

# Agglomeration Advantages in the Developing World: Identification and Micro-mechanisms

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March 2016

## Abstract

Credible evidence on the magnitude and sources of agglomeration advantages is still limited, particularly in the developing world. In this paper we study agglomeration advantages in the context of Ethiopian manufacturing sector. Since the late 1990s, the Ethiopian government has made the expansion of the manufacturing sector a priority. Foreign direct investment (FDI) has been viewed by the government as critical to technology upgrading in this sector. As a result, a variety of incentives were put in place to attract FDI and Ethiopia's new investment code was translated into English and publicized widely in 2002. The result has been a dramatic increase in FDI flows to Ethiopia's manufacturing sector. We use Ethiopia's industrial census for the period 1996 to 2014 combined with a technology transfer survey module designed by us to assess the impact of FDI on productivity in Ethiopia's manufacturing sector. Our identification strategy exploits government designation of locations for large greenfield foreign direct investments. Using this strategy, we show preliminary evidence that FDI has a positive impact on local firms' productivity. We then use the technology transfer module to explore the micro mechanisms of agglomeration advantages. We find that technology transfer occurred via labor flows from foreign to domestic firms, knowledge spillovers, and linkages between domestic suppliers and foreign firms. We are currently pursuing an alternative identification strategy which relies on a comparison of geographic locations surrounding 'planned' investments to geographic locations that received 'actual' investments.

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