devaluation, this trade-off may have been perceived as preferable, as also indicated by an AAU economist interviewed in October 2022. However, in constraining the growth of export-oriented manufacturing in particular, the overvalued Birr thus likely constitutes “a key reason for the failure of further industrialisation” (Priewe 2016: 21). To make matters worse, the gap between the official and parallel market exchange rates has widened. This is an effect of both the closed nature of the Ethiopian financial system and of the pervasive shortage of foreign exchange, as the demand for foreign currency is higher than what is available due to weak export earnings. The widening gap between official and parallel rates further discourages exports, “as the exporters’ cost is likely to be affected by parallel market rate while their revenue is determined at the official exchange rate” (FDRE 2020a: 10). This problem would disappear if the government would allow the exchange rate to be determined by the market, which would effectively amount to a major devaluation. However, the EPRDF sternly resisted calls for such measures. According to Haile (2019: 17), a 10 percent effective devaluation would result in an estimated 26 billion Birr increase in the public sector external debt stock, equivalent to approximately USD 500 million at the current 2023 nominal exchange rate. Partly because of this, because of the ability for Ethiopia to import cheaply, and because of the inelasticity of demand for Ethiopian commodity exports, the benefits of the overvalued currency (and of state control over the exchange rate in general) seem to have outweighed any potential advantages of exchange rate liberalization or substantial devaluation.

8.3.2. State-owned policy banks and the private sector credit shortage

During initial liberalization in the 1990s, the Ethiopian government opened the financial sector to domestic private investment but prohibited the entry of foreign banks (Oqubay 2018: 9). The closed nature of the Ethiopian financial system has been heavily criticized by the IFIs (Manyazewal and Shiferaw 2019: 144), but the EPRDF considered this necessary until domestic banks developed sufficient capacity to compete with superior foreign competition (Hauge and Chang 2019: 830).

The banking sector is also dominated by state-owned banks, above all the CBE, Ethiopia's largest bank by far. According to an official at the Ministry of Planning and Development (MoPD), the CBE's profits far exceed those of the country's 17 private commercial banks combined (I-6). The Development Bank of Ethiopia (DBE) has also played a crucial role in the government's developmental efforts. In the mid-2010s, these two banks accounted for almost half of total bank assets in Ethiopia (Tomkinson 2019: 281). They offer subsidized loans to priority sectors, with the CBE providing working capital and the DBE providing investment capital (Hauge and Chang 2019: 833).

In the early years of GTP I, more than 80 percent of DBE loans went to investment projects in the priority export and import substitution sectors of textiles, cement, and sugar (Weis 2016: 303). The floriculture industry is also largely dependent on DBE loans, as most investments in the sector are financed in this way (Melese and Whitfield 2023: 8). In general, however, agriculture has only accounted for a small amount of the DBE's loan disbursements, when compared to manufacturing, according to a senior DBE official interviewed for this thesis (I-12). The bank in turn was partly financed by one of Ethiopia's most unorthodox and interventionist financial policy instrument: the 27 percent directive. Introduced in 2011, the rule required private commercial banks to allocate 27 percent of their disbursements to buy bills from the NBE. This money was then channeled to the DBE to finance private sector industrial and agricultural projects (Manyazewal 2019: 186). The state thus forced private banks to indirectly finance investment projects that they would not otherwise have supported because of the high risk associated with lending to the manufacturing sector. To the further dismay of private banks, the CBE was exempt from the rule (Weis 2016: 304). By the late 2010s, however, there appeared to be a lack of viable investment opportunities for the DBE, with 35 percent of the bank's total assets held in NBE treasury bills instead of going to priority projects (World Bank 2019: 30). Because of the difficulties faced by domestic firms in productive sectors, the DBE has also struggled with a large number of non-performing loans, particularly in the manufacturing sector (I-10; Whitfield et al. 2020: 1029). It has since come under enormous pressure, and calls for reform have become more widespread (FDRE 2020a: 19), to which I will return in Chapter 9.

As noted, the financial system became increasingly geared towards the prioritization of public investment, SOEs, and strategic sectors. In the mid-2010s, industry and other priority sectors received over half of domestic credit (Tomkinson 2019: 116), and SOEs were estimated to account for around 62 percent of total domestic credit stock, up from a mere 7.6 percent in the early 2000s (FDRE 2020a: 7). This figure illustrates the extent to which the EPRDF relied on

SOEs to power the country’s growth trajectory, despite the fact that the DBE lent primarily to the private sector. The public sector was also privileged in terms of foreign exchange allocation, as currency rationing in times of scarcity gave top priority to infrastructure investments, strategic sectors, and essential imports such as medicine and food (Haile 2019: 9).

The flipside of this has been that the private sector has had more difficulty in accessing sufficient credit, and has also borne the brunt of foreign exchange shortages (ibid.). As mentioned, a lack of access to finance is among the most binding constraints to the growth of the Ethiopian manufacturing sector and the private sector as a whole. According to one MoPD official, “the state-owned banks […] give priority for the public sector investments. So, there is somehow crowding out of the private sector” (I-6). The private sector’s share of total loan disbursements fell from over 80 percent in 2005 to just over 20 percent in 2013, while the volume of lending to public enterprises increased sevenfold (Weis 2016: 304).

However, as with the crowding out argument regarding public versus private investment, the government claims that the private sector is not actually using the credit that is available (Gebreeyesus 2019: 693). Regardless of whether this argument is valid, what might be even more detrimental to the development of the Ethiopian manufacturing sector is the unwillingness of private commercial banks to finance long-term industrial and manufacturing projects. In the words of an AAU economist interviewed in November 2022, “our financial system, basically, is geared to assisting trade [...], not production much” (I-4). According to the academic, a large portion of the private sector’s share of total credit goes to traders because they are seen as safe borrowers, quick to repay, and highly profitable for banks. An MoF official also noted that commercial banks were eager to lend to the construction sector but not to manufacturing and other priority sectors (I-7). Löscher (2019: 158) indeed identifies signs of a housing bubble, particularly in urban centers. This strengthens the government’s argument that credit for private investment is in fact available but directed to the wrong places. Compared to established coffee exporters, for example, emergent manufacturing companies are more likely to default, which deters private lenders (and with which the DBE is also struggling). In addition, a major part of the problem is that private banks require large amounts of collateral from borrowers, which many do not have. This may also be the reason why small- and medium-sized enterprises appear to be severely underfinanced compared to larger enterprises (Debebe and Bessie 2022: 29). Likewise, smallholder subsistence farmers are usually not able to acquire loans from private banks due to this reason (I-4). In general, these lending practices been detrimental to the development of Ethiopia's productive sectors. According to a UNIDO official interviewed for this thesis:

> If you have a very viable and feasible project at hand and if you approach a bank in Ethiopia, then that bank doesn't give you a loan, you see, that bank requires to have a collateral, […] a building or something […]. That really hindered […] local investments. (I-5)

In line with the EPRDF's view, this could be seen as part of Ethiopia's rent-seeking problem. From this perspective, the inability of the private banking sector to support the structural transformation of the economy by failing to lend to manufacturing projects is what makes heavy financial state intervention, such as the activities of the DBE, necessary in the first place. However, despite the fact that the state-owned banks have almost exclusively targeted priority sectors, "the point is that that is not enough", according to one MoF official interviewed (I-7). Oqubay (2019: 646-647) equally contends that the lack of access to long-term loans for industrial projects is a result of both the limited lending capacity of public banks (despite efforts such as the 27 percent directive) and the unwillingness of the private banks to step in. The remarkable growth of the financial sector may indeed itself be considered a symptom of the rent-seeking behavior of Ethiopian capitalists. During the mid-2010s, almost all private commercial banks recorded two-digit annual growth rates, as did the CBE (Löscher 2019: 154). This indicates a high profitability of banking in general, and of the prevalent short-term lending practices in particular.

Despite the insufficiencies of the Ethiopian financial system and the more recent indication of a bubble in the construction and real estate markets, financialization as described in Section 6.1.3. has not occurred to a significant extent. This is due to the concerted effort of the government to preserve national ownership and state control in the sector, despite facing intense external pressure at times. As a result, the Ethiopian economy has been shielded from the issues caused by volatile cross-border portfolio flows and the resulting financial vulnerability that many peripheral countries face. During an interview conducted for this thesis, an MoPD official (I-6) shared an anecdote that exemplifies this: if one were to ask people on the streets of Addis Ababa about their understanding of the 2007-2008 global financial crisis, many would likely not understand what was being asked. The closed nature of Ethiopian finance meant that the general public was not noticeably affected by the global economic fallout of the crisis and thus public awareness of the events is minimal.

In summary, the EPRDF regime's cautious and highly interventionist approach to financial regulation enabled it to channel large amounts of resources to its priorities in infrastructure and industry, while the overvalued exchange rate allowed the country to afford the necessary inputs.

Although the manufacturing sector continues to suffer from a lack of finance, the state had a high degree of control over the patterns of resource allocation in the Ethiopian economy. This heterodox financial architecture is part of what the government went to considerable lengths to protect from IFI-imposed liberalization. The high growth rates of the EPRDF era and the concomitant reduction of poverty would likely not have been possible without these efforts.

8.4. Mobilizing external finance

Despite the Ethiopian state's highly active approach to mobilizing domestic finance, this was not enough to power the process of structural transformation. As noted in Section 5.6., late industrialization generally requires large amounts and sustained inflows of foreign currency to enable the import of essential goods. For most of its history, however, Ethiopia has not generated enough foreign exchange from exports to fully cover its import costs, and thus has run large current account deficits that have had to be financed by inflows of external finance.

8.4.1. Ethiopia's balance of payments

While export revenues increased tenfold between the mid-1990s and the mid-2010s, the cost of imports grew even faster, leading to a widening trade deficit and critical foreign exchange shortages (Gebreeyesus 2019: 699). The public investment and infrastructure-led growth model of the PASDEP to GTP II era was highly dependent on imports, with exports falling short of expectations and continuing to lag behind. For much of the 2010s, merchandise exports were between USD 2.5 billion and 3.5 billion, whereas imports roughly doubled to around USD 15 billion between 2010 and 2015 (World Bank 2023). The GTP I target of reaching USD 6.5 billion in merchandise export earnings was thus completely missed (Tomkinson 2019: 141). Overall, Ethiopia's net trade in goods and services has largely shown a declining trend, deteriorating from a negative value of less than USD 1 billion in 2000 to a deficit of over USD 14 billion in 2016. It then recovered and reached below USD 10 billion in 2020, reflecting a renewed focus on exports, but later worsened again to over USD 13 billion in 2022 (World Bank 2023), presumably due to the impact of the COVID-19 pandemic and the civil war in the Tigray region.

The reasons for the lackluster export performance lie primarily in the peripheral structure of the Ethiopian economy, i.e., in the fact that structural transformation has largely not taken place. Notwithstanding the significant contribution of Ethiopian Airlines to the country's foreign exchange earnings (van Wijk 2022: 109), Ethiopia is still heavily dependent on agricultural and raw materials exports. Between the early 2000s and mid-2010s, agriculture and livestock together accounted for around 70 percent of total export value (Cochrane and Bekele 2018: 6), with coffee and oilseeds among the top export items (Gebreeyesus 2019: 699). These goods are generally more vulnerable to demand shocks and price fluctuations (Gebrehiwot 2019: 238). For example, between 2012 and 2013, the price of coffee, the country's main foreign exchange earner, fell by 31 percent, thus adding to the volatility of Ethiopia's trade balance (Oqubay 2015: 155). Crucially, these primary commodities are also largely unresponsive to currency devaluation, which may have contributed to the continuous overvaluation of the Birr, and the EPRDF's reluctance to comply with IFI demands for devaluation, as suggested by an MoPD official interviewed for this thesis (I-6). The export-oriented manufacturing sector, which contributed only between 7 and 12 percent to total merchandise exports in the mid-2010s (World Bank 2023) did not significantly alleviate Ethiopia's widening current account deficit.

To ease the deficit burden, substantial efforts at reducing imports were undertaken, with cement and sugar among the highest priority sectors. Policy intervention to accelerate import substitution in these sectors included the aforementioned formation of large SOEs, selective import bans and tariffs, as well as targeted credit and allocation of foreign exchange (Oqubay 2018: 12, 17). Significant achievements were made in the development of a domestic cement industry. The sector's output multiplied by a factor of 28 between 1991 and 2017, making Ethiopia one of the largest cement producers in Africa, and generating significant linkages to the transport and construction sectors (Oqubay 2018: 18). Import substitution in the sugar industry was less successful. Despite plans to become a major exporter of sugar, only 18 percent of the production targets were met by the end of GTP I, and the country remained dependent on sugar imports (Zikargie et al. 2022: 444).

An AAU economist interviewed in late 2022 also noted the political dimension to the failure of large-scale import substitution. Concerning food items that could be produced domestically with relative ease, he noted that "in the interest of traders and all, it is allowed to spend the much-needed foreign exchange to such kind of goods" (I-4). When further asked whether he thought traders had a lot of influence on policymaking, the academic replied:

> Yes, yes, yes, traders have. And most of the time, you know, these politicians are somehow themselves, I think, linked to those things. They are not producers. They are about hotels, about wholesale trade, about, you know, these kinds of things, and it seems so because the easiest things to do are these things. (I-4)

The prevalence of rent-seeking activities (e.g., trading) and the limited success of import substitution are thus closely linked, and the – alleged – involvement of politicians may partly explain why policies aimed at import substitution were not pursued more vigorously.

