Briefing Note #6:

Sugar industry in the Lower Omo: Exploring different scenarios of privatization

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About this Research

The Ethiopian government has pursued over the past decade a strategy of expanding sugar production to meet local demand and to generate foreign revenue. To date this has been mostly state-led, with core operations in the hands of parastatals, notably the Ethiopian Sugar Corporation. In the past six months, however, the Ethiopian government has offered four of its largest sugar estates for sale to private investors. This briefing note explores the impact of the privatization of the estates on local communities through a scenario analysis. The major factors determining the possible scenarios are the investors' business models and the capacity of local communities to negotiate for their own interests. This policy brief recommends that the government should situate community interests among the top priorities in the auction and privatization of sugar estates, and that private investors (jointly with the government) should explore policy options and business models to mitigate undesired outcomes and to ensure benefit sharing and participation by local communities.

Context

As of May 2019, the Ethiopian state is actively seeking investors for sugar cane estates in South Omo and Bench-Maji Zones (located at the south western margins of the country) including the four processing factories of the Kuraz Sugar Development Project (KSDP), which were initially run by the state-owned Ethiopian Sugar Corporation (ESC).[i] The impact of the KSDP on local communities in Lower Omo has been a topic of interest among academics and policy makers nationally and internationally.[ii] Most commentators have assumed that KSDP would remain a government owned enterprise, ignoring the possibility of its privatization.[iii] This briefing note explores potential impacts of privatization by mapping three basic scenarios:

(1) Decision of investors is mainly driven by commercial interests: maximizing profits and neglecting human and environmental costs.

(2) Only minimal benefits are provided to local communities, e.g. low paying jobs for those employed in sugar factories

(3) Due consideration is given to the interests of local communities, with an emphasis on benefit-sharing and on meeting or surpassing development goals declared by the Ethiopian government

The realization of these scenarios is determined by political and regulatory changes. They are therefore not mutually exclusive but exemplify different tendencies.

The sugar industry in the Lower Omo Valley

The construction of the Gilgel-Gibe III hydropower dam in 2006 marked the beginning of river basin development in the Lower Omo. Downstream sugarcane irrigation formed a central component of this plan (See Box 1).

Box 1. Sugar industrialisation plans

- The Ethiopian government's Growth and Transformation Plan (GTP) (2010/11-2014/15) foresaw the construction of ten processing factories, including the expansion of sugarcane plantations over hundreds of thousands of hectares across Ethiopia.
- With an initial target of 175,000 hectares and 5 factories Kuraz was the largest venture of its kind. Its estates spanned three administrative zones in southwest Ethiopia -- South Omo, Bench-Maji, and Kaffa.
- Land clearing, waterworks for irrigation, and the construction of transportation infrastructure and processing factories for the Kuraz project first started in 2012 in Salamago district of South Omo Zone (Omo I and II), then Bench-Maji Zone (Omo III). Irrigation and factory works are still underway in Nyangatom

The Omo-Turkana Research Network is an international consortium of social and environmental scientists researching the impacts of hydrological, agricultural, and social change on the people and ecosystems surrounding the Lower Omo Valley and Lake Turkana.

After nearly a decade of planning and implementation, sugar industrialization in the Lower Omo has increased the country's foreign debt burden, without altering the country's reliance on imported sugar.[iv] Partly as a result of this impasse, major policy reforms were announced in June 2018 by the administration of Prime Minister Abiy Ahmed with the objective of partially or wholly privatizing state-owned enterprises (SOE), including sugar estates.[v] Ten months later, in April 2019, the Ministry of Finance and ESC invited interested companies to complete a Request for Information (RFI). The primary aim of this pre-privatization process is to transfer partial or full ownership of state-owned sugar estates to private investors and reduce the large foreign debt load of the country.[vi]

Several foreign investors expressed interest in acquiring estates forming part of KSDP.[vii] The evaluation of assets, including debt load, began shortly afterwards—a challenging task due to complicated funding and financing structures.[viii] Although way behind expectations in terms of cultivated area and processing capacity, the Kuraz project and related infrastructure developments have had far-reaching effects on the socio-economic situation in the Lower Omo Valley.[ix] The indigenous agro-pastoralist population has not been compensated for the loss of land and water resources allocated to sugar cultivation along the banks of the Omo River. One reason are the prevailing agro-pastoralist resource use strategies which, in contrast to sedentary farming societies, do not provide evidence of perennial land usage. Agro-pastoralist communities follow seasonal migration patterns with their herds and therefore land can easily be misunderstood as being vacant, unused, and unclaimed.

