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Determinants and Impediments of FDI inflows in Ethiopia- A Firm Level Investigation

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Abstract

From a neo liberalist's perspective FDI triggers technology spillovers, assists human capital formation, contributes to international trade integration, helps to create a more competitive business environment and enhances enterprise development. This will contribute to higher economic growth, which is the most potent tool for poverty alleviation. To realize these benefits, many African countries including Ethiopia, have liberalized their trade regime and attempted to create an investment friendly climate through improving their infrastructures and adjusting microeconomic instabilities. Ethiopia has shown significant increase in FDI inflows, though it accounts among the least share (as a percentage of GDP) in sub-Saharan Africa, after the adoption of liberalization measures with the fall of Derg regime in 1990's. Therefore, this paper seeks to examine the determining factors of FDI inflow and potential factors that hinder it. Accordingly, sample of foreign firms based in the capital Addis Ababa and the nearby cities, and public servants of EIA were taken to collect information. The empirical results derived from the study shows that domestic and regional market seeking, political and social stability and investment incentives were found as the main determinants of FDI. Whereas, exchange rate volatility, corruption, and lack of clear policies and regulatory impediments were identified as the three main factors that have the potential to deter foreign investment in Ethiopia.

Key words: **FDI, Ethiopia, Determinants, Impediments**

Acronyms

BIT: Bilateral Investment Treaty
BoP: Balance of Payment
BPM: Balance of Payment Manual
EIA: Ethiopian Investment Agency
EPA: Ethiopian Privatization Agency
FDI: Foreign Direct Investment
GDP: Gross Domestic Product
GTP: "Growth and Transformation Plan", Ethiopian
IMF: International Monetary Fund
IPAs: Investment Promotion Agencies
ISIC: International Standard Industrial Classification
LDCs: Least Developed Countries
LLDCs: Land Locked Developing Countries
M & A: Merger and Acquisition
MDG: Millennium Development Goals
MIGA: Multilateral Investment Guarantee Agency
MNE: Multi-national Enterprises
MOFED: Ministry of Finance and Economic Development, Ethiopia.
MoT: Ministry of Trade, Ethiopia
OECD: Organization for Economic Cooperation and Development
PASDEP: Plan for Accelerated and Sustained Development to End Poverty
SDPRP: Sustainable Development and Poverty Reduction Program
SIDS: Small Island Developing States
SSA: Sub Saharan Africa
TNC: Trans-national corporations
UNCTAD: United Nation Conference on Trade and Development
WIR: World Investment Report

1. Introduction

The global economic integration which gained momentum since the beginning of the 1990s has led to a significant flow of foreign direct investment towards developing countries. Following the decline in official development aid (ODA) flows, many developing countries are increasingly aware of the role of foreign direct investment (FDI) as an engine of growth in their economies. Foreign investors can contribute to growth of a country by providing a package of financial capital, transfer of technology, sharing risks in large projects, job opportunity, information, goods and services that can make a country more competitive in the world market. (Krifa-Schneider, 2010).

The global foreign direct investment (FDI) inflows rose 16 per cent in 2011, surpassing the 2005–2007 pre-crisis level for the first time, despite the continuing effects of the global financial and economic crisis of 2008–2009 and the ongoing sovereign debt crises (UNCTAD WIR, 2012). This increase occurred against a background of higher profits of transnational corporations (TNCs) and relatively high economic growth in developing countries during the year (*ibid*). This surge in inflows of FDI facilitates capital accumulation and transfer of technology to developing countries.

According to WIR (2012), FDI Inflows to Africa showed a decline in three successive years (2009-2011) and this was attributed to the political turmoil raised in North Africa consequently followed by large divestments. In contrast, inflows to Sub-Saharan Africa recovered to $36.9 billion in 2011, close to their historic peak in 2008 ($37.3 billion), (WIR 2012). The same statistics also reveal large disparities in the distribution of FDI among host African regions and countries. For example, West Africa was the largest recipient of FDI in 2011, with almost half of the total- 46 per cent, followed by Central Africa with 24 per cent, Southern Africa with 18 per cent of inflows and East Africa received a meager share of 11.3 per cent of SSA’s FDI inflows (*ibid.*). However, in the recent years there have been significant improvements in the conditions governing FDI by many African countries – including, but not limited to, economic reform, democratization, privatization, greater peace and political stability.

Ethiopia is one of the fastest growing non-oil producing economies in Africa. Since 1990s, Ethiopia has transformed from a command economy to a market oriented economy with a broad

range of policy reforms such as power decentralization and privatization, deregulation of domestic prices and devaluation of currency etc. All this major changes led to the change in investor's attitude towards investing in Ethiopia since and then (UNCTAD 2002). More recently, the government launched a five year Growth and Transformation Plan/GTP/ which aimed at achieving MDGs and joining the country to the bandwagons of middle income countries. However, Ethiopia's gross domestic savings as proportion of GDP is quite low, and it is unlikely to achieve its short and long run objectives by mobilizing the meager domestic savings i.e. 9.4% (MOFED, 2010). Thus, FDI along with other measure is an essential tool to finance its growth and development plans. The incumbent regime realizes the importance of foreign direct investment to sustain the economic growth and has tried to create a favorable foreign investment climate by taking various investment incentives schemes such as tax holidays, tax free imports and other policy measures. Despite those economic liberalization and other measures taken, Ethiopia is not able to attract a significant level of investment from abroad compared to some other African countries. Handful of researches, such as Hailu and Assefa 2006, has been done to explain this fact and to show the main determinants of FDI in Ethiopia which depended on macro economic data. However, this research focused on finding the main determinants and impediments of FDI inflows to Ethiopia using a survey of foreign firms based in Ethiopia.