Overall, while imports of goods and services as a share of GDP have fallen from almost 31.5 percent in 2011 to 18.3 percent in 2022 (World Bank 2023), suggesting some success in import substitution, this has not been nearly enough to bridge the gap between imports and exports and alleviate the structural shortage of foreign exchange.

8.4.2. External development finance, policy space, and the mounting debt burden

To mitigate this lack of foreign currency, Ethiopia has relied on inflows of finance through grants, concessional and, to a lesser extent, non-concessional loans, remittances, and, more recently, large amounts of FDI (to which I will return in Section 8.6.).

The EPRDF's approach to external resource mobilization centered around maximizing the amount of grants, followed by concessional loans, and preferably through budget support to the federal government in order to guarantee state control over these flows (Manyazewal 2019: 183). Between 2000 and 2008, ODA inflows (i.e., development finance from the OECD-DAC group) increased by 500 percent to around USD 3.3 billion, then fluctuated between roughly USD 3 and 4 billion until the mid-2010s, before climbing to around USD 5 billion in 2020 (World Bank 2023). During this period, aid and concessional loans thus exceeded Ethiopia's merchandise export earnings. In 2016, the country was in fact the largest recipient of ODA in the world (Tomkinson 2019: 127), despite the EPRDF's confrontational stance towards some of the IFIs and the government generally not meeting common criteria of good governance (Clapham 2018: 1156). In per capita terms, however, ODA to Ethiopia was just over half the LDC average (World Bank 2023), more accurately reflecting the uneasy relationship.

Despite the country's heavy reliance on Western aid, the government managed to remain broadly independent of potential demands from its development partners, thus retaining a large degree of policy space. As noted in Section 7.2. regarding the 1990s, this was based on the EPRDF's strong sense of policy ownership, the party's ability to exploit disunity and disagreements between donors and lenders, and a previous track record of successful poverty reduction. These dynamics continued throughout the 2000s and 2010s, and were further compounded by two additional factors since the mid-2000s. First, Ethiopia's growing role as a force for "stability" in the Horn of Africa and Western ally in the "war on terror" led to significant increases of US aid to the country and to much more leeway in conducting unorthodox policies (Borchgrevink 2008: 210). Second, the rise of China as a major provider of development finance allowed the EPRDF to diversify its sources and to further play competing donors and lenders off against each other (van Wijk 2022: 111). Although Chinese loans were non-concessional, and thus more expensive than concessional loans obtainable from the IFIs, they enabled the Ethiopian government to finance projects that Western agencies are typically unwilling to support. As noted, Chinese finance was channeled mainly into infrastructure development in transportation, power, and telecommunications (Manyazewal 2019: 183). During this period, Ethiopia became the largest African recipient of Chinese loans, receiving USD 13.6 billion between 2000 and 2017 (Ikpe 2021: 186). Together with the factors outlined in Section 7.2., these two developments – the strategic location of Ethiopia in the Horn of Africa, and the rise of China – allowed the government to decide more or less independently on the areas and projects in which it felt investment was needed, without significant policy consultation with IFIs or bilateral partners. It then sought to fill the gaps identified by "effectively presenting a menu of options" (Tomkinson 2019: 132) to donors and lenders. An Ethiopian politician cited in Collins (2022: 609) describes the party's approach in the following way:

> We don't reject any prescriptions outright, but we design our own programme and when we go to negotiate [with the IMF and World Bank] and they present their prescriptions, we analyse their policy with ours. If they go together, we take it; if not we reject it.

The result of this was that not only Chinese loans but even those of the World Bank were broadly aligned with the policy goals of GTP I and II (Tomkinson 2019: 129). Thanks to this selective attitude, and the government's ability to leverage Ethiopia's geopolitical significance, this period thus largely saw a continuation of what had already characterized the EPRDF's approach to external development finance in the 1990s. In terms of policy space, Ethiopia has therefore managed to remain fairly independent.

However, the growing importance of non-concessional loans, not only from China but also from other non-Paris Club countries and private creditors, has led to a mounting debt burden. In 2006, the total external debt stock of Ethiopia (most of which is public and publicly guaranteed debt) fell from USD 6.18 billion to 2.22 billion as a result of debt relief under the HIPC program and the Multilateral Debt Relief Initiative (MDRI) (World Bank 2023; Borchgrevink 2008: 212). After this, however, external debt rapidly ballooned to over USD 30 billion in 2020 (World Bank 2023). While the World Bank remained the largest creditor (Tomkinson 2019: 127), the composition of external debt changed markedly during this period. Between 2007/08 and 2016/17, the share of debt owed to private creditors increased from 10 to 27 percent, partly due to the USD 1 billion Eurobond issued by the government in 2014 (Manyazewal 2019: 185, 187). Large Ethiopian SOEs were also able to obtain long-term commercial loans, which amounted to an estimated USD 4 to 5 billion in the mid-2010s (Priewe 2016: 11). The growing importance of private creditors means that room for maneuver and prospects for potential debt rescheduling or relief became much slimmer (Manyazewal 2019: 188). Given the higher interest rates on commercial loans, this recourse to such comparatively less desirable private sources of finance highlights the dire foreign exchange situation towards the end of GTP I, resulting from the persistently weak performance of the export-oriented manufacturing sector (Dercon 2022: 247). The non-concessional nature of these loans invariably aggravated the problem.

As a result of this borrowing spree, external debt service has exploded since the late 2000s. Between 2009 and 2015, it increased tenfold from around USD 100 million annually to just over USD 1 billion, before doubling again to USD 2 billion per year by 2019 and remaining at that level in 2020 and 2021 (World Bank 2023). In 2017, this meant that around two thirds of the value of Ethiopia's merchandise exports left the country again in the form of debt service. For the fiscal year 2022/23, more than 22 percent of government spending is allocated to debt servicing, almost double the amount spent on education (MoF 2022: 9). In 2022, more was spent on external debt service payments than on poverty-focused social spending (UNDP 2023: 7). By the time the Eurobond matures in 2024, Ethiopia will have paid close to USD 500 million in interest payments alone, half the total value of the bond (World Bank 2022: xviii). These immense outflows of foreign exchange put a heavy strain on Ethiopia's prospects for structural transformation. In combination with low export earnings, these outflows create a vicious circle, resulting in even less foreign exchange available to the manufacturing sector. This in turn worsens the sector's inability to increase its export capabilities, which further exacerbates the shortage in foreign exchange. An Ethiopian national working at the United Nations Economic Commission for Africa (UNECA) summarized the problem in the following way:

> We go to World Bank, we borrow money. We're going to the private sector, we borrow Eurobonds and all that, and we keep piling, piling, piling, piling. It gets to a point where we cannot pay, right? And therefore we're spending more money, resources from development, we're using it to service our debt. (I-2)

By the middle of the GTP II period, the situation had become so acute that imports not only of consumer goods but also of capital and intermediate goods had to be curtailed in order to relieve some pressure on the balance of payments (Tomkinson 2019: 141).

Crucially, the build-up of external debt in the face of persistently weak export earnings also raises the risk of debt distress and the concomitant issues of conditional lending discussed in Section 6.2.1. Reflecting the country's rapidly deteriorating debt service ratio, the IMF raised Ethiopia's risk of debt distress from "low" to "moderate" in 2015 (Gebreeyesus 2019: 694), and again to "high" in 2017 (Tomkinson 2019: 135). For the EPRDF, the possibility of becoming unable to service the country's outstanding debt meant that it risked having to resort to IMF bailout loans that come with significant strings attached, a prospect the party had spent most of its tenure working hard to prevent. Ethiopia's mounting balance of payments problems thus put the EPRDF's entire project of state-led developmentalism under severe stress.

Overall, the Ethiopian government relied heavily on external sources of finance to power its ambitious attempts at structural transformation. Since exports could not keep up with the highly import-intensive growth spurt of the 2010s, such inflows were indeed necessary. Looking at it the other way round, external finance enabled the country to pursue this development strategy in the first place. Ethiopia subsequently became one of the world's largest recipients of ODA in absolute terms. Despite growing aid dependence, and in continuation from the 1990s, the EPRDF-led government managed to preserve policy space through a combination of political prowess and beneficial external factors. However, the increasing importance of non-concessional loans in financing Ethiopia's deficit since GTP I led to a sharp rise in external debt. The country's already scarce foreign exchange earnings were severely strained by the huge capital outflows servicing this debt. As a result, the risk of debt distress increased significantly, ultimately causing a crisis in the EPRDF's growth model, and forcing the ruling party to reconsider their approach to export-oriented industrial policy.

8.5. Embracing GVC integration: FDI, industrial parks, and trade policy

From the mid-2010s onward, the need to ease the burdens of weak export performance and growing debt led to the embrace of Ethiopia's integration into labor-intensive segments of GVCs by attracting FDI and constructing more than a dozen state-owned industrial parks.

This turn towards FDI and GVC integration since GTP II represented a major shift in the EPRDF's development strategy. Both foreign capital and (privately owned) industrial parks had already been present in the country before this point, but the determination with which the government pursued these matters now changed significantly. These developments are particularly noteworthy given that the EPRDF had historically been extremely cautious about allowing foreign capital to play a prominent role in the economy, and accordingly, had tightly restricted FDI inflows up to this point. Tomkinson (2019: 143) argues that this shift was not based on a newfound belief in the improved prospects for structural transformation arising from global integration. Rather, there was a perceived need to protect the existing developmentalist agenda – and particularly the closed financial sector – from outside pressure at virtually any cost. For the EPRDF, this meant linking up to GVCs primarily in order to increase foreign exchange earnings and thus avoid debt distress and structural adjustment lending, which could end up dismantling the Ethiopian state's control over the economy. This thinking is illustrated by a government official's remark on export volumes, quoted in Tomkinson (2019: 143): "[i]f we bring about an increase we will survive, but if we fail … we will be dictated to by the IMF".

Increasing export earnings was a matter of existence for the regime, and GVC integration was seen as the most promising way of doing so.

One of the long-term objectives of GTP II was thus to transform Ethiopia into a hub for light manufacturing in Africa (Gebreeyesus 691). FDI was to become the engine of this transformation, as the domestic manufacturing sector had proven too weak to do so. Earlier, in the late 2000s, the floriculture sector had taught the EPRDF that concerted state efforts at FDI attraction could lead to a rapid expansion of the country's foreign exchange earning potential without losing control of the development process. The party was now keen to replicate this experience on a larger scale in the garment and leather sectors (Tomkinson 2019: 136). In addition to earning foreign exchange as the main motivation for this shift, other objectives of Ethiopia's new FDI strategy were to create jobs for the many unemployed youth, to promote domestic manufacturing enterprises through technology and knowledge transfer, and to encourage the creation of backward linkages to the broader economy (World Bank 2022: xii; I-3). In 2014, the EIC was revitalized, becoming an independent agency charged with attracting and retaining FDI in light manufacturing and reporting directly to the prime minister (Tang 2022: 1970). The IPDC was founded to oversee the construction and operation of large state-owned industrial parks, the number of which has grown to 13 by the early 2020s (Guteta and Worku 2023: 215). These were built by Chinese SOEs (van Wijk 2022: 102) and many were financed through the USD 1 billion Eurobond issued in 2014 (Manyazewal 2019: 187). Foreign companies operating in the industrial parks were required to export their produce and sales to the domestic market were prohibited, both to ensure foreign exchange income and to protect what little domestic production existed.

Regarding investment incentives, the industrial parks themselves were the most significant one. By bringing together a large number of companies in a small area, such facilities allow for the concentration of specialized infrastructure and typically offer comprehensive logistics services to companies (Hauge 2019: 2076). The appeal of this model to foreign capital was demonstrated by the fact that Bole Lemi Industrial Park, the first of the newly constructed parks, was booked out before it even became operational (Staritz et al. 2016: 14). FDI in the industrial parks was to be further encouraged through a range of financial incentives. These included income tax exemptions (for up to 10 years), export tax exemptions, import duty exemptions for capital goods and raw materials, subsidized land lease (free of charge for factories and residential quarters for up to 80 years), and guaranteed capital repatriation for foreign investors (Hauge 2019: 2077). The 15 percent devaluation of the Birr was also intended to act as an incentive for exporters, as was Ethiopia's access to a US preferential trade agreement, the African Growth and Opportunity Act (AGOA). In terms of a "carrots and sticks" approach to industrial policy, these benefits acted as carrots for attracting investors, but the sticks that would ensure their contribution to the government's secondary goals (e.g., technology transfer or foreign firms sourcing from local markets) were notably absent. As Tomkinson (2019: 302) argues, given the country's status as an emerging FDI destination on the one hand, and the need for investments to bring in foreign exchange quickly on the other, the government felt constrained in its ability to use instruments such as local content requirements so as not to scare off potential investors that could easily leave for other low-cost locations.