Furthermore, the regulation of the Omo River's flood cycle through the Gilgil-Gibe III dam renders the continuation of flood recession agriculture – a mainstay of the local economy – impossible.[x] Households that have lost access to fertile riverbanks for cultivation were promised employment and training opportunities on KSDP in addition to access to small-scale irrigation schemes provided by ESC. However, only limited job opportunities were provided through a program that included skill training to increase the employability of the local community.[xi] There were also plans to form sugarcane outgrowing associations facilitating communities' transition from agro-pastoralism to intensive agriculture. In Salamago district of South Omo Zone, households were given 0.75 hectare irrigated land, reaching up to a total of 1,654 hectares, on the understanding they would sell their produce to the factory.[xii] Due to delays in completion of the sugar factories, however, the crops grown by outgrowers were not purchased; and the communities' bargaining power was undermined by the existence of only one potential buyer. Various studies suggest a need for additional measures to mitigate negative impacts and achieve improvement of the quality of the life of agro-pastoralists.[xiii]

Key Findings

Privatization and shifting objectives of sugar industrialization

Sugar industrialization as pursued by the KSDP may serve as an allegory for the projects of the Ethiopian Developmental State in the pastoral lowlands. The objectives of KSDP fall into three main intersecting categories: *macroeconomic* (i.e. employment creation), *agro-economic* (i.e. export revenues, fulfilment of domestic demand), and *developmental* (i.e. modernization of agro-pastoralist livelihoods). While the ESC as a state-owned corporation is committed to achieve this threefold objective, the implementation and operationalization of the project will be largely determined by the commercial and economic considerations of the private investors. A central question is how investors will make allowance for the *developmental* goals of KSDP, including the mitigation measures outlined above.

Our scenario mapping (shown in Figure 1) is based on the assumption that the degree and type of socio-economic impacts depends on two factors. First, the terms and conditions of privatization as stipulated in the contracts (e.g. employment guarantees, training programs, social services) and second, the inclusion of local communities' interests or their ability to negotiate for them. We restrict our analysis to the communities directly affected by KSDP, i.e., the Bodi and Mursi in Salamago district and the Nyangatom in Nyangatom district. Our three scenarios are:

Scenario I: Under this scenario, the decision of the investor is mainly driven by commercial and economic factors aiming to make the highest profits over the shortest possible time (e.g. mechanization of harvest) disregarding environmental, labor, or social safeguards because the government has not created the contractual obligation to do so. We consider the likelihood of this situation as high. In the eyes of private investors, social services, for instance, should be the government's responsibility to deliver utilizing tax revenues. Similarly, government regulations with regard to the investor's responsibility towards the community either do not exist or are not enforced effectively in light of competing interests of increased foreign currency revenues and the fulfilment of domestic demand for sugar.

A likely outcome of Scenario I is that local agro-pastoral groups will be put under further strain, deepening their impoverishment and potentially contributing to more frequent and severe violent conflicts in the area. As a consequence, the government will be forced to take security measures to pacify the area and to protect the interests of the sugar estate and the labor force. Overall, Scenario I could then result in a vicious cycle of impoverishment and violence.

Scenario II: Given a strong engagement from either the government or local communities, the investor will comply with a minimum level of benefit-sharing as initially promised by the government to the local community, including provision of low-paying jobs and allowing local communities to use cane tops as fodder and fuel. This will enable agro-pastoral communities to benefit from some opportunities offered by industrialization. The sugarcane tops will, however, not substitute for lost grazing land, and available jobs will not be sufficient to compensate for the economic losses due to increasing constraints on agro-pastoralist livelihoods.

This scenario is not significantly different from what might be expected under continued state ownership of the sugar estates. The agro-pastoral groups will continue to face pressure from the resource alienation and other negative impacts related to altered resource use. The net impact on local communities would be predominantly negative, and similar to the experience of sugar industrialization in the Awash Valley from the 1960s onwards.[xiv] As in Scenario I, this might lead to a cycle of violence, potentially affecting the operationalization of the estates.

Scenario III: The government will exert regulatory pressure on private investors to support community interests, and / or the community strongly resists exploitative policies. The business model of the investor will then give appropriate consideration to the threefold goals envisioned by the Ethiopian government at the initial planning and implementation stage of the project. The developmental objectives of the project will be taken seriously and adapted to local realities and needs, making the community a partner in industrialization and ensuring minimal negative consequences or potentially net positive returns to the agro-pastoralists. At the same time, conflict dynamics could change for the better due to reduced competition over resources and higher operational security of the estates. Employment opportunities for the local community will not be limited to low and medium level jobs. Employers will design positions with various transferable skills, including leadership roles, and provide development opportunities for local communities. The provision of skills could be realized through a government-initiated inclusion of such benefits in the sale of the estates or high community service standards of the private investor. In addition to creating the least negative impacts, and potentially positive impacts, for the local community, this scenario will be beneficial to the government as the investors will fulfil (most/all) social service delivery needs of the agro-pastoralists and there will be limited security tension as a result.