At global level different researches have been conducted to analyze the empirical determinants of FDI inflows to developing countries. But there is a dearth of literature targeted to analyze the determinants of FDI to Africa. Various empirical literatures show that there is no single list of determinants attributed to every region or country to attract foreign investment. Aseidu (2004) support this argument, by explaining the fact that determinants in East Asia and Latin America do not apply to African countries. Despite the dearth in literature on the empirical determinants of FDI in Africa, very few other scholars such as Morisset (2000), Asiedu (2002, 2003 and 2004), Naudé and Krugell (2003), Akinkugbe (2005), Breslin and amanta (2008), Rojid, Seetanah, Ramessur-Seenarain and Sannassee (2009) and Hailu (2010) are among the major contributors in developing empirical literature on the determinants of FDI in Africa.

This study focuses on finding the main deriving factors and impediments of FDI in Ethiopia from investor's/ firm's/ perspective. The rest of the paper is organized as follows; section two examined the theoretical and empirical literature on foreign direct investment and its

determinants, specifically in Africa. Section three reviewed the Ethiopian economy, and FDI regulatory and institutional framework in Ethiopia. Section four presented the empirical methodology used and discussion of data. Section five summarized the main findings of the study and made conclusions from empirical study.

1. Literature review

As noted in the introduction part, the crucial role of FDI in terms of capital formation, spillover effects on trade and technological progress has led to the development of theoretical and empirical literatures which have focused on identifying the possible determinants of FDI. This section provides a review of literature on the definition of concepts, theoretical and empirical determinants of FDI, and trends and dynamics of FDI in Africa.

2.1. Foreign Direct Investment: Main Concepts and Theories

Definitions

According to the IMF (1993) and OECD (1996), the formal definition of FDI is "foreign Direct investment reflects the objective of establishing a lasting interest by a resident enterprise in one economy ("*direct investor*") in an enterprise ("*direct investment enterprise*") that is resident in an economy other than that of the direct investor". The "*lasting interest"* implies the existence of a long-term relationship between the direct investor and a significant degree of influence on the management of the enterprise. "*Significant degree of influence*" and *"long-term relationship"* are the key words to distinguish FDI from portfolio investment, which are short term activities undertaken by the institutional investors through the equity market. A "*lasting interest*" in foreign entity emphasizes the difference to other forms of capital flows and occur in the form of know how or management-skill transfer (Lipsey, 2003).

Types of FDI

There are three main types of FDI from investor's perspective: *vertical, horizontal and conglomerate FDI* (Caves, 1971). For Caves, *Horizontal FDI* refers to undertaking for the purpose of horizontal expansion to produce goods and services roughly similar to those the firm produces in its home market. This type of FDI is called "horizontal" because the multinational duplicates the same activities in different countries Lipsey 2003 (as cited by Alexander 2003).

Horizontal FDI arises because it is too costly to serve the foreign market by exports due to transportation costs or trade barriers. *Vertical FDI*, on the other hand, refers to those multinationals that fragment production process geographically for the purpose of providing input goods to parent company (backward vertical FDI) or to draw inputs from parent company for own production (forward vertical FDI) (*ibid*). It is called "vertical" because MNE separates the production chain vertically by outsourcing some production stages abroad. The third type of FDI, *conglomerate*, involves the former two types of FDIs.

From the host country perspective, FDI can be classified in to three;

i. Import substituting FDI
ii. Export increasing FDI and
iii. Government initiated FDI

Import substituting FDI involves the production of goods previously imported by host country, necessarily implying that imports by the host country and export by the investing country will eventually decline. This kind of FDI is likely to be determined by the size of host country market, trade barriers and transportation costs (Moosa 2002).

Export oriented FDI is described by Reuber (1973) as the type of investment that reflects a wide range of consideration such as the desire to develop secondary and more diversified sources of supply by way of obtaining lower-cost products to be used either as inputs or for sale elsewhere. Export increasing FDI is motivated by firms desire to seek raw material and intermediary products. Host countries will increase its export of raw material and intermediary products to investing country or other countries where the firm has other subsidiaries. Examples of this type of investments are found in the raw material sector. Generally, such foreign investors are mainly interested in extracting products from the host country and selling them abroad through established market channels. In making such investments, firms sometimes also create a supporting infrastructure such as housing, hospitals and schools. This investment focuses on the needs of a particular market which is largely or entirely outside the host country (Reuber, 1973:73).