Not being a WTO member, Ethiopia's ability to integrate into global manufacturing value chains was largely thanks to AGOA. This provided duty-free access to the US market and allowed apparel buyers to save up to 32 percent of the value of finished products, making Ethiopian exports more attractive than those from competing countries (World Bank 2022: xiv). As a result, the US became the number one destination for Ethiopian textile exports, with its share increasing from 10 percent in 2014 to 69 percent in 2019 (World Bank 2022: xiii). The EU's Everything But Arms (EBA) program offered similar benefits to Ethiopian exporters (Staritz et al. 2016: 7).

Partly due to the availability of such preferential arrangements but mainly because of the EPRDF's desire to preserve policy space, Ethiopia has been reluctant to join the WTO and other multilateral arrangements. The country has been in the WTO accession process for two decades but has purportedly made little progress (Tomkinson 2019: 146), and negotiations were suspended for 8 years until they resumed in 2020 (WTO 2020). Although Ethiopia, as an LDC, could join the WTO without reducing its tariffs (Gebrehiwot 2019: 240), a potential accession would likely require extensive liberalization of its financial sector and opening it up to foreign competition (Kassahun 2012: 209), something the EPRDF historically tried to avoid at all costs. Likewise, the country is not part of the Common Market for Eastern and Southern Africa (COMESA) FTA. While GTP II identified trade integration as an urgent requirement for the success of its export-oriented manufacturing sector (Gebrehiwot 2019: 239), the EPRDF presumably felt that the sector was not yet ready for facing the superior competition that would result from either WTO or COMESA membership (Makonnen and Lulie 2014: 19). Overall, this approach has allowed Ethiopia to pursue an export-oriented strategy without integrating into multilateral structures that would hurt nascent manufacturing capabilities and constrain policy space through both the rules of the trade regime and the commitments made for accession. However, this has made the country dependent on preferential market access to the US and the EU. As Staritz et al. (2016: 7) note, “[i]f these preferential trade agreements (PTAs) disappeared – certainly at this early stage – industrial expansion in the sector would collapse”. This dependence would eventually come back to haunt the country’s exporters in late 2021, as will be discussed in Section 9.3.

As a result of the new strategy, FDI inflows increased from under USD 300 million in 2010 to around USD 1.3 billion in 2013, and to over USD 4 billion in 2016 (World Bank 2023). In 2017, Ethiopia was the largest FDI recipient in Africa (Gebreeyesus 2019: 687). China became the largest source of FDI (Tang 2022: 1971) and the majority of these investments went into the manufacturing sector (Oqubay 2019: 645). Ethiopia’s FDI promotion efforts were in fact so successful, and so much to the delight of the IFIs, that the country won the World Bank’s Star Performer Award in 2017 for its investment policy reform (Manyazewal 2019: 185).

Beyond the headlines, however, the success of the new FDI strategy was modest overall. Net annual exports from the industrial parks reached around USD 163 million in the late 2010s (World Bank 2022: xiii). While this constitutes a substantial share of all manufacturing exports, it is a drop in the ocean of Ethiopia’s trade deficit. On top of this, FDI inflows began to decline again from 2017 onwards, due to growing social unrest and wavering foreign investor confidence, reaching USD 2.4 billion in 2020 (World Bank 2023). Other goals of GVC integration were also not reached. As noted, foreign firms in the industrial parks were banned from selling to the local market, thus making forward linkages (i.e., domestic firms sourcing from foreign firms in the industrial parks) impossible. Backward linkages, on the other hand, were a key policy objective of GTP II, but in the absence of local content requirements, these largely failed to materialize. Less than 5 percent of all intermediate inputs used in the industrial parks are of local origin (World Bank 2022: xiii). Domestic input-producing manufacturing firms have not become connected to the industrial parks in any meaningful way. Accordingly, the industrial parks were referred to as “islands” by IPDC and Ministry of Industry (MoI) officials interviewed in October and November of 2022 (I-3; I-10). FDI to Ethiopia thus resulted in the kind of enclave economy discussed in Section 6.1.2., leading to a distinct duality between modern foreign firms sourcing most of their inputs from abroad on the one hand, and a domestic manufacturing sector largely unable replace foreign suppliers on the other. Ethiopia’s import dependency (i.e., the ratio of imports to inputs) consequently remained steadily high between the mid-1990s and the mid-2010s (Oqubay 2019: 637).

The extent of technology or knowledge transfer from foreign to domestic firms has also been weak (World Bank 2022: xiii; I-10). As Vrolijk (2021: 259) notes, there is "little indication that government policy achieved significant learning between domestic and foreign companies, despite policy tools such as technology-transfer agreements". In addition to the general inadequacy of Ethiopian manufacturing firms, and the lack of performance requirements on FDI, there are sector-specific reasons for why these spill-over effects have not taken place at a significant scale, which will be discussed in Section 8.6.

In summary, the EPRDF's strategy for GVC integration was rooted in the country's dire foreign exchange situation and, crucially, in the need to keep the demands of the IMF at bay. This was to be achieved by attracting foreign investors into newly build state-owned industrial parks, which resulted in a rapid increase in manufacturing FDI, particularly in the garment sector. However, beyond successful FDI attraction, the benefits of the new strategy remained at low levels. Despite high initial growth in export earnings, neither the capabilities of the domestic manufacturing sector nor the country's foreign exchange earning potential improved significantly. A lack of linkages meant that the industrial parks, in which FDI was concentrated, became enclaves with little connection to the domestic economy. Thus, in the words of an MoI official interviewed, "it was a quick reform, but it has costed us in the longer term" (I-10).

8.6. Uneven outcomes in export-oriented priority sectors

Some of the reasons for the inability of domestic companies to integrate into GVCs have already been discussed, such as lack of interest or lack of funding. However, to better understand why this has been the case, and beyond GVCs, why some sectors have been able to contribute to structural transformation, while others have not, it is necessary to look at the concrete constraints and prospects for success in individual industries. Since the early 2000s, the EPRDF focused on a number of strategic export-oriented sectors to increase the country's foreign exchange earning potential and to accelerate industrialization. In this section, the development of three of these priority industries, apparel, leather, and floriculture, will be discussed.

8.6.1. Apparel

The apparel industry has been among Ethiopia's highest priority sectors since the formulation of ADLI, and its importance to the developmental agenda was confirmed in the 2002 IDS and the subsequent five-year plans from PASDEP to GTP II. As such, the sector has received special attention, including preferential allocation of land, loans, and foreign exchange as well as through other types of incentives, especially those linked to export performance (Staritz et al.

2016: 15). SOEs (which were later transformed into nominally private, endowment-owned firms) were also among the largest domestic apparel manufacturers, allowing the state to intervene directly in the sector (Whitfield et al. 2020: 1035).

Since GTP II, the focus shifted to attracting large TNCs and their supplier networks into the newly built industrial parks. The apparel industry subsequently became the main destination for foreign investment, and by the early 2020s, accounted for around 95 percent of exports from state-owned industrial parks. Exports from the industrial parks in turn made up 70 percent of Ethiopia's total apparel exports, indicating a significant overlap between the sector and the industrial parks (World Bank 2022: xiii). As foreign investors flocked to what was widely regarded as "the last frontier region of low-cost apparel production" (Whitfield et al. 2020: 1019), apparel exports from Ethiopia increased more than ninefold between 2010 and 2017, reaching USD 117 million in foreign exchange earnings (Whitfield et al. 2020: 1025). Hawassa Industrial Park became the IPDC's flagship establishment and the largest textile industrial park in Africa (van Wijk 2022: 102), attracting some of the largest fashion companies in the world. FDI attraction became a high-level political affair, with senior officials personally visiting lead firms and promoting Ethiopia as an investment destination. The decision by fashion giant PVH, which owns brands such as Tommy Hilfiger and Calvin Klein, to set up production in Hawassa was reportedly brokered in such a personal manner (Dercon 2022: 246). Together with Ethiopia's preferential access to the US and the EU and changes in the sourcing strategies of TNCs, these industrial policy efforts led to a rapid expansion of the apparel sector (Staritz et al. 2016: 7).

The EPRDF was aware that FDI alone would not be sufficient for domestic producers to acquire technological capabilities and become competitive, and thus for the sector to become a major foreign exchange earner and contributor to structural transformation. The Textile Industry Development Institute (TIDI) was tasked with supporting the domestic sector through capacity-building, advisory services, research, and marketing activities (Staritz et al. 2016: 15). Linkage creation was another priority for the government. To overcome the sector's import dependency, the end goal was to establish a fully domestic supply chain, whereby export-quality fabric was to be produced from locally grown cotton (Whitfield et al. 2020: 1031).

However, as indicated in Section 8.5., the success of these measures was limited. Beyond notable exceptions such as PVH, other global lead firms were reluctant to invest in Ethiopia due to high trade costs and a sense of political instability (Tomkinson 2019: 145). The overvalued exchange rate has also undermined export competitiveness and discouraged further FDI inflows. In addition, the apparel sector is characterized by low productivity, which has contributed to the unwillingness of TNCs to invest in Ethiopia. This is largely due to high labor turnover, which in turn stems from low wages, poor working conditions, and low unionization rates (Staritz et al. 2016: 25; Whitfield et al. 2020: 1032). Those firms that have entered the country overwhelmingly do not source their inputs from the domestic market. This is because, as noted, raw materials (e.g., cotton) and intermediate inputs are not available locally in sufficient quality or quantity. As a result, local firms have not been able to meet the stringent requirements of buyer firms, which have accordingly resorted almost entirely to imported inputs (Staritz et al. 2016: 24). The envisaged linkages between domestic suppliers and TNCs located in the industrial parks have thus not materialized on a significant scale, and import dependency has prevailed. Between the mid-1990s and the mid-2010s, the ratio of imports to inputs in the textiles and apparel sectors in fact increased by 38.5 percent (Oqubay 2019: 637).

There has also been limited technological learning or upgrading among Ethiopia's apparel producers. Despite capacity-building efforts, including through TIDI, there was little knowledge transfer to local companies through measures such as participation in trade fairs or hiring foreign experts. The lack of performance requirements attached to such support initiatives further compounded the problem (Whitfield et al. 2020: 1029-1030). As with other manufacturing subsectors in Ethiopia, access to foreign exchange and to domestic loans was also challenging, despite priority allocation (Staritz et al. 2016: 24; Whitfield et al. 2020: 1033).

Overall, despite successful FDI attraction, Ethiopia's integration into the apparel GVC has largely failed to deliver the expected benefits. Due to the lack of sufficient inputs in terms of quality and quantity and the low technological capabilities of domestic suppliers, TNCs have continued to source from abroad. To the extent that GVC integration does take place, Ethiopian firms remain at the bottom of the "smile curve" with respect to their area of specialization. Despite industrial policy efforts, neither domestic investments nor FDI in the apparel sector has thus resulted in significant advances regarding the creation of linkages or the accumulation of technological capabilities. Ultimately, apparel manufacturing in Ethiopia takes place in an enclave manner, and domestic activity remains confined to low-complexity activities, with little value being retained in the country.

8.6.2. Leather

Similar to the apparel industry, the leather sector (and its tanning and leather products subsectors) has been a priority of Ethiopia's industrial policy since the beginning of the EPRDF's rule. It was selected for its backward linkages to the large rural sector and its labor-intensity, and thus its perceived capacity for rapid expansion and potential for earning foreign exchange

(Brautigam et al. 2018: 163). Investment and export promotion measures were also similar to those used in the apparel sector, ranging from preferential access to finance and land to tax exemptions and export subsidies. One of the EPRDF's main objectives for the sector was to support the development of more sophisticated production capabilities at domestic tanneries to move them from semi-finished to finished leather exports (Grumiller 2021: 445). In addition to generating higher foreign exchange earnings, upgrading to domestic production of finished leather was also expected to lead to forward linkages to the leather products sub-sector.

However, domestic tanneries remained persistently unwilling to move into these higher-complexity activities (Oqubay 2015: 198). As a result, the government introduced export taxes on unfinished leather products in 2008 and 2012, effectively banning the export of these goods and forcing domestic tanneries to upgrade to finished leather if they wished to stay in business. This policy intervention resembles the "carrots and sticks" strategies that East Asian developmental states used to make capital comply with developmental goals. The de-facto export ban proved to be somewhat successful, as the number of domestic tanneries producing finished leather for export increased from 6 in 2011 to 20 in 2015 (Brautigam et al. 2018: 166). However, the supply of finished leather to the domestic leather products sub-sector was still insufficient, prompting the government to allow duty-free imports of finished leather in 2011 (Brautigam et al. 2018: 167).

In line with the increasing orientation of Ethiopia's development strategy towards FDI, both the tanning and the leather products industries were also opened up for foreign investors in hopes of improved linkages between sub-sectors. This led to a dominance of foreign companies, particularly Chinese, and to an increase in finished leather and leather manufacturing exports, while the share of unfinished leather further decreased (Grumiller 2021: 444, 446). Between 2009 and 2014, several foreign companies relocated from China to Ethiopia, including one of the world's largest shoe manufacturers (van Wijk 2022: 103), and FDI attraction was later further intensified as part of the industrial parks strategy (Grumiller 2021: 446). However, while exports of leather and leather products grew by almost a third between 2007 and 2014, the sector still accounted for only about 4 percent of Ethiopia's exports and had achieved just over a quarter of the USD 500 million export target set out in GTP I (Brautigam et al. 2018: 162). Moreover, much of the growth was due to the new presence of foreign firms in tanning and footwear production, which unsurprisingly came at the expense of domestic companies (Grumiller 2021: 448).