Policy backing community needs

Scenario II

- Strong government interest but weak community engagement, leads to private sector delivering minimum level of benefits
- Low-paying, medium-skilled jobs

Scenario III

- Government attempts are supported by community engagement; highest possible level of benefit delivered
- High-paying, high-skilled jobs

Weak benefit negotiating ability by community

Strong benefit negotiating ability by community

Scenario I

- Weak government interest, weak community engagement, investor exclusively focused on profit
- No jobs or low-paying, low-skilled jobs.

Scenario II

- Weak government interest, but strong community engagement, leads to private sector compromising and delivering minimum benefits
- Low-paying, medium-skilled jobs

Policy ignoring community needs

Figure 1: Scenarios for the privatization of the sugar industry in the Lower Omo

Policy Recommendations

Despite the failure of the KSDP to deliver on expectations to date, Ethiopia's new government is not showing signs of rolling back sugar industrialization plans in the lowlands. Instead, it is betting on privatization to bring in the capital and skills to complete its developmental agenda.[xv] The government, at least at the level of discourse, is committed to a range of social protection measures to local communities (see Scenarios I and II); privatization is likely to change the approach to these measures. Private investors are likely to ensure that the government secures their interests to attain the highest possible returns on investment (see Scenario I). Scenarios I and II therefore appear more likely than the more desirable Scenario III. If precautionary steps are not taken, privatization will happen at the expense of the indigenous local communities. To mitigate against this outcome, we recommend the following:

(A) Inclusion

- Genuine consultations on the terms of privatization and on the planned scope of work to be pursued by the buyer – although long overdue – could increase the chances of local acceptance of the project and reduce grievances.
- Commitment by investors to provide jobs, training, and education programs to members of the indigenous local communities would facilitate their inclusion in the estate economy.

(B) Mitigation

- Promoting corporate social responsibility in education, health, agriculture, and veterinary care – including provision of food aid and small-scale irrigation systems – would help compensate for economic losses due e.g. to the end of flood retreat agriculture.
- Wider benefit-sharing arrangements might be based on payment of land rent fees to district governments. In the recent past, the average land rent fee was approx. 111 Birr per hectare per year, considering the distance from Addis Ababa and proximity to water resources.[xvi] On this basis Nyangatom district (where the ESC is establishing a plantation of approx. 50,000 ha), would receive approx. 5 million Birr annually. This could be used by the local government to buffer the community from negative impacts. This approach would be consistent with current discourses on benefit sharing in the extractive sector.[xvii]
- Although precedents of water use fees are not available in Ethiopia, a newly established Commission within the Ministry of Water, Irrigation and Energy could redistribute fees it collects from buyers back to the local community.

(C) Adapted business models

- The conversation on the privatization of sugar factories in the Awash valley, namely Metehara and Wonji-Shoa sugar factories, has proved the potential for partial ownership by the neighboring communities and those working for the estates. The share company seeking to buy these estates, Ethio Sugar SC, is planning to provide three million shares to 60,000 shareholders, of which 11,000 will be local farmers, 20,000 factory workers and 10,000 public servants in Oromia.[xviii] The Southern Nations Nationalities and Peoples' Region (SNNPR) state might not have the political interest or resources to undertake such a task on behalf of the Lower Omo. However, the South Omo Zone administration could explore similar options as one of the stakeholders in the privatization of the sugar factories.
- In the condition where the local community will be provided an opportunity for shareholding, credit and financing opportunities should be put in place. A resource already provided by the community to the projects – land – can be accounted for in share prices. This would however require change to the current *terra nullius* model of valuation, under which the land 'taken' from the people and 'given' to the factories is valued as 'unused' and therefore 'free'.
- There should be clear legal conditions set out for companies that seek to branch out to other sectors after investing in factories. A precedent exists for investors in Ethiopia using initial investments as a stepping-stone to more lucrative ones. If, for example, investors were to enter the cattle ranching market in the Lower Omo, the competition would risk pushing agro-pastoralists into deeper poverty: given their alienation from grazing land they are susceptible to selling their cattle at low prices. A more sensitive approach to development of cattle markets would be to support cooperatives run by local youth in synergy with the sugar factories, for example using by-products such as molasses and cane tops.

Concluding Remarks

This policy brief presents possible consequences of the privatization of sugar estates in Lower Omo. Depending on the approaches taken by investors, the Ethiopian government, and local communities, privatization could either alleviate or exacerbate social and economic hardships in the region. We urge the government and other stakeholders to reflect on the scenarios we have sketched, and to promote and pursue policy options that will (1) ensure inclusion of local communities, (2) mitigate negative effects and (3) explore options for adapted business models.

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