Government initiated FDI involves government's action to attract more FDI in order to eliminate its balance of payment deficit (Moosa 2002). Government may provide the necessary investment

incentive to attract foreign investment into its economy. These are accepted by investors whereas market as well as cost conditions may have precluded them from investing in the host country under normal or no-incentive conditions. For example, in Ethiopia the incentives take the following forms: 100 per cent exemption from customs duties and import taxes on all capital equipment and up to 15 per cent on spare parts; exemption from export taxes (except for coffee); income tax holidays varying from two to eight years (depending on the sector and region within Ethiopia); tax deductible R&D expenditure; no taxes on the remittance of capital; the carrying forward of initial operating losses; and investor choice in depreciation models, full repatriation of capital and profits encompassing not only profits, dividends and interest payments on foreign loans but also on asset sale proceeds and technology transfer payments (EIA 2012a).

Finally, FDI may be classified into expansionary and defensive types. Expansionary FDI seeks to exploit firm specific advantage in the host country. This kind of FDI benefited MNCs in increasing sales both in host and investing country. Defensive FDI seeks for cheap labor or materials with the objective of reducing cost of production (Chen and Ku, 2000).

2.2. Main FDI Driving Factor: A Theoretical Framework

Nowadays the issue of foreign direct investment has got more attention at global and national levels. Different theoretical literatures have been done to explain the issue of FDI and the motivation underlying FDI. A group of scholars such as J. Dunning, S. Hymer and R. Veron…et al. are among the contributors in developing various theories of FDI.

The popular conceptualization of, and theoretical framework for, FDI determinants is the "eclectic paradigm" attributed to Dunning (1977, 1993). It provides framework that group *micro- and macro-level determinants* in order to analyze the reason for MNCs investment abroad. The framework posits **OLI framework** that firms invest abroad to look for three types of advantages: Ownership (O), Location (L), and Internalization (I) advantages (discussed below). The Micro-level determinants explain the motivation for multi-national companies/MNCs/ to open foreign subsidiaries. It also examines the consequences to investors, to the country of origin and to host country, of the operations of the MNCs rather than the investment flows and stocks. The Macro-level determinants entirely explain FDI inflows from the host countries point of view. It tries to explain FDI as a particular form of capital flows across borders, from the countries of origin to

host countries, which are found in the balance of payment/BoP/. The variables of interest are: capital flows and stocks, revenue from investment. (Vinita Denisia, 2010)

The first theoretical explanations of international trade is related with the traditional theories of international trade which is based on the Ricardo's model of Comparative advantage and factor proportion or factor endowments theory of Heckshier and Ohlin (HO). Comparative advantage theory which is based on two countries, two products and single factor i.e. labor (2-2-1 model) explain that international trade or export, i.e. an alternative to FDI, takes place if a country has a comparative advantage in producing a particular good (Krugman and Obstfeld 2006). This theory entirely forgot to explain FDI and fails to provide an answer as to why firms choose to operate outside their country of origin. HO model of international trade which involves two countries, two products and two factors of production such as capital and land (2-2-2 model) (*ibid*), also fails to explain FDI than focusing on international trade. Other scholars of international trade such as Robert Mundell 1957, developed a model which involves two countries, two goods, two factors of production and two similar production functions in both countries, where production requires a higher proportion of factor than the other, fails to explain the international production of goods through the flows of investment across countries.

Therefore, all this failures of the traditional international trade theories in explaining the motives of MNCs to operate outside their economy led to the development of the following theories;

2.2.1. The Early Neoclassical and Portfolio Investment theory

This is one of the earliest explanations of FDI. According to this theory, Interest rate differentials between countries are the main reasons why MNCs operate outside their country of origin. Capital, under this neoclassical theory, moves from a country where the rate of return is low to a country with a high return on capital. The theory is based on a perfect competition and risk free capital movements assumptions (Harrison et al, 2000). But in reality capital flow is not always one-way. Especially the existence of risk and barriers to capital movement will erode the legitimacy of the theory, and capital can freely flow in any direction or from both sides (Hosseini 2005).

1.2.2. Production Life-Cycle Theory

This theory was developed by Raymond Vernon in 1966 to explain FDI in manufacturing industry made by U.S. companies in Western Europe after the end of WWII. The theory focuses on four stages of production cycle i.e. *innovation, growth, maturity* and *decline*, and explains FDI as part of this cycle. According to Vernon, transnational companies first produce an innovative product for the local market and it will become advantageous in possessing the new technology. But when the home demand is saturated firms will start to export the surplus to serve foreign market. At the later stages of production cycle, when the new product reaches maturity and loses its uniqueness, the competition from rival firms will become intense. Therefore, at this stage producers will start to look for lower cost foreign destinations. The theory reveals FDI as a defensive mechanism to preserve firm's position in the market (Dunning 1993). However, it is noted that this theory fails to explain why FDI is more efficient than exporting or licensing for operating abroad and it is not supported by empirical evidences as some of MNCs operate both at home and abroad simultaneously (Chen, 1983).