One of the main obstacles to the development of a domestically integrated value chain has persisted since ADLI and the 2002 IDS. Similar to the lack of sufficient domestic cotton input in the Ethiopian apparel industry, limited supply of high-quality animal hides has also held back the leather sector. This is particularly noteworthy given that Ethiopia has one of the largest livestock populations in the world (Oqubay 2015: 12). These quality issues and the resulting weak linkages were also identified as the sector's most binding constraints by an EIC official interviewed for this thesis (I-1). According to the official, the persistence of traditional skinning methods in most rural areas of the country means that much of the animal hides cannot be processed for leather production. Linkages between livestock and leather tanning were not the only ones missing, as indicated above. Given that domestic tanneries were initially specializing in the production of unfinished leather, the leather products sub-sector remained woefully short of sufficient domestic inputs. This did not change significantly with the increasing importance of FDI, as foreign firms came to Ethiopia primarily to access raw materials and then export cheap finished leather to their parent companies or global buyers for further processing. As a result, the FDI strategy not only harmed domestic companies but did also not resolve the problem of weak linkages between tanning and leather product manufacturing (Grumiller 2021: 452-453). Despite individual exceptions, such as the large Chinese shoe manufacturer mentioned above, which sourced 80 percent of its inputs from local suppliers by 2017 (van Wijk 2022: 103), the leather sector's overall import dependency increased by 75 percent between the mid-1990s and the mid-2010s (Oqubay 2019: 637). Higher export earnings from the sector must thus be seen in the context of this simultaneous increase in imports.

Adding to the modest net export earnings was the fact that, unlike foreign firms, domestic leather goods manufacturers continued to focus on the domestic market rather than on exports (Oqubay 2015: 213). This has mainly been due to the high risk associated with trying to become competitive in international markets, and with what Oqubay (2018: 19) calls "a fixed mindset". Ethiopian firms attempting to participate in global markets are constrained by the fallacy of composition (as discussed in Section 6.1.2.), as they face competition from other low-cost (but more productive) countries, mainly in Asia. The result is a concentration of bargaining power on the side of global lead firms, whose stringent product requirements Ethiopian firms find difficult to meet (Oqubay 2015: 212-213; Grumiller 2021: 445). An ECCSA official interviewed for this thesis also suggested that the lack of technological capabilities has meant that Ethiopian firms have been unable to penetrate European or US markets, for example in footwear (I-8). This is despite capacity-building efforts by a sectoral development institute, the work of which, however, appears to be insufficiently taken up by domestic companies (Vrolijk 2021:

260). State-led efforts to upgrade the country's exports from semi-finished to finished leather were also met with international resistance, particularly from Italian tanneries fearing for their market share and the Italian state acting on their behalf (Brautigam et al. 2018: 167). This highlights how the companies and states of core countries can actively interfere with peripheral industrial policy strategies if their interests are at stake. These specific difficulties to the growth and transformation of the Ethiopian leather sector are, of course, further compounded by the general constraints faced by all Ethiopian manufactured exports, including lack of finance, inadequate infrastructure and high trade costs, and the overvalued Birr.

In summary, the development of the Ethiopian leather sector has had only moderate success. The industry has been constrained by a pervasive lack of sufficient inputs and an unwillingness of domestic firms to move into more complex activities. In order to mitigate these issues, the state has disciplined tanneries to upgrade to finished leather production, and has allowed FDI to improve linkage creation. However, integration between sub-sectors remains low, and supply deficiencies have not been addressed. While potential linkages between agriculture and manufacturing had already been identified in the ADLI strategy as crucial for Ethiopia's industrialization, these have remained largely elusive.

8.6.3. Floriculture

The floriculture sector is one of very few export-oriented sectors that newly emerged in Ethiopia since the beginning of the EPRDF's rule (Melese and Whitfield 2023: 2). Unlike other priority sectors, floriculture was not highlighted in the state's ADLI strategy and the 2002 IDS. In 2004, a newly established industry association began lobbying the government for support, marking the beginning of closer industrial policy attention. Before that, the sector was virtually non-existent, exporting around 3 tons of cut flowers annually and earning a mere USD 320 thousand in foreign exchange (Oqubay 2015: 153). Recognizing the growth potential of the sector, the government began incentivizing both domestic and foreign investment through the usual set of policies, including subsidized access to land and loans, tax exemptions, and removal of tariffs and duties (Melese and Whitfield 2023: 6). As noted in Section 8.3.2., the DBE played an important role in financing domestic investments in the industry, as commercial banks were unwilling to do so at a sufficient scale. Compared to other export-oriented sectors, the floriculture industry exhibited a larger degree of embedded autonomy. The Ethiopian Horticultural Development Agency (EHDA) was established in 2008 to help exporters overcome infrastructural and bureaucratic hurdles (Melese and Whitfield 2023: 6), and the relationship between government, bureaucracy, and industry appeared to be "based on building trust and collective learning" (Oqubay 2018: 19). With very little domestic demand for flowers, the floriculture sector exports almost all of its produce, mainly to Europe. Because of this, and the perishable nature of the product, reliable access to air cargo is critical. Ethiopian Airlines, the state-owned national carrier, expanded its cargo capacity in support of the floriculture sector, and has even incurred some losses as a result (Oqubay 2015: 170). This illustrates the pivotal role SOEs can play in the development of strategically important sectors. The industry also benefited from the state's ownership of land, as fertile plots near Addis Ababa airport were allocated to producers at low cost (Melese and Whitfield 2023: 6).

Combined with support from Dutch development programs and strong interest from local and foreign investors, this concerted industrial policy effort resulted in a rapid increase in the sector's production capacity (Melese and Whitfield 2023: 2). By the early 2010s, 50,000 tons of flowers were being exported per year, and annual export earnings had grown to about USD 200 million – making the sector Ethiopia's fifth largest source of foreign exchange (Oqubay 2015: 153, 155). By the mid-2010s, the industry's contribution to total merchandise exports had reached 10 percent (Oqubay 2018: 16). Despite initial import dependency, significant advances in import substitution were made through the creation of backward linkages to the packaging industry and forward linkages to the transport and logistics sector (Melese and Whitfield 2023: 2). And with air transport accounting for more than half of the floriculture industry's costs (Oqubay 2015: 168), the ability to rely on a domestic airline has significantly helped to reduce the outflow of foreign exchange that would otherwise be used to import these transport services. Although the spectacular growth of floriculture has been heavily dependent on FDI, the creation of domestic linkages has thus prevented the emergence of the kind of enclave economy seen in the apparel or leather sectors.

In addition to the successful creation of linkages, the presence of foreign producers has facilitated technological learning among domestic firms and helped them integrate into international markets. In this respect, FDI was indeed seen as positive even by most domestic producers (Oqubay 2015: 188). However, in terms of market share, foreign firms have increasingly come to dominate the sector. Between the mid-2000s and 2016, the number of domestic producers fell from 38 to 15, while the number of foreign companies increased from 26 to 66. By 2015, local producers accounted for only 15 percent of exports (Melese and Whitfield 2023: 6-7). Thus, there appears to be a creeping denationalization of the floriculture industry.

The marginalization of domestic producers is also evident in their limited success at upgrading. Given the high risks associated with upgrading, and the fact that the floriculture GVC is governed by large buyer firms that set requirements and standards, domestic firms have proven unable or unwilling to move to more sophisticated activities in breeding or marketing (Melese and Whitfield 2023: 5). Most Ethiopian flower exporters continue to focus on relatively low-value varieties and use intermediaries to sell their produce, rather than accessing consumer markets directly (Oqubay 2015: 190). This is exacerbated by the lack of performance requirements linked to government support. While producers receive loans from the DBE, the bank has not properly monitored the performance of the companies it has lent to, and companies have had little incentive to invest in upgrading (Melese and Whitfield 2023: 3, 16-17). As a result of their subordinate position in the GVC, Ethiopian producers only receive 2 percent of the retail price of cut flowers sold in Europe (Priewe 2016: 28)

In spite of this, the Ethiopian floriculture sector has overall shown better results than the apparel and leather sectors. Starting from very low levels in the mid-2000s, it has become a major foreign exchange earner for the country. The sector has critically depended on active state intervention to mediate these outcomes, and has benefited from preferential land allocation and quasi-direct SOE support both in terms of transport through Ethiopian Airlines and finance through the DBE. However, while the large presence of foreign capital has led to significant spill-over effects to domestic producers, the latter have become increasingly marginalized and have had little success in upgrading. Ethiopian flower producers have thus remained at the bottom of the floriculture GVC, and government intervention, lacking "carrots and sticks", has done little to change this. Despite these shortcomings, the floriculture sector has arguably been Ethiopia's most successful export-oriented sector.

8.6.4. Technology, enclaves, and policy inefficacy: the challenges of Ethiopia's export-oriented priority sectors

Although Ethiopia's apparel, leather, and floriculture sectors have shown very different outcomes, they also share many similarities. In all three sectors, technological learning and upgrading processes among domestic producers have been slow to materialize and have at times been met with resistance from both value chain lead firms and Ethiopian firms themselves. Industrial policy instruments used by the government have often been similar across sectors, and their (albeit sometimes limited) effectiveness depended on the state's continued ability to preserve its developmentalist policy agenda. Without the DBE and other SOEs, public land ownership, and sectoral development institutes, domestic firms would arguably have had even less chance of success. However, while there were often "carrots" to incentivize investment and exports, "sticks" have been used far less systematically to encourage upgrading to more sophisticated activities. As spill-over effects do not happen automatically, it appears that not enough attention has been paid to the actual process of technological learning. One of the main reasons for the lack of upgrading among domestic firms may therefore be that the government "does not follow a coherent and rigorous approach to incentivize, regulate, monitor and evaluate technology-transfer processes" (Vrolijk 2021: 258). The domestic acquisition of technological capabilities, i.e., the process of learning for productivity, as discussed in Section 5.2., has thus had limited success.

This also applies to linkages. With the notable exception of the floriculture sector, where decisive policy intervention and the strategic use of SOEs have led to forward and backward linkages and substantial import substitution effects, the same cannot be said of apparel and leather. Both manufacturing sectors are held back by an acute lack of domestic inputs and are thus heavily reliant on imports. Their foreign exchange earning ability and potential contribution to structural transformation at large is curtailed by such import dependency. The government's inability to strengthen domestic linkages has therefore led to the emergence of enclave economies. The marked absence of FDI performance requirements, which could potentially mitigate these issues, may partly be due to a fear of deterring foreign investors. According to an EIC official interviewed for this thesis, TNCs are simply not interested in using domestic inputs: "Most of the time we ask for the investors: […] '[W]hy don't you use the local products?', and all, all of the times, they are telling us: 'Your manufacturers in your country are not competent, competent in terms of quality, quantity'" (I-3). Because of this, the EPRDF appears to have chosen a broadly liberal approach to managing the developmental impact of foreign capital, despite the distinct interventionism that otherwise characterized the party's development strategy. This choice has come at the expense of encouraging upgrading and linkage creation, while also increasing the country's dependence on foreign capital. Overall, while they have contributed to higher foreign exchange earnings, structural transformation has largely not taken place in Ethiopia's export-oriented priority sectors.

8.7. Conclusion: the achievements and failures of the Ethiopian developmental state

This chapter traced the development of the EPRDF's heterodox economic policy agenda between the mid-2000s and 2018, and discussed some of its main achievements as well as the difficulties that continue to constrain structural transformation in Ethiopia.

As outlined in Section 8.1., the EPRDF sought to build an Ethiopian developmental state aimed at structural transformation. To this end, it strove for hegemony through performance legitimacy, professionalized the country's bureaucracy, and formulated successive five-year development plans, all in the interest of the "single-minded pursuit of accelerated development" (Meles Zenawi, cited in Weis 2016: 294).

Section 8.2. discussed how Ethiopia's growth trajectory under the EPRDF's developmental state was largely based on public investment, of which the country had one of the highest rates in the world. Much of this was channeled into infrastructural expansion, which was seen as a prerequisite for the eventual transformation of the economy. High transport costs and unreliable energy supply were identified as major constraints on export competitiveness and industrialization at large, and despite major efforts and remarkable achievements during the EPRDF's rule, these issues continue to hold economic development back.

SOEs and party-affiliated companies have played a vital role in Ethiopia's development. By driving infrastructure development and manufacturing investment in import-dependent and export-oriented sectors, these state-directed firms thus filled the gaps in productive activity that domestic capitalists were unwilling or unable to fill. Critics have argued that this dominance of SOEs has left little room for private sector involvement, and the domestic private sector has indeed remained marginal. The EPRDF considered most capitalists to be engaged in rent-seeking activities, and the lack of private investment in agriculture and manufacturing on the one hand, and the boom in the service sector on the other, do point in this direction. State-business relations were largely characterized by mutual distrust and thinly veiled contempt, and the EPRDF's fear of losing control played a crucial role in the suppressed position of the private sector. The resulting lack of embedded autonomy further contributed to the overall weak performance of Ethiopia's productive sectors, especially domestic manufacturing.

In addition to this lack of political affiliation and potential crowding out by SOEs, as well as the aforementioned infrastructure constraints, Ethiopia's manufacturing sector faced other steep challenges. These included a lack of credit from domestic banks, pervasive foreign exchange shortages, the overvalued exchange rate, a lack of sufficient domestically produced inputs, low rates of technological learning, and hence low productivity and a lack of competitiveness. Together, these factors have hindered the development of the Ethiopian manufacturing sector, which has remained between 3 and 6 percent of GDP throughout the 2000s and 2010s (World Bank 2023).

Concerted policy efforts were made to mitigate some of these problems, particularly in the highly regulated financial sector, which was the focus of Section 8.3. As private banks proved unwilling to finance investment projects in priority sectors, the EPRDF used state-owned banks to fill these gaps. CBE and DBE provided preferential credit to priority sectors, with a large proportion of investments in manufacturing and agriculture financed in this way. And through the application of highly heterodox regulation, the state essentially forced commercial banks to contribute to this endeavor. However, targeted development banking alone proved insufficient to support the growth of Ethiopia's productive sectors, which therefore remained underfunded.

These issues were reflected in the continuous deterioration of Ethiopia's balance of payments throughout this period, as elaborated in Section 8.4. Despite considerable efforts at import substitution, the EPRDF's growth model remained highly import-intensive and characterized by weak domestic linkages, with most intermediate inputs imported from abroad. The lack of structural transformation also meant that the country remained reliant on the export of low-value agricultural commodities.

To finance Ethiopia's trade deficit, inflows of external finance were needed. The EPRDF government became adept at attracting substantial amounts of concessional development finance, resulting in the country becoming one of the largest recipients of ODA in the world. Despite this reliance on aid, the EPRDF managed to retain a high degree of policy space for its heterodox development strategies, in part due to the country's geopolitical significance. However, flows of concessional finance were not sufficient to meet Ethiopia's foreign exchange needs, leading to an increased reliance on commercial loans and a massive increase in external debt. The concomitant growth of interest payments further exacerbated the acute shortage of foreign currency, leaving the already underfinanced manufacturing sector woefully short of resources. This has resulted in a vicious circle of weak export earnings, foreign exchange shortages, external borrowing sprees, and further value outflows via debt repayment.

In the mid-2010s, the IMF classified Ethiopia as being at high risk of debt distress. As the EPRDF was well aware of the dangers of conditional lending, avoiding IMF bailout loans had become a top priority for the party. Against this background, the country's deteriorating situation thus led to a reorientation of Ethiopia's development model towards attracting FDI and integrating into GVCs in order to increase export earnings, as discussed in Section 8.5. In this regard, Ethiopia benefited from preferential market access to the US and the EU, which allowed it to pursue an export-oriented GVC strategy without being subject to the rules and regulations that come with WTO membership and other trade and investment agreements. FDI attraction into priority manufacturing sectors was to be achieved through a series of investment incentives, most notably the construction of large state-owned industrial parks. Given the EPRDF's historical reluctance to allow foreign capital to play a larger role in the economy, this strategic adjustment underscored the difficult economic situation Ethiopia found itself in.

There were also hopes of increased technology transfer from foreign to domestic firms and of linkages between the industrial parks and the rest of the economy. However, due to a number of problems, both general and sector-specific, these effects largely failed to materialize. Dependent on large amounts of imported inputs, the industrial parks therefore remained enclave economies with few linkages. In addition, most Ethiopian firms continue to be characterized by weak technological capabilities and have overwhelmingly remained at the lower end of GVC participation. The lack of significant spill-over effects in the export-oriented apparel, leather, and floriculture sectors, which were examined in Section 8.6., has thus contributed to the overwhelming lack of structural transformation of Ethiopia's priority sectors and the economy as a whole.

Of the constraints arising from a peripheral position in the world economy, as discussed earlier in Chapter 6, the structural shortage of foreign exchange has arguably been the greatest impediment to Ethiopia's development. In addition to constraining the growth of the domestic manufacturing sector, the pervasive lack of foreign exchange conditioned the need for additional flows of external finance, which in turn led to higher debt and an even worse situation. This chronic shortage of foreign exchange, itself a symptom of peripherality, has therefore significantly limited the country's capacity to accomplish structural transformation during the EPRDF's tenure. In the words of an EIC official interviewed, "the biggest issue that is hindering the Ethiopian industrialization to go forward is the foreign currency scarcity" (I-1). These dynamics could have also led to lower degrees of policy space for heterodox policy, had the Ethiopian government not placed great importance on trying to retain sovereignty in the face of aid dependence. Limiting the influence of IFIs and lenders was one of the EPRDF's top priorities, and the party went to great lengths to protect its developmentalist agenda from the impact of structural adjustment lending. One aspect Ethiopian policymakers sought to protect at almost any cost was the closed nature of the financial sector, which allowed for state control over resource allocation. Because of this level of commitment, financialization has largely not taken place in Ethiopia. The effects of the global trade and investment on the policy space of Ethiopia has also been muted. Given the availability of preferential access to the US and the EU, the EPRDF refrained from joining the WTO and other multilateral agreements, which would likely have entailed financial liberalization, and would have led to deindustrialization and reduced policymaking sovereignty. Overall, transnational constraints to structural transformation have deeply impacted Ethiopia's economic outlook and have shaped the EPRDF's policy agenda. However, domestic issues such as weak linkages or the unwillingness of private capital to invest in productive activities are in fact equally important in explaining the lack of industrialization in Ethiopia. These problems illustrate how difficult it is for a peripheral country to escape its subordinate position, even in the face of a clear developmentalist agenda and deliberate policy action.

Despite the many obstacles that continue to hamper structural transformation, the EPRDF's developmental state did accomplish much. Life expectancy at birth increased by 15 years between 2000 and 2019 (World Bank 2023). The rate of extreme poverty has fallen by almost half (World Bank 2022: xi), as has child mortality, and access to clean drinking water has doubled (Peterson 2020: 87). Since 2000, primary school enrolment has more than doubled to reach over 85 percent in 2015 (World Bank 2023). While it is difficult to fully attribute these achievements to the workings of the Ethiopian developmental state, the fact that government spending on health and education increased rapidly during EPRDF rule and that Ethiopia now hosts Africa's largest social protection program (Gebremariam 2018: 61) does suggest a pro-poor agenda.

Beyond these successes, Ethiopia "forcefully illustrate[s] that developmentalism remains possible in the age of neoliberalism" (Tomkinson 2019: 311). The level of commitment to structural transformation exhibited by the Ethiopian state was almost unparallel among today's peripheral countries. In its pursuit of industrialization, the country followed decidedly heterodox policy strategies and exhibited an interventionist approach to managing the (internal and external) constraints to development. Unfortunately, this has not been enough to escape peripherality, or even to prevent the eventual demise of the Ethiopian developmental state.

9. Developmentalism dismantled? The post-EPRDF period since 2019

From the mid-2010s, Ethiopia experienced growing ethnic tensions and social unrest that eventually led to the dissolution of the EPRDF in 2019, and to a bloody two-year civil war that ravaged the country between late 2020 and late 2022. In addition to causing widespread human suffering, these events arguably also led to the end of Ethiopian developmentalism as it characterized the EPRDF period.

This downward spiral first began to escalate in 2014, when a new urban development plan for Addis Ababa was unveiled. The plan (which ultimately never came to fruition) sought to extend the capital's boundaries into the surrounding Oromia region and would have entailed large-scale dispossessions of farmers (Kelecha 2022: 13-14). After decades of feeling left out of what they saw as an ethnically skewed development process, widespread protests erupted among the Oromo ethnic group (Wayessa 2021: 97). The government's violent response to the protests only fueled them further and led to growing divisions within the ruling coalition, between the hitherto dominant TPLF on the one hand, and the Oromo and Amhara constituent parties that sympathized with the protests on the other (Dercon 2022: 253). Following the resignation of the incumbent prime minister Hailemariam Desalegn in February 2018, Abiy Ahmed, an ethnic Oromo, took office in April that year, despite opposition from the TPLF (Brown and Fisher 2020: 192).

Under the new prime minister, the government began implementing sweeping political and economic reforms. Thousands of political prisoners were released, some of the most repressive laws were repealed, and diplomatic relations with neighboring Eritrea were restored (Berhe 2021: 138). In late 2019, after 29 years in power, the EPRDF was officially dissolved, and three of its largest constituent parties agreed to regroup under the banner of the Prosperity Party (PP). The TPLF, however, did not join the newly established PP, which further contributed to the deterioration of political relations. Finally, on the night of the 3rd to the 4th of November 2020, the now essentially ousted TPLF launched an attack on several federal military bases in the north of the country (Dercon 2022: 254), marking the beginning of the Ethiopian Civil War (also known as the Tigray War), which lasted exactly two years until a peace agreement was signed in early November 2022.

Against this backdrop, and in the context of a continuously deteriorating foreign exchange situation, the new Ethiopian PP-led government under Abiy Ahmed has embarked on a project of economic liberalization. Privatization, financial deregulation, macroeconomic policy reform, and a liberal approach to trade and investment became the official policy objectives of the PP regime. These neoliberal changes in economic policymaking, the way they could impact Ethiopia's prospects for structural transformation, and the extent to which they constitute a radical shift from the EPRDF's earlier developmental agenda will be the focus of this chapter.

However, given the lack of peer-reviewed scholarly work on these developments as of mid-2023, I will have to rely in part on newspaper articles from Ethiopian and international outlets, the reliability of which cannot be verified by the author, especially in the context of a highly conflictual political arena. Official policy documents by the Ethiopian government are another important source for this chapter. Given my lack of comprehensive insight into Ethiopian policymaking discourse, these will also have to be taken at face value. This is problematic because, in the words of an AAU economist interviewed in October 2022, “it is very difficult to predict in this country because people do not do what they say. You have something here, written for policy […], you do something else” (I-4). This thesis will thus not be able to come to definitive conclusions about the nature of the changes in economic policymaking since 2018/2019. Nevertheless, I will attempt to offer some perspectives on how the PP’s changes to Ethiopia’s political economy might affect the trajectory of the country’s industrialization process.

Section 9.1. examines the PP’s policy reorientation towards privatization and liberalization, as reflected in the Homegrown Economic Reform Agenda (HERA) of 2019 (FDRE 2020a) and the Ten-Year Development Plan (TYDP) of 2020 (FDRE 2020b). Section 9.2 assesses the extent to which these changes represent a departure from the EPRDF’s development strategy, and discusses the question of whether there are still developmental elements to Ethiopia’s policy agenda. Section 9.3. provides a brief outlook on the grim economic situation in Ethiopia before Section 9.4. concludes the chapter.

9.1. Privatization, liberalization, deregulation: Ethiopia’s new economic policy agenda

At the 2019 World Economic Forum, Ethiopian prime minister Abiy Ahmed promised the world that, at long last, Ethiopia would open up: “We will make it easier to do business for everyone who wish to invest in our country. […] We are committed to opening up the economy to international investors in telecom, logistics, energy, aviation, railways, and industrial parks” (cited in Wayessa 2021: 97). This new direction for policymaking later became, as was by now usual in Ethiopia, enshrined in a number of official policy strategies and development plans. In 2019, the HERA outlined the most important pillars of the economic reform:

> “improving the efficiency of SOEs and privatization, […] gradually moving towards a flexible exchange rate regime, […] enhancing financial sector development and developing capital markets, […] eas[ing] the constraints to doing business, [and] easing tariff and non-tariff barriers to international trade (FDRE 2020a: 2)

This was followed in 2020 by the TYDP, in which these plans were developed in more detail, and a new investment law. The latter allowed private investment in many areas of the economy previously reserved for the state (most notably the telecom sector), including the partial opening of additional sectors to FDI (Hagos 2022: 147). The official rationale for this new paradigm was that “it is time for the government to slow down its investment and leverage its past achievements for private sector development" (FDRE 2020a: 13). Thus, in a reversal of what the EPRDF had done for much of its time in power, the PP government now sought to strengthen the role of the private sector in Ethiopia's development, while reducing state control and intervention.

Privatization of SOEs was seen as one of the most pressing issues, both to empower the private sector and to combat the government's dwindling foreign exchange reserves. Shortly after taking office, the prime minister announced plans to fully or partially privatize some of Ethiopia's largest SOEs, including Ethiopian Airlines, Ethio Telecom, and the state-owned power and logistics companies (Maasho 2018). To manage and oversee the privatization and SOE reform process, the Ethiopian Investment Holdings (EIH) was established in 2021, controlling most of the major SOEs and accounting for 34 percent of Ethiopia's GDP (Minney 2022). In 2022, the government also offered 8 state-owned sugar factories up for sale (Bogale 2023). However, mainly because of the war, little progress has been made, especially concerning the large SOEs. Plans for the privatization of Ethiopian Airlines (which accounts for close to 90 percent of Ethiopia's services export earnings, according to an MoPD official interviewed (I-6)) were in fact dropped altogether in 2020 (ENA 2020). The most significant developments concern the telecommunications sector, where the government plans to sell 45 percent of state-owned Ethio Telecom, and has already issued a USD 850 million telecom license to a foreign consortium led by the Kenyan company Safaricom, with plans to allow at least one more private operator in the sector (Reuters 2023a). This is noteworthy as the telecom sector had long been a contentious issue during the EPRDF era, with donors pushing for liberalization but the government adamantly refusing to do so (Furtado and Smith 2009: 142). In the name of "promot[ing] private sector participation and competition" (FDRE 2020a: 25), the PP is now willing to abandon this stance.