1.2.3. Internalization theory of FDI

This theory tries to explain why multinational companies open subsidiaries in foreign countries than selling their technology. The theory was pioneered by Hymer (1976). He asserts that the main driving motive for FDI is firm's desire to exercise a full control over operation. Hymer's argument relied on the existence of imperfect competition; hence firms should first possess some kind of monopolistic advantage before engaging in cross boarder activity. Those advantages may include ownership of patents, know how, managerial skills…etc. that the local companies do not have. In support of this theory Krugman and Obstfeld (2006) explained the difficulty in selling or licensing some kind of technology. Technology, an economically useful knowledge, may sometimes be embodied in the mind of a group of individuals and is impossible to write or sale to other parties. This difficulty in marketing and pricing of certain knowhow leads MNCs to open foreign subsidiaries under their supervision. In addition, if each firm enjoys a monopolistic position a conflict may arise as the buyer of the input tries to hold the price down while the producing firm tries to raise it. So this problem can be easily avoided by integrating various activities within a firm rather than subcontracting the activities (ibid p173).

1.2.4. The Eclectic Paradigm

John Dunning's eclectic paradigm provides a general explanation for the determinants of FDI. Dunning (1993) has identified three variables: ownership-specific (O), location-specific (L), and internalization (I), all identified in earlier theories of trade and FDI. The paradigm is also called as the **OLI framework**. The key assertion is that all three factors (OLI) are important in determining the extent and pattern of FDI. Ownership-specific variables include tangible assets such as natural endowments, manpower, and capital but also intangible assets such as technology and information, managerial, marketing, and entrepreneurial skills, and organizational systems. Location-specific (or country-specific) variables refer to factor endowments as well as market structure, government legislation and policies, and the political, legal, and cultural environments in which FDI is undertaken. Finally, internalization refers to the firm's inherent flexibility and capacity to produce and market through its own internal subsidiaries. It is the inability of the market to produce a satisfactory deal between potential buyers and sellers of intermediate products that explains why MNEs often choose internalization over the market route for exploiting differences in comparative advantages between countries. From these three advantages if only one is met, then firms will rely on exports, licensing or the sale of patent, to service foreign markets. Thus, the generalized predictions of the eclectic theory are that a firm can only capture a foreign market through FDI if it has the capacity to exploit simultaneously all the three advantages. In Dunning's eclectic theory, the ownership and internalization advantages are firm specific features whilst the location advantages are country specific characteristics which the host country can influence directly. In general, countries that have location advantages can attract more FDI. But firms do not undertake FDI only for the presence of location specific advantages in the host country. Their location choice decisions consider the profitability with which the ownership and internalization advantage can be combined with the location ones. The eclectic paradigm, like other theories of FDI, has some limitations, however. First, it does not adequately address how an MNE's ownership specific advantages such as distinctive resources and capabilities should be deployed and exploited in international production. Possessing these resources is indeed important, but it will not yield high returns for the MNE unless they are efficiently deployed, allocated, and utilized in foreign production and operations. Second, the paradigm does not explicitly delineate the ongoing, evolving process of international production. FDI itself is a dynamic process in which resource commitment, production scale, and investment

approaches are changing over time. The product life-cycle theory also falls short on explaining the dynamics of the FDI process. Third, the conventional wisdom seems in adequate in illuminating how geographically dispersed international production should be appropriately coordinated and integrated. The internalization perspective addresses how an MNE could circumvent or exploit market failure for intermediate products and services but does not discuss how a firm could integrate a multitude of sophisticated international production and balance global integration with local adaptation. Dunning (1993) explained that the principal objective of firms in undertaking foreign production is to advance their long-term profitability. However, FDI is also MNC's strategic logic underlying FDI than a prime profitability motive. For example, some firms may try to diversify or reduce risks, and to match competitors' actions. The following strategic logics were identified by Dunning (1993) as the possible motives for FDI:

_ *Resource seeking FDI***:** is Investments which seek to acquire factors of production that are more efficient than those obtainable in the home economy of the firm. In some cases, these resources may not be available in the home economy at all (e.g. natural resources, an over words - naturally occurring materials such as coal, fertile land, etc., that can be used by man, and cheap labor).

_ *Market-seeking FDI:* MNCs attempt to secure market share and sales growth in the target foreign market. Apart from market size and the prospects for market growth, the reasons for market-seeking FDI include situations in which (a) the firm's main suppliers or customers have set up foreign producing facilities abroad and the firm needs to follow them overseas; (b) the firm's products need to be adapted to local tastes or needs, and to indigenous resources and capabilities; and (c) the firm considers it necessary, as part of its global production and marketing strategy, to maintain a physical presence in the leading markets served by its competitors.

_ *Efficiency-seeking FDI*: attempts to rationalize the structure of established resource-based or marketing-seeking investment in such a way that the firm can gain from the common governance of geographically dispersed activities. MNEs with this motive generally aim to take advantage of different factor endowments, cultures, economic systems and policies, and market structures by concentrating production in a limited number of locations to supply multiple markets.

_*Strategic asset-seeking FDI*: MNCs use this strategy to acquire the assets of foreign firms so as to promote their long-term strategic objectives, especially advancing their international

competitiveness. MNEs with this intention often establish global strategic alliances or acquire local firms.

Many MNEs today pursue pluralistic goals and engage in FDI that combines characteristics of several of the preceding categories.