SOE reform has not been limited to privatization. In an effort to disentangle public holdings from the influence of the TPLF, the PP replaced the leadership of most major SOEs. These included the two state-owned banks, Ethio Telecom, IPDC, and the manufacturing conglomerate METEC, which was further split into two separate entities to curb the influence of the previously ruling elites (Meester et al. 2022: 48, 50). The centralization of control over Ethiopia's SOEs in the hands of the newly established EIH also appears to partly serve this purpose. Overall, the new government seems determined to both reduce the influence of TPLF-affiliated elites and to place more control over the country's "commanding heights" in the hands of domestic and foreign capital, thereby likely reducing the state's ability to intervene in the development process in the future (de Waal 2018: 11).

Another key pillar of the PP's reform package involves sweeping changes to the financial system. Perhaps the most impactful plans concern foreign investment in the banking and insurance sectors. While the 2020 investment law still only allows domestic investment in financial services (Hagos 2022: 147), the government has announced plans to allow the entry of up to five foreign banks by the late 2020s (Endeshaw 2023), and similar announcements have been made for the insurance industry (Addis Standard 2023a). Safaricom, Ethio Telecom's sole competitor in the telecom sector, was also the first foreign company to be granted a license to offer mobile money services (Clynch 2023b). In terms of macroeconomic policy, the PP government plans to gradually move towards a market determination of both the interest rate and the exchange rate (FDRE 2020b: 34), which could have far-reaching implications on resource allocation, investment, trade, and debt service. However, plans to float the exchange rate have reportedly been postponed in order to allow the NBE to first build up higher foreign reserves to ward off vulnerabilities (Birr Metrics 2023). The restructuring of the financial sector is to be further promoted through the creation of capital markets. As of now, Ethiopia is the largest economy in the world without a stock exchange (Collins 2022: 606). This is set to change, however, as there are plans to establish the Ethiopian Securities Exchange in 2024, which is believed to help the private sector access finance and will provide the platform for the privatization of SOEs (Minney 2022).

Ethiopia's state-owned banks, CBE and DBE, have been put under the supervision of a newly founded agency, indicating again the PP's desire to uproot former governance structures (Meester et al. 2022: 49). In addition, there are plans to fundamentally reform the DBE's "overall business model and credit policy" (FDRE 2020a: 19). This appears to be partly in response to widespread corruption within the bank, which had led it to "reward politically connected but inefficient industrialists or firms […] without a proper assessment of project viability" (Araya 2022). Such practices have further fuelled the DBE's problem of non-performing loans, which have reportedly grown to 15 billion Birr (equivalent to USD 270 million) mainly as a result of the war and project failures (Mengesha 2023). Crucially, the 27 percent directive, which had channeled resources from commercial banks via NBE and DBE to priority sector projects, was repealed in 2019. This threatens to severely undermine the ability of Ethiopia's chief development finance institution to support priority sector development. The government expected this policy amendment to increase the provision of credit to the private sector (FDRE 2020a: 19), and this has indeed been the case since then, according to an MoPD official interviewed for this thesis (I-6). However, the reform is likely to lead to an increase in imports of consumer goods, which would exacerbate the foreign exchange shortage, and leave Ethiopia's productive sectors (which commercial banks have historically been unwilling to finance) short of funds. After all, this tendency of resources to flow into what the EPRDF saw as rent-seeking activities was the reason for the introduction of the instrument in the first place.

The PP government also shifted towards a more liberal trade policy. The decision to join the African Continental Free Trade Area (AfCFTA) was reportedly taken in March 2018, in the midst of the EPRDF leadership succession, reflecting the changing tide in the country (de Waal 2018: 11). Despite hopes for higher export earnings, state officials seem to also be aware of the detrimental effects this will likely have on the country. According to Gebremeskel Challa, the Minister of Trade and Regional Integration, regional free trade will not only reduce state revenue from tariffs but also impact Ethiopia's manufacturing sector: "Our market will be filled with Kenyan products, simply. This will be good for our consumers, but it will kill our country" (cited in Endale 2023). An MoPD official interviewed for this thesis also stressed that "there is no way we can compete with the established companies in Egypt, for example, in South Africa" (I-6). In 2020, the WTO accession process was also revived after an eight-year hiatus, and Ethiopia now appears much more eager to conclude a deal quickly. In the words of a high-level Ethiopian official cited in WTO (2020), the goal was now to "bring Ethiopia into the WTO within the shortest possible period, ideally not later than the end of 2021". While these efforts were disrupted by the war, they appear to have resumed since the implementation of the peace agreement. The PP's willingness to liberalize the hitherto closed telecom and financial sectors, long demanded by the WTO (Tomkinson 2019: 146), seem to help accelerate the process. While WTO membership would help diversify Ethiopia's export markets, the rules and regulations that come with it would effectively "lock in" much of the PP's liberal agenda, thus reducing policy space and making it much more difficult to return to more interventionist industrial policy strategies in the future.

In summary, the PP-led government under Abiy Ahmed has embarked on a decidedly neoliberal reform course. Privatization, financial sector restructuring, and trade liberalization all point to an eagerness to reduce state control over Ethiopia's economy. Although this will likely generate numerous lucrative investment opportunities for domestic and foreign capital, it poses serious questions for the future viability of structural transformation in Ethiopia. Privatization may be beneficial for immediate revenue generation, but in the long run it reduces the state's ability to directly steer the development of priority sectors. Similarly, while there are undoubted benefits to greater trade openness and deeper regional integration, Ethiopia's lack of competitiveness is likely to cost the domestic manufacturing sector dearly. Moreover, the rules of the multilateral trade and investment regime deeply impinge on the policymaking sovereignty of participating countries and make a return to developmentalism all but impossible. Arguably the most significant reform plans, however, concern the financial sector. Here, the prospect of foreign bank entry, the gradual shift to market-based forms of resource allocation, and the apparent disempowerment of the DBE represent a distinct departure from the EPRDF's previous approach to financial regulation. As for the economic effects of inviting foreign banks, an AAU economist interviewed for this thesis raised a critical issue:

> in the short run, they might bring some dollars with them, so they lend to the importers, to the exporters, or what other, industrialists, but […] at the end of the day, they have to generate the foreign exchange to expatriate, […] eventually to take away, you see? They can't pump in, always, they have to suck, later on, they have to take. (I-4)

While some of these changes may appear as small tweaks here and there, they are part of an overarching trend towards financialization. The question will ultimately be how these reforms will affect the flows of finance within the Ethiopian economy, and accordingly, how this will impact the prospects for manufacturing development. While it may be too early to tell, it is likely that the reduction of state control will result in priority sectors remaining underfunded, and that foreign bank entry will exacerbate foreign exchange shortages in the long run. Overall, these reforms constitute a radical shift in Ethiopia's policy orientation, and appear to undermine the country's already slim chances at economic development.

9.2. Neoliberalization and the remnants of developmentalism

To understand why these reforms took place, they must be seen in the context of the many interrelated problems that had accumulated during the later years of the EPRDF's rule. Domestically, weak economic performance, ethnic divisions and high unemployment had led to widespread popular discontent and thus to a crisis in the EPRDF's developmental hegemony. At the same time, with the growing risk of debt distress and the acute foreign exchange shortage, it had become increasingly difficult to access external sources of finance to uphold the existing import-intensive model. The latter was indeed identified as a key problem by the PP government in its HERA policy paper, stating that "external lenders would unlikely be willing to finance the status quo" (FDRE 2020a: 13). To appease both domestic constituencies and, crucially, the IFIs, donors, and private foreign lenders and investors, something had to change. This suggests that the PP's reform plans were, at least in part, designed to signal a willingness to reform in order to regain access to external loans and grants, not unlike the EPRDF's strategy in the early 1990s. An MoPD official interviewed in late 2022 argued in a similar way:

> [B]y the time the new government came to power in April 2018, I mean, the government coffer was, you know, totally empty, okay? So, you have to make some concessions […] with institutions such as IMF, okay? […] [P]resenting yourself as a reformist and all, you know, like, I will do this, and I will do that. (I-6)

The fact that the privatization of Ethiopian Airlines was announced with great determination, only for the government to later backpedal and cancel the plans, points in this direction. One MoF official also suspected that the plans to privatize Ethiopia's national airline were primarily intended to demonstrate "the government's ambition and the commitment" (I-7) to economic reform. A DBE official interviewed for this thesis suggested that the new PP government in fact directly followed the IFIs' policy advice in order to grants and loans, and that it was in a particularly weak bargaining position vis-à-vis these institutions due to the dire foreign exchange situation at the time of the transition:

> Ethiopia is totally dependent on capital from outside […]. But because of the instability issues […] nobody think that foreign direct investment can flow as it was before. So that will bring by itself a shortage of […] foreign exchange […]. Therefore, the government, the new administration wants to get something because the advice from IMF or World Bank is not just sending an advice, but it is tied with support. So, for the sake of getting that support, financial support, in terms of loan, or in terms of grant or any other scheme, the government wants to take the advice. (I-12)

This was also the understanding of the MoPD official, who noted that policymakers were aware of the detrimental effects of liberalization, but that they had had little choice:

> [S]ome of the people at the National Bank or at the Ministry of Finance, they know some of the measures that they are taking, to liberalize, you know, to devaluate, they know it will create a mess on the domestic economy. But what do you have? I mean, you have to somehow get these loans from IMF and all. They put you in a very difficult position (I-6)

Unsurprisingly, the PP's neoliberal reform agenda has indeed been celebrated by the IFIs and many core country governments, and has resulted in renewed political and financial support. Privatization, financial and telecom sector reforms, and liberalization of exchange rates and interest rates had long been demanded by official lenders and donors. In support of Ethiopia's HERA policy strategy, the IMF thus announced a USD 2.9 billion financing package in 2019 (Meester et al. 2022: 50). The Ethiopian government also secured USD 3 billion in aid and investment from the United Arab Emirates (van Wijk 2022: 107). If the aim was to regain the favor of IFIs and bilateral development partners, the PP has thus certainly succeeded.

To some extent, the neoliberal reform agenda must therefore be understood as a response to the crisis of the EPRDF's development model, which manifested itself in weak export revenues, growing indebtedness and the resulting foreign exchange shortages and refinancing difficulties. Presenting itself as an eager reformer may have in fact been necessary in order for the government to avoid defaulting on its debt and possibly having to implement even more far-reaching

IMF-mandated austerity measures. By unilaterally liberalizing, the PP at least managed to retain some degree of domestic control over economic policymaking. This is not to say that the PP's reforms are a kind of "developmentalism in disguise" but that neoliberalism was likely chosen not entirely out of conviction but out of necessity. The question, then, is whether Ethiopian developmentalism has been completely abandoned or whether there are significant continuities from the EPRDF era, and what this would mean for the country's economic prospects.

There are indeed some indications that what has happened in Ethiopia has not been a comprehensive neoliberal "shock therapy" but a more careful and deliberate process. For one, there appears to be an extent of continuity regarding the institutions involved in the preparation of the HERA and TYDP policy papers, instead of a complete bureaucratic renewal (Endale 2020). The emphasis on the importance of Ethiopia's private sector for the country's development, while now more forcefully argued, was not entirely new either. The EPRDF had long maintained the same position, and the PP now merely began to actually put this into practice.

Regarding financial sector liberalization, there also seem to be more nuances than initially apparent. While the planned entry of foreign banks is a move in a neoliberal direction, the government also announced that these banks would have to engage in joint ventures with domestic banks or establish local subsidiaries (Endeshaw 2023). This would at least ensure better state control over FDI in the banking sector and could lead to spill-over effects to domestic banks. One MoF official interviewed also expressed certainty that the government would mandate a rule similar to the 27 percent directive for eventual foreign bank entry: "when you give credit, this amount, you have to buy a bond, this amount, from the National Bank and then the National Bank will give it to the Development Bank, so that the Development Bank will avail it" (I-7). It is therefore likely that the liberalization of the financial sector will not take place in a "shock therapy" manner but will be a more cautious endeavor.

In a similar vein, Collins (2022: 602) sees privatization "not as an 'opening up' to the demands of global capitalism, but as a calculated policy decision existing within the logics of the state's developmentalist ideology". For her, privatization is not aimed at reducing state control but merely a policy tool for linkage creation and future revenue generation through taxation. However, while this might be true for the privatization of state-owned sugar factories, it is difficult to argue the same way for large strategic SOEs. Nevertheless, as noted above, privatization has made far slower progress than IFIs and private investors had initially hoped, suggesting again a rather careful approach.

And while IFIs have applauded the PP's reform package, they still seem to regard Ethiopia's development model as characterized by strong interventionism. According to a World Bank official cited in Endale (2020), "the tenets of developmental state are still in place in the [TYDP]. Active governmental role in the economy, dictating financial flow and crowding out the private sector are still in place".

When asked whether the PP government has ushered in the end of the Ethiopian developmental state, public officials interviewed for this thesis also gave very different answers. On the one hand, one official from the MoPD saw "a complete shift in the way the government view[s] […] what development is all about, […] who should run the wheel" (I-6), and a senior trade unionist described the Ethiopian developmental state as "dead" (I-9). One MoF official called the new agenda "a paradigm shift, factually" (I-11). Another MoF official, on the other hand, took the view that this was "[n]ot at all" (I-7) the end of the developmental state. Similarly, an MoI official described the reform process as "two steps forward and one step back" and does not "think it's being neoliberal, fully" (I-10).

These conflicting narratives are also reflected in ambiguous official statements made by high-ranking government representatives. For instance, between June 2019 and July 2020, State Minister of Fiscal Policy and Public Finance, Eyob Tekalign, promised that "the developmental state will continue for sure" (cited in Davison 2019) and that "government should play a strong coordination and leadership role in the economy" (cited in Sintayehu 2020). However, the minister also noted that the developmental state paradigm "is not a religion. If it is unworkable, there is no reason that prevents us from replacing it" (cited in Berhane 2019) and that "from the financial point of view, the developmental state model lacks clarity and brought no feasible results" (ibid.). Given these somewhat contradictory statements, the extent to which there are still developmentalist elements to Ethiopia's economic policy is therefore not entirely clear, at least from the outside.

Ultimately, what matters are the policies that are actually implemented and their impact on the Ethiopian economy. Despite some developmental continuities and an apparently cautious approach to economic reform, the PP's policy plans clearly point to a reduced role of the state in Ethiopia's development. The Ethiopian government has largely abandoned the developmental agenda of its predecessor and has instead acceded to the IFIs' longstanding demands for liberalization. A developmental state that implements neoliberal policies ceases to be developmental, whether it liberalizes out of ideological conviction or because of external pressure. Thus, while there are little indications of rapid “shock therapy”, Ethiopia has certainly undergone a creeping process of neoliberalization.

9.3. Ethiopia’s bleak economic outlook

The outbreak of civil war in late 2020 has complicated the PP government’s neoliberal policy reforms and deeply impacted the country’s already grim economic outlook. In late 2021, the US suspended Ethiopia’s AGOA status due to the war, thus withdrawing duty-free access to the US market (Meester et al. 2022: 155). Since the country’s GVC strategy relied heavily on exporting to the US, this had devastating consequences. PVH, the fashion giant producing in Hawassa Industrial Park subsequently closed its factories and left the country (Reuters 2021), and four industrial parks fully suspended operations in the wake of the conflict (World Bank 2022: xiv). An EIC official interviewed for this thesis highlighted the political dimension of the AGOA withdrawal, lamenting Ethiopia’s reliance on such preferential arrangements, and on FDI more generally:

> The US government is trying to use it as a controlling mechanism to Ethiopia. So, whenever they feel like, they can, like, pull it out and leave us in the dark. […]. Being dependent on some other countries’ policies and free trade privileges, yeah, that’s the negative part. (I-1)

Moreover, the 2019 IMF program was temporarily put on hold, as the US considered the Ethiopian government to be engaged in gross human rights violations and thus used its influence over the Fund to block the continuation of disbursements (Gramer 2023). The EU also froze close to 90 million euros in concessional finance (Meester et al. 2022: 55). ODA has fallen from USD 4.7 billion in 2020 to USD 3 billion in 2021 and further to 2.7 billion in 2022, a decline of more than 40 percent (UNDP 2023: 1). Overall, aid inflows between mid-2021 and mid-2023 were less than a quarter of what was expected, as development partners withheld promised funds in response to the war (Addis Standard 2023b). In addition, the country recorded an 11.9 percent decline in export earnings in 2022, mainly due to the price of coffee falling by over a third (Shemsu 2023). Ethiopia is thus now in an even more serious foreign exchange crisis than it had been at the beginning of the PP’s reign.

As a result, more than 200 Ethiopian manufacturing companies went out of business in 2022 due to lack of access to finance, especially foreign exchange (Tegegn 2023). As demand for foreign currency has increasingly outstripped scarce supply, the price on the parallel market has risen sharply, leading to a depreciation of the Birr and a widening of the gap between the official and parallel exchange rates (Addis Standard 2023b). This has in turn contributed to an inflation rate of over 30 percent and a severe cost of living crisis in Ethiopia, with many households struggling to afford basic food items (Reuters 2023b).

The intensification of economic crises has been reflected in declining GDP growth rates, slowing from the double-digit rates of the 2000s and 2010s to 5.3 percent in 2022 (World Bank 2023). And while the US has revised its position on Ethiopia in June 2023, paving the way to a possible reinstalment of Ethiopia's AGOA status (Gramer 2023), it remains questionable whether foreign companies will be willing to invest in the country's priority export sectors in the near future. Moreover, given the volatile economic situation and mounting debt pressure, the rating agency Fitch has further downgraded Ethiopia's status in early 2023, noting that "the country's external liquidity will continue to worsen" (Fitch Ratings 2023) and identifying a "significant risk of a default event" (ibid.). Refinancing existing debt has become much more difficult for the Ethiopian government. In addition to the lack of concessional flows, commercial lenders are also increasingly unwilling to step in, according to an MoPD official interviewed, who also emphasized how this has been influenced by the political dimension of Ethiopia-IFI relations:

> the private lenders […] pretty much follow what the IMF is saying about your economy, okay? […]. [N]ow, the fact that both the IMF and the World Bank, they paint this grim picture about the Ethiopian economy, […] it has an effect on the private lender as well. […]. So, the fact that you don't have a very good relationship with IMF or World Bank, it costs you a lot. (I-6)

Although Ethiopia applied for debt relief under the G20 Common Framework in early 2021, little progress has been made so far, which reportedly hinges on the IMF's demand that the Ethiopian government close the gap between the official and parallel exchange rates (Clynch 2023a). Further commitments to IFI conditions are likely to follow in order for Ethiopia to avoid a disorderly default. These conditional loans, in turn, will further undermine Ethiopia's prospects for economic development, and will hurt poor people most, as one AAU economist interviewed for this thesis noted:

> they [IMF and World Bank] force the government and the government, you know, dumps it to the people, and the people are suffering. Devaluation, devaluation, people are suffering, not the government. And they call it progress, they call it, you know, compliance to IMF. (I-4)

Overall, Ethiopia's economy is in deep crisis. Political unrest, weak exports, and mounting debt have plagued the country for years. The result has been an ever-worsening shortage of foreign currency, which not only hampers essential imports and leads to inflation and deindustrialization but also opens the door to external demands for SAP-style liberalization, primarily from the IFIs. Since the civil war, these problems have intensified to such an extent that "the bargaining power of the country has weakened, even, to resist the advice from these organizations", according to a DBE official interviewed (I-12). The Ethiopian government may now have little choice but to follow the ever more far-reaching prescriptions of the IMF and its peers.

9.4. Conclusion: the demise of the Ethiopian developmental state

Since the dissolution of the EPRDF in 2019, Ethiopia has undergone a shift towards a neoliberal economic and industrial policy orientation. After the limited success of structural transformation and equitable economic development in Ethiopia, social unrest became widespread, and the country eventually spiraled into civil war.

Ethiopia's new ruling party, the PP, has promised far-reaching economic reforms, including privatization, financial sector reforms, and trade liberalization. In an effort to empower the domestic private sector, the PP announced the privatization of some of Ethiopia's largest SOEs, including Ethiopian Airlines and Ethio Telecom. While plans to sell the country's national airline have been cancelled, the telecom sector was liberalized fairly quickly, indicating a stark departure from the EPRDF era. Some of the most far-reaching reforms concern the financial sector, where the PP announced that it would allow the entry of foreign banks, as well as liberalize interest rates, and gradually move to a flexible exchange rate regime. With the repeal of the 27 percent directive and other broad reform plans, the role and effectiveness of the DBE is set to decline. Taken together, these policy changes are likely to reduce state control over patterns of resource allocation and may lead to less direct support to priority sectors. In terms of trade policy, Ethiopia has joined the AfCFTA as well as revived its WTO accession process. The PP thus seems to strive for regional and global trade integration as quickly as possible, which can help boost exports but will likely lead to deindustrialization, in addition to constraining policymaking options in the future. Overall, the PP government's policy agenda follows neoliberal orthodoxy and mirrors the long-standing prescriptions of the IMF and World Bank.

These changes need to be seen in the context of the EPRDF's failure to achieve export growth and structural transformation. Persistent deficits, a growing debt burden and the resultant foreign exchange shortage have made it all but impossible to continue with the previous government's growth model. In order to maintain access to flows of external finance, the PP government needed to signal its willingness to reform, which invariably had to involve substantial liberalization in order to appease donors, lenders, and investors. Beyond what is possibly a genuine commitment to neoliberalism, there is thus a certain element of external pressure to the PP's reform agenda. The policy prescriptions mandated by the IMF echo Chang's (2002) notion of "kicking away the ladder". And while there are indications that some degree of developmental thought persists in Ethiopia, in reality – in terms of policy – this is largely inconsequential.

In the few years since Abiy Ahmed became prime minister of Ethiopia, the country's economic situation has only worsened. The civil war has not only led to immense human suffering but also reduced Ethiopia's already slim prospects for economic development. Declining export earnings, mounting debt, inflation, further deindustrialization, and weak GDP growth paint a bleak picture. Ethiopia is now in desperate need of debt relief and additional funding, which is likely to lead only to further liberalization. And since the IFIs' cure is often even worse than the disease, this will not solve Ethiopia's problems but may instead exacerbate them.

10. Conclusion: the limits to structural transformation in Ethiopia

The aim of this thesis was to paint a picture of what it takes for a poor country to attain structural transformation in the 21st century – and what is holding it back. To this end, I drew on a wide range of literatures, from dependency theory and Latin American structuralism to developmental state theory and other heterodox industrial policy approaches, as well as those that criticize the hurdles placed in the way of economic development in the periphery. As a case study, I tried to assess the ways in which the Ethiopian state, primarily during the tenure of the EPRDF between 1991 and 2019, tried to navigate the developmental constraints of the imperialist world system. The thesis was split into three parts, with Part I. laying the meta-theoretical and methodological groundwork for the subsequent analysis of the global context in Part II. and the Ethiopian experience of state-led developmentalism in Part III.

Overall, the thesis found that, despite remarkable progress, the development of Ethiopia's productive capacities and thus the country's process of structural transformation has been undermined by a complex interplay of internal and external pressures and constraints. Key among these were the inability of domestic firms to sufficiently acquire technological capabilities (partly due to unequal power relations in GVCs), limited success in the creation of linkages and in import substitution, unfavorable political conditions, and severe shortages of foreign exchange. Ethiopia's weak economic performance, its persistent trade deficit, and the resulting deteriorating external debt situation eventually led to the adoption of neoliberal policies, raising questions about the future viability of interventionist industrial policy in the country.

10.1. Summary of main findings

This analysis was grounded in the ontology and epistemology of critical realism, a philosophy of science approach introduced in Chapter 2 that is committed to ontological realism, epistemological relativism, and judgmental rationality. Critical realism posits that there is a reality independent of our perceptions, and that it is ontologically stratified into three layers: the empirical, the actual, and the real. In this understanding, science should strive to explain the interplay of (not directly observable) mechanisms that operate in the real domain. Critical realism also emphasizes the interplay between structures and human agency in shaping social phenomena. This perspective is crucial for this thesis, as it focuses on the complex interactions between the Ethiopian state and global structures and agents. The chapter also introduced CIPE, a theoretical framework that draws on historical materialism and critical realism. CIPE scholars examine the uneven global development of capitalism, leading to asymmetric relationships between countries. Together with related but less abstract theoretical bodies, such as dependency theory, this approach provides a valuable foundation for analyzing the dynamics of Ethiopian developmentalism within the broader context of the imperialist world economy, shedding light on the complexities of peripheral state interaction with internal and external forces.

Chapter 3 then offered some epistemological and methodological considerations for the proceedings of this thesis. Critical realism emphasizes that any explanation of the world is situated in specific historical contexts and can be fallible and contestable. It rejects the notion that knowledge can be derived directly from reality, emphasizing the role of theories and concepts as lenses through which we perceive the world. Based on this understanding, methodology in critical realism prioritizes dialectical reasoning and theoretically grounded analysis over specific methods. In this thesis, I therefore critically engaged with existing literatures on economic development in general and in Ethiopia in particular. Additionally, I drew on 12 semi-structured interviews that were conducted with officials from Ethiopian ministries and state agencies, one academic economist, and representatives from the trade union confederation, the chamber of commerce, and international organizations.

Part II. of this thesis turned to the global context in which Ethiopian developmentalism operates. In Chapter 4, I examined relations of dependency and core-periphery polarization, reflected in the international division of labor. Dependency theory, rooted in the critique of but also building on Latin American structuralism, provided insights into the unequal patterns of power, productivity, and specialization in global capitalism. These dynamics were linked to Marxist theories of imperialism that emphasize the centrality of technological disparities and value transfers. Mechanisms such as unequal exchange, deteriorating terms of trade, transfers of capital and labor, and productivity differentials perpetuate this inequality, with neoliberal globalization adding to the complexity through the rise of GVCs and financialization.