1.3. FDI REVIEW OF AFRICA

2.3.1. Regional Distribution of FDI in AFRICA

As discussed above, Africa saw a third year decline in FDI inflow and reached $42.7billion by 2011. However, this figure of an overall declining trend in FDI does not have an overall regional implication across the continent. The negative growth for the continent as a whole was driven in large part by reduced flows to North Africa caused by political instability and by a small number of other exceptions to a generally more positive trend. Inflows to sub-Saharan Africa recovered from $29.5 billion in 2010 to $36.9 billion in 2011, a level comparable with the peak in 2008 ($37.3 billion). According to the UNCTAD WIR 2012, West Africa was the largest recipient of FDI in 2011, with almost half of the total- 46 per cent – followed by Central Africa with 24 per cent and Southern Africa with 18 per cent of inflows. East Africa received a meager 11.3 per cent of SSA's FDI inflows.

2.4. Empirical evidence on the determinants of FDI*

Globally, the literature on FDI flows to developing countries is vast, but there is still a dearth of literature on Africa which focuses on in-depth analyses of the determinants and dynamics of FDI flow. Apart from the annual overviews in UNCTAD's World Investment Reports, the empirical analysis on African FDI is still quite limited. The more recent and most significant studies and their results are those by Morisset (2000), Asiedu (2002, 2003 and 2004), Naudé and Krugell (2003), Akinkugbe (2005), Breslin and amanta (2008), Rojid, Seetanah, Ramessur-Seenarain and Sannassee (2009) and Hailu (2010). Empirical literatures on the determinants of FDI in Africa are summarized below by the authors and then further analyses on the determinants are presented as follows:

** Since my objective in this paper is to identify determinants of FDI in Ethiopia, this part of literature focuses only on the empirical studies made on the determinant of FDI in developing country more specifically Africa.*

Morisset (as cited by Naudé & Krugell, 2003:5) finds that more FDI flows to countries with larger local markets and/or natural resources. She concludes that aggressive liberalization, modern investment codes and strong economic growth are important prerequisites for increased flows of FDI to Africa.

Asiedu (2002) uses a comprehensive dataset of 71 developing countries, about half of which are in the poorest region of Africa – SSA – over the 1988 to 97 period to analyze whether the determinants of FDI to developing countries are equally relevant for SSA. The author focuses on three main variables – return on investment, infrastructure development and openness to trade – and she concludes that Africa is different. Openness to trade promotes FDI, but the marginal benefits from increased trade are less than in other developing countries; and, lastly, Africa requires different FDI policies than other developing regions. Asiedu, in her 2003 publication, used panel data for 22 countries in sub-Saharan Africa over the period 1984-2000 to examine the impact of political risk, the institutional framework and government policy on FDI flows. She concluded that macroeconomic stability, efficient institutions, political stability and a good regulatory framework have a positive effect on FDI on the continent. In her study, she also refers to several investor surveys that revealed that, firstly, factors that attract FDI to Africa are different from those that work in other regions, and, secondly, that the region is also structurally different from the rest of the world (Asiedu, 2003:4). Asiedu (2004), again, covering the period 1980-1999, concluded that despite the fact that Africa has reformed its institutions, improved its infrastructure and liberalized its FDI regulatory framework, the initiatives have been less significant than those implemented in other developing countries, making SSA less attractive for FDI inflows.

Naudé and Krugell (2003) covered the period 1970-1990 in their cross-country analysis on whether institutions and geography matter as determinants of FDI in Africa. They concluded that geography does not have a direct influence on FDI flows to Africa. They used a number of specifications on policy instruments to demonstrate that neither market seeking nor re-exporting motives for FDI seem to dominate. In critically reviewing the claims of earlier studies on the dominance of economic policies, they concluded that good policies are only significant if they are made by good institutions. As an institutional measure, political stability proved to be a significant determinant of FDI.

Akinkugbe (2005) included 53 African countries in his panel regression model, covering the period 1970-2000. His findings reveal that the drivers of the volume of investment flows to these countries are a combination of high per capita income, trade openness, level of infrastructural development and a high rate of return on investment, all of which are significant decision variables for potential investors.

Breslin and Samanta (2008) endeavored to establish a relationship between corruption and FDI in 11 African countries, covering the period 1995-2004. No conclusive evidence was found that corruption has an effect on FDI inflows.

Rojid et al. (2009) analyzed potential determinants of FDI for a sample of 20 African countries, covering the period 1990-2005. By applying a panel data fixed effects model, they conclude that abundance of natural resources, openness to trade, the size of the domestic market and the stock of human capital are positive in attracting FDI. They further conclude that political instability and labour costs have an inverse relationship with FDI.

Hailu (2010) applied a cross section fixed effect Least Squares Dummy Variable estimation technique to determine possible demand side effects of FDI inflows to 45 African countries. Covering the period 1980-2007, he concludes that natural resource endowment, labor quality, trade openness, market access and quality infrastructure have positive and significant effects on FDI inflows. He further concludes that when government expenditure and private domestic expenditure are added, the effects still remain positive, with an ultimate conclusion that African governments have a large pool of demand side policy instruments at their disposal to attract FDI.

Haile & Assefa (2006) analyzed determinants of FDI in Ethiopia using a time series data (1974-2001) and concluded that growth of real GDP, export orientation and liberalization promote the inflow of FDI while macroeconomic instability and poor infrastructure deter the inflow of FDI. Their paper concluded that, liberalization of the trade and regulatory regimes, stable Macroeconomic and political environment, and major improvements in infrastructure are essential to attract FDI to Ethiopia.

UNCTAD (2002) identified some of the national determinants of FDI inflows to Ethiopia. Among others, large domestic market and a unique geographical location, a unique history, national culture and tradition with a pool of highly educated and dedicated elite to draw upon as managers and advisors, with English (the language of business) widely spoken, a comparatively safe and less corrupt business and social environment and the capital city that hosts the headquarters of the Organization of African Unity, the Economic Commission for Africa and other regional organizations as well as a significant cosmopolitan middle class with experience in international business; Were among the factors that drive foreign investment in Ethiopia.

3. Ethiopian Economy, and FDI performance and policies

3.1. ETHIOPIA; country profile

Ethiopia is Located in the north-eastern part of Africa, commonly known as the Horn of Africa, at the cross-roads between Africa, the Middle East and Asia. Ethiopia, with the total population of over 80.1 million in 2010, is the second populous country in Africa after Nigeria. Ethiopia is a Federal Democratic Republic composed of nine regional states (Tigray, Afar, Amhara, Oromia, Somali, Benishangul-Gumuz, Southern Nations-Nationalities and Peoples Region (SNNPR), Gambella and Harari) and two city administrative states, Addis Ababa and Dire Dawa. A summary of key figures describing its general country profile can be found in table 3.1.

<Table 3.1 here>

3.2. Ethiopian Economy

The Ethiopian economy witnessed a double digit growth rate trajectory since 2004. Real GDP grew by an average of 10.4 and 11.4 percent in year 2009/10 and 2010/11, which places Ethiopia among the top performing economies in Sub-Saharan Africa despite world economic meltdown and global financial crisis (African economic outlook 2012). Growth has been broad-based, with the services and the industrial sectors growing at unprecedented rates. Accordingly, agriculture, industry and services grew by an annual average of 9%, 15% and 12.5% respectively during the 2010/11 fiscal period (*ibid*). As articulated by MOFED (2010) in its five-year Growth and Transformation Plan (GTP) of 2010/11-2014/15, the plan emphasizes on agricultural transformation and industrial growth, and projects the economy to grow at a rate of 11.2per cent (base case) and 14.9per cent (high case), well above the previous five year plan’s (PASDEP)

average of 11per cent. The 2010/11 fiscal year's 11.4 growth rate is a witness to the success stride of GTP. It is observed that the country's macroeconomic management failed to reduce inflation, which was driven mainly by escalating food prices, in the 2010/11 fiscal year. Loose monetary policy, rising prices of imported inputs, malfunctioning of the domestic market, and supply shocks were among the causes for resurgence of inflation (African Economic Outlook 2012). The government has been pursuing prudent monetary and fiscal policies which have focused on reducing inflation, boosting domestic revenue mobilization and reducing domestic borrowing as shown in the GTP. This has led to improvements in the fiscal position in 2011. Though the GTP expected a rise in fiscal deficit, the balance of payments position showed improvement in 2010/11 on strong export growth and increases in private transfers and external financing. Between 2010 and 2011, exports grew substantially while imports slowed down, thereby contributing to improvements in the trade deficit (*ibid*).

3.3. Investment Regime in Ethiopia (Aug 1992-Aug 2012)

3.3.1. FDI Regulatory framework

Since 1992, following the power transition from former socialist and military government to current government, the climate for foreign investment has improved dramatically (UNCTAD 2002). The regulatory regime undertook major reenactments of investment proclamations from the year 1992 to 2008*.

The first *investment proclamation no 15/1992* was issued in may 1992, which established *Ethiopian investment office*. However this proclamation provided few incentives only in agricultural sector (no incentive for social sector) and $125,000 in blocked account was a minimum requirement for foreign investors to invest in Ethiopia. The investment proclamation was amended in 1996 to create additional incentives for foreign investors. Major new provisions included duty-free entry of most capital goods, a cut in the capital gains tax, inclusion of additional sectors such as health, education, tourism, consultancy services in the incentive scheme, removal of the requirement for foreign investors to deposit 125,000 USD and specification of areas eligible for incentives based on the International Standard Industrial Classification (ISIC) code. Consequently, the number of foreign investment projects approved increased.

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* The key reenactments of proclamations and regulations are 7/1996, 37/1996, 35/1998, 36/1998, 116/1998, 168/1999, 280/2002, 84/2003, 373/2003, and 146/2008.

Investment Proclamation no. 116/1998 was issued in 1998 which redefined domestic investors to include foreign nationals (Ethiopian by birth), allowed private-government joint investments in defense and telecommunication, and opening hydro-power electric generation to domestic and foreign investors (annex I, for detailed eligible areas of investment reserved for government, domestic and foreign investors).