Some possible ways out of peripherality, particularly through the processes of structural transformation and industrialization, were explored in Chapter 5. The chapter emphasized the importance of political will as the necessary precondition for such development. In this context, the concepts of delinking (submitting international integration to the goals of national development) and developmentalism (state-led efforts to accumulate technological capabilities and hence achieve economic development) were found to provide useful analytical tools. Based on these broad political orientations, interventionist industrial policy describes targeted government measures to strengthen certain economic activities, particularly the manufacturing sector, in order to drive structural transformation. The chapter also addressed the significance of domestic and transnational class relations and the role of the state for the viability of developmentalism. In this regard, the chapter drew specifically on the (historically extraordinary) experience of East Asian developmental states, which were characterized by collaborative relations between state, bureaucracy, and industrial capitalists. This allowed for embedded autonomy and enabled the state to implement "carrots and sticks" policies in order to incentivize and discipline private capital to invest in technological learning. Different industrial policy strategies and corresponding instruments focusing on import substitution, export promotion, and GVC participation were also discussed, as well as the role of linkages and agricultural development in the process of structural transformation. Finally, heterodox insights on development finance showed that developmental states need to take control over the flow of resources, both domestic and external.

The last chapter of Part II., Chapter 6, focused on the difficulties peripheral developmental states face in their pursuit of structural transformation, and in particular those that result from their subordinate position in global capitalism. For analytical reasons, these were divided into economic and political constraints. Economic constraints include chronic foreign exchange shortages due to unfavorable specialization and outflows of value, power relations and other adverse effects of GVC participation and reliance on FDI, and subordinate financialization, which can limit financing for productive activities and heighten vulnerabilities. Political constraints revolve around limitations on policy space imposed by external debt and the risk of neoliberal structural adjustment, donor influence and aid conditionalities, global trade and investment agreements, and the potential for violent intervention by powerful states. These constraints not only hamper the efforts of peripheral countries to escape dependency, but also illustrate the power relations inherent to the world economy and highlight the complex interplay between internal and external processes in the context of structural transformation.

One peripheral country that actively resisted these difficulties was Ethiopia. In Part III. of this thesis, I thus turned to the historical trajectory of the Ethiopian developmental state, characterized by the ruling EPRDF party's distinct commitment to structural transformation. By looking at the case of Ethiopia, I was able to assess the concrete ways in which transnational constraints manifest themselves in peripheral countries, as well as the prospects and limitations of countervailing developmental strategies.

In the first chapter of Part III., Chapter 7, I traced the early years of the EPRDF's rule until the early to mid-2000s. The party came to power after a civil war that left the country and its economy in shambles. Early developmental aspirations focused on agricultural transformation, given the EPRDF's peasant constituency and the sector's propensity to create linkages. As one of the world's poorest countries, Ethiopia was heavily dependent on external funding. However, despite clear efforts by the IFIs to impose liberal policy prescriptions, the new government showed a strong dedication to maintaining state control over the "commanding heights" of the economy. This resistance to external pressures for liberalization and the EPRDF's overall commitment to national policy ownership would become a defining feature of Ethiopian developmentalism. Thus, in prioritizing agricultural development, inter-sectoral linkages, state ownership, and policy space, this early era already showed considerable overlap with the heterodox policy orientation outlined in Part II. The EPRDF's developmental trajectory shifted in the early 2000s, when internal leadership struggles and a near electoral defeat resulted in a renewed focus on structural transformation, or in the words of Meles Zenawi, the "single-minded pursuit of accelerated development" (cited in Weis 2016: 294).

The mid-2000s thus saw the emergence of what has since come to be regarded as an Ethiopian developmental state, the achievements and failures of which were discussed in Chapter 8. During this period, which lasted roughly until 2019, the state invested heavily in the expansion of physical infrastructure; used SOEs and targeted industrial policies to develop strategic industries, substitute imports, and promote exports; employed highly interventionist financial policies and aid management techniques to channel domestic and foreign resources into priority sectors; and later strove for GVC integration by encouraging FDI into state-owned industrial parks. This agenda, which largely mirrored the heterodox policy stance, was enshrined in a series of five-year development plans.

As a result of these efforts, Ethiopia came to be one of the fastest growing economies in the world. This was largely based on public investment, infrastructure development, and the expansion of the service sector. By contrast, the growth and development of the manufacturing sector stagnated, and its share in Ethiopia's GDP remained very low, despite targeted industrial policy attention. This has mainly been due to a lack of credit from domestic banks, foreign exchange shortages, high trade costs, an overvalued exchange rate, insufficient domestically produced inputs, limited technological learning, and therefore a lack of productivity and competitiveness. Moreover, the unwillingness or inability of domestic capitalists to invest in productive activities, ethnic divisions and political instability, mutual distrust between the state and the private sector, and a resulting absence of embedded autonomy further compounded the lack of structural transformation. While the EPRDF's approach to development finance and financial sector regulation, including preferential lending to priority sectors by state-owned banks, mitigated some of these problems (and helped avoid some of the most severe effects of subordinate financialization), it was not enough to overcome the country's developmental challenges. This was reflected in persistent trade deficits, escalating external debt, and an ever-growing debt service burden.

In 2018, Abiy Ahmed became prime minister of Ethiopia and swiftly began implementing neoliberal policy reforms, conforming to the long-standing demands of the IFIs. The period since then, which also included the dissolution of the EPRDF in 2019 and a two-year civil war between 2020 and 2022, was discussed in the final chapter of this thesis, Chapter 9. The newly formed PP government promised the privatization of some of Ethiopia's largest SOEs, wide-ranging financial sector reform (including opening up to foreign investors), and trade liberalization. In many ways, this new agenda represents a complete reversal of the EPRDF's previous development strategies. While it may be too early to tell, in the long run these reforms are likely to reduce the Ethiopian state's control over the flow of resources in the economy and undermine the country's already slim prospects for industrialization.

10.2. Concluding remarks

Ultimately, the EPRDF's import- and debt-intensive development model proved unable to build technological capabilities fast enough to achieve substantial export diversification and growth, which could have enabled the state to withstand external pressures for liberalization, especially from the IFIs. Better economic outcomes could have also secured domestic performance legitimacy and strengthened the hegemony of the EPRDF's developmental state. Instead, widespread unemployment, ethnic grievances, and the overall absence of equitable development made the system unsustainable. These factors, in combination with a domestic ("rent-seeking") bourgeoisie that wanted to rid itself of the EPRDF's suppression, eventually led to the party's downfall. The shift towards neoliberalism thus underscores the vulnerability of developmentalism in the face of persistent internal and external developmental challenges and pressures.

Although not solely responsible for the lack of structural transformation in Ethiopia, the external constraints discussed in Chapter 6 provided a challenging environment for the EPRDF's developmentalism to operate in, and have conditioned the trajectory and outcomes of the country's industrial policy strategies. External constraints have therefore significantly, albeit to very different degrees, contributed to the perpetuation of technological lagging and peripherality in Ethiopia. Key among those were the foreign exchange constraint, external debt, and the practices of "ladder-kicking" by the IFIs. The fact that some of the constraints, notably financialization and the rules and regulations of the global trade and investment regime, have overall had a muted direct impact on Ethiopia's economy is largely due to the concerted efforts of the EPRDF, including its heterodox way of managing aid relations. Other constraints, however, could not be navigated in a similar manner. As has been noted many times, the importance of sufficient foreign exchange for structural transformation can hardly be overstated. In Ethiopia, import substitution and export growth did not proceed fast enough to close the trade deficit and prevent the escalation of external debt, which, among other things, undermined further refinancing. Without sustained flows of concessional and largely unconditional flows of external finance, which historically covered the deficits of US-allied late industrializers, this has reduced the room for maneuver and the margin of error for Ethiopia, and for contemporary developmental states in general. This also illustrates once again that the East Asian experience is, for the most part, not replicable. Ethiopia's foreign exchange shortage has also partly been due to the global sourcing strategies of TNCs and the fallacy of composition in the apparel and leather GVCs. While the EPRDF tried (largely with limited success) to influence local learning patterns and investment decisions through industrial policy, these external dynamics are not under the control of a peripheral state. In the end, therefore, the unequalizing tendencies of the global economy, combined with the domestic constraints plaguing the country, were too powerful for Ethiopia to overcome. As a UNIDO official interviewed for this thesis noted, "there's some struggle visible – struggle to break out – but […] it's not good enough" (I-5).

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Annex

Interviews conducted for this thesis		
Code	Organization	Date and modality
I-1	Ethiopian Investment Commission (EIC)	Oct. 25, 2022 – in person
I-2	United Nations Economic Commission for Africa (UNECA)	Oct. 26, 2022 – in person
I-3	Industrial Parks Development Corporation (IPDC)	Oct. 28, 2022 – in person
I-4	Addis Ababa University (AAU)	Oct. 31, 2022 – in person
I-5	United Nations Industrial Development Organization (UNIDO)	Nov. 3, 2022 – in person
I-6	Ministry of Planning and Development (MoPD)	Nov. 7, 2022 – in person
I-7	Ministry of Finance (MoF)	Nov. 9, 2022 – in person
I-8	Ethiopian Chamber of Commerce and Sectoral Associations (ECCSA)	Nov. 10, 2022 – in person
I-9	Confederation of Ethiopian Trade Unions (CETU)	Nov. 10, 2022 – in person
I-10	Ministry of Industry (MoI)	Nov. 11, 2022 – in person
I-11	Ministry of Finance (MoF)	Nov. 17, 2022 – in person
I-12	Development Bank of Ethiopia (DBE)	Dec. 19, 2022 – online

Abstract
This thesis investigates the challenges surrounding structural transformation and industrial policy in 21st century peripheral countries, with a special focus on the developmental journey of Ethiopia. It provides insights into the unequalizing workings of the world economy, highlighting global core-periphery polarization and the role of technological lagging and transfers of value. The thesis discusses developmental strategies that have historically been used by late industrializing countries, and examines the economic and political constraints that undermine peripheral attempts at structural transformation. Ethiopia, often hailed for its unconventional policies and impressive growth rates, serves as a case study to analyze how a poor country navigates the complexities of developmental constraints in its quest for economic development. Based on an in-depth literature review and 12 semi-structured interviews conducted in Ethiopia and online between October and December 2022, the thesis finds that, despite targeted efforts and remarkable progress, structural transformation in Ethiopia has been hindered by a complex interplay of internal and external pressures and constraints. These include a lack of credit for the manufacturing sector, difficulties in acquiring technological capabilities, limited success in creating linkages and fostering import substitution and export growth, political and ethnic grievances, foreign exchange shortages, external debt, and pressure from international financial institutions. Ultimately, the thesis discussed how Ethiopia's economic struggles and the failure to achieve structural transformation have led to the adoption of neoliberal policies, raising questions about the future of interventionist industrial policy in the country.

Kurzfassung
Diese Masterarbeit befasst sich mit den Herausforderungen und Schwierigkeiten, die mit Strukturwandel und Industriepolitik in peripheren Ländern des 21. Jahrhunderts verbunden sind, mit besonderem Fokus auf die Entwicklung Äthiopiens. Sie bietet Einblicke in die Funktionsweisen des kapitalistischen Weltsystems und skizziert Dynamiken globaler Kern-Peripherie-Polarisierung sowie die Rolle von technologischen Rückständen und Werttransfers. Die Arbeit diskutiert Entwicklungsstrategien, die in historischen Fällen nachholender Industrialisierung angewandt wurden und untersucht die wirtschaftlichen und politischen Hindernisse, die die Bemühungen der Peripherie um strukturelle Transformation untergraben. Äthiopien, das lange für seine unkonventionelle Politik und seine hohen Wachstumsraten gelobt wurde, dient als Fallstudie, um zu analysieren, wie ein peripheres Land versucht, solche Entwicklungshindernisse zu überwinden. Aufbauend auf einer umfassenden Literaturrecherche und zwölf semi-strukturierten Interviews, die zwischen Oktober und Dezember 2022 in Äthiopien und online durchgeführt wurden, kommt die Arbeit zu dem Schluss, dass der Strukturwandel in Äthiopien trotz gezielter Bemühungen und bemerkenswerter Fortschritte durch ein komplexes Zusammenspiel interner und externer Faktoren behindert wurde. Dazu zählen ein Mangel an Krediten für den Industriesektor, Schwierigkeiten bei der Aneignung technologischer Fähigkeiten, begrenzte Erfolge bezüglich Linkages, Importsubstitution und Exportwachstum, politische und ethnische Widrigkeiten, Fremdwährungsknappheit, Auslandsverschuldung und Druck seitens internationaler Finanzinstitutionen. Die Arbeit diskutiert abschließend, wie die wirtschaftlichen Probleme des Landes und das Scheitern der strukturellen Transformation zu einer neoliberalen Wende geführt haben, was Fragen nach der Zukunft interventionistischer Industriepolitik in Äthiopien aufwirft.