Finally, in 2002, *Investment Proclamation no. 280/2002* was issued. Under this proclamation the following provisions were provided;

- Reducing of the minimum investment capital required for foreign investors from: 500,000 USD to 100,000 USD (wholly foreign), 300,000 USD to 60,000 USD (Jointly with domestic) and 100,000 USD to 50,000 USD (Consultancy)
- Avoiding minimum investment capital requirement for foreign investor reinvesting his profits or dividends or exporting at least 75% of his output
- Allowing foreign investor or foreign national treated as domestic investor the right to own a dwelling house and other immovable property required for his investment
- Allowing investors to employ duly qualified expatriate experts required for the operation of their business

3.3.2. Institutional frameworks to promote FDI

Ethiopian investment agency (EIA) is the autonomous Government institution responsible for most aspects of FDI in Ethiopia which has the lead remit for promoting, coordinating, managing and monitoring all types of inward investment including joint-ventures (EIA 2012a). EIA is accountable to the Board of Investment (BOI) chaired by the Ministry of Industry. The responsible organ for collecting the data on foreign direct investment (FDI) is the statistic and information technology service, which is part of EIA. Only data on inward FDI inflows are recorded since August 1992 and no data on outflow are recorded till to date. According to the Investment Guide to Ethiopia (UNCTAD-ICC, 2000) the functions of the EIA, among others, include:

- promoting the country's investment opportunities and conditions to foreign and domestic investors;
- issuing investment permits, work permits, trade registration certificates and business licenses;
- registering technology transfer agreements and export oriented non-equity-based foreign enterprise collaborations with domestic investors;

- negotiating and, upon government approval, signing bilateral investment promotion and protection treaties with other countries;
- advising the Government on policy measures needed to create an attractive investment climate for investors; and
- Assisting investors in the acquisition of land, utilities, etc., and providing other pre and post-approval services to investors.

EIA has reported that as of August 15, 2012 it has processed a total of 6,235 FDI projects, of which 743 projects are implemented while another 1,444 are newly operational FDI projects and the rest 4048 projects are waiting for implementation (Pre-implementation phase). Out of 1,444 operational FDI projects the majority are concentrated on manufacturing sector and Real estate, Machinery and Equipment Rental and Consultancy Service with 568 and 355 projects respectively, followed by agriculture with 202 projects (EIA 2012).

Other government agencies and private sectors organizations also involved in the promotion of FDI in Ethiopia. Among the state sectors, Ethiopian Privatization Agency (EPA) plays a significant role in attracting foreign investment through enabling foreign investors to participate in the privatization program, particularly in large state owned companies. Other government departments that are involved in the attraction of FDI to Ethiopia include: the Ministry of Trade and Ministry of Industry; the ministries and agencies associated with specific sectors such as mining and tourism; the ministry of Foreign Affairs and ministries dealing with taxation remits including customs. Moreover there are also regional investment promotion agencies that encourage FDI into their region (UNCTAD, 2002). The private sector includes Ethiopian Chamber of Commerce and Sectoral Associations, Addis Ababa Chamber of Commerce and Sectoral Associations, Ethiopian Horticulture Producer Exporters Association (EHPEA) and Ethiopian Leather Industries Association (ELIA), are among others (EIA 2012a). However, one can observe that the coordination among those institutions is lesser. Therefore, the investment agency has to take the responsibility to make an incessant contact with them. More recently, the Ethiopian Investment Agency has recently started one-stop-shop service and made some structural changes to improve the efficiency of the service delivery for foreign investors.

3.4. Development and Performance of Foreign Direct Investment in Ethiopia

FDI as a component of capital formation has got importance in Ethiopian economy notable after 1992. Ethiopian government opened various economic sectors for both domestic and foreign investors since then. However, out of the total investment projects licensed between 1992- 2012, FDI's share is about 15.71 percent which is one of the meager flow in Africa (EIA, 2012a).

FDI inflows to Ethiopia showed an increase in absolute terms from an annual average of $131.6 million between 1995 and 2000 to $404.1 million in the year between 2001 and 2006 (figure 3.2) although there are fluctuations due to the political instability in those periods. And also, the percentage share of FDI inflow to GDP rose from the 1995-2000 average of 1.57 to 4. As shown in Figure 3.2, during the Ethio-Eritrea war (1998-2000) the inflow of FDI had fallen to a large extent. Besides, in 2005, during the country's election crisis time, the FDI flows declined to $265 million from $545 million in the preceding year of 2004. Recently, the FDI inflow to Ethiopia has been unable to revive for three years in a row, since the global financial crisis hammered the world economy in 2008. FDI inflows have declined continuously from an annual average of 242 million dollar between 1995 and 2004 to 184 million dollars in 2010 (figure 3.2).

Moreover, despite the improvements in the overall economic contexts, Ethiopia's share of FDI inflows to Africa remains below 2 percent (UNCTAD 2011). Inauspiciously the share of FDI in the Ethiopian gross fixed capital formation has declined from an annual average of 14.8 percent over the 1995 to 2004 to a meager 3.2 percent in 2010 (figure 3.3). Figure 3.3 also shows that the percentage share of FDI to GDP remains the least, as it was recorded 5.43 in 2003, which was the highest over the past 20 years.

<<figure 3.2 and 3.3 Here>>

3.5. FDI distribution in Ethiopia by Country of Origin

According to EIA 2012 unpublished document, of the total 6235 FDI projects in Ethiopia, more than 900 projects inflows are from Chinese investors (though exclusively Chinese owned firm accounted for 773 where as others are joint-ventures). The second largest source is Sudan, accounted for the total of 717 projects (only 622 are exclusively owned by Sudanese). 939 FDI projects are from USA (only 484 are exclusively owned by US citizens). Britain, Italy Germany, France, Sweden Netherlands and turkey are the major source of FDI from Europe. Other

developing countries such as India, Saudi Arabia, Egypt, UAE, South Korea, South Africa and Kuwait etc are also source of FDI in Ethiopia (*ibid*). There are also significant investments coming from African countries such as Sudan, Nigeria, Egypt, South Africa and Somalia. Worldwide basis, developed countries are the major source of inflows; however, one can note that the majority of FDI inflows to Ethiopia are from developing countries such as china, India and Saudi Arabia (Saudi Arabia's investment is dominated by a single company by the name MIDROC-group, whose owner is of both nationals; Ethiopian and Saudi Arabia). This trend might indicate that Ethiopia could not provide an attractive business environment for FDI originated from developed economies. Few economists argued that this failure of Ethiopian government is the consequence of its policy choice i.e. the government paid more attention to economic development at the expense of political development and democratization in which the developed world are not lured to this processes.

4. Data and Empirical Methodology

4.1. Data Source and Data Analysis

4.1.1 Quantitative and Qualitative Data Collection Tool

The targets of this study were foreign investors in Ethiopia and the respective government officials (EIA, EPA and MoT). Data were collected both through qualitative and quantitative techniques. Questionnaire was developed from review of literature on the main determinants and impediments of FDI in Africa. Staffs of EIA were solicited to provide information on institutional determinants and impediments. Due to its area proximity, the researcher administered a questionnaire to samples of 50 foreign firms found in Addis Ababa from the total 270 firms. 34 questionnaires were properly completed and returned. This represents the response rate of 68%. The data obtained was presented using charts, percentage, ratio and tables. Descriptive analysis technique was used to analyze the quantitative data obtained through Questionnaire, and interview was narrated critically.

5. Results and Discussions

5.1. Institutional Promotion efforts*

In order to attract a significant amount of FDI to Ethiopia, the Ethiopian investment agency /EIA/ follows two directions /promotion efforts/; *specific* and *general* promotion. Specific promotion focuses on promoting the investment potential of the country to specific foreign allies. The country has built special investment partner with the following countries; Saudi Arabia, china, India, Holland, Turkey and Germany...Etc. Priority to those countries is given because of their specializations in certain sectors. For instance, the leather sector is mainly controlled by Italian companies, horticulture by Netherland and textile by Turkey. General Promotion focuses on promoting the overall investment climate and investment facilities of the country through building a country profile to the rest of the world.

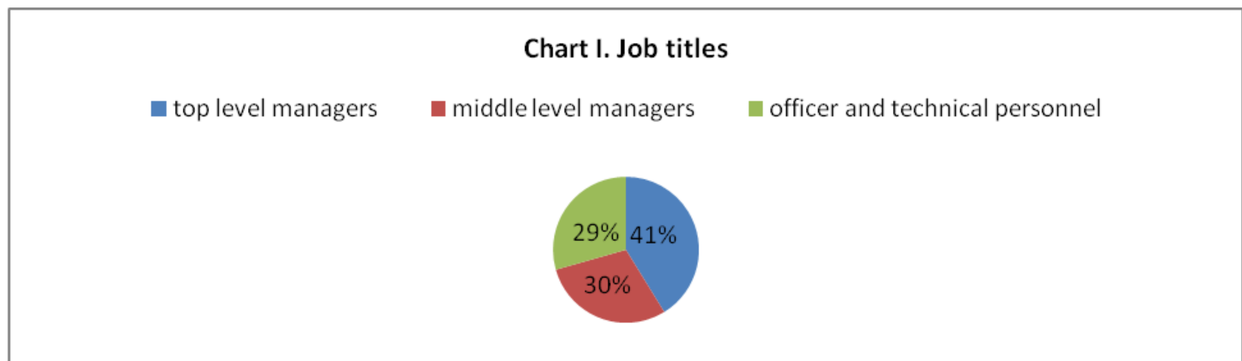
To purse those two directions the agency follows three strategies. These strategies includes

1. Image building: this includes building a country profile that focuses on introducing the general investment potentials of the country and specific advantages of investing in Ethiopia. This is done through diplomatic missions and online publications.
2. Investment generating: Ethiopia has built a bilateral and multilateral investment and trade relations with different countries over the past two decades. These efforts will continue in the future to generate more investment.
3. Investment servicing at home: the agency also provides *licensing* and *aftercare service* targeting both domestic and foreign investors. Aftercare service includes *investment support* and *follow up service*. Investment support is an aftercare service that provides support for foreign investors. Supports are mostly done at the request of investors. For instance, investors may ask for the necessary infrastructures (such as land, power, tele…etc) or support for duty concession for imports and the agency will make a deal with the concerned public agency. Follow-up service, on the other hand, is a continuous contact with investors through email and phones to facilitate firm's operation. The contact will be made for two years and if the investor fails to start the business within these years, its license will be cancelled by the agency.

Nowadays, the agency started a One-Stop-Shop** which is a one window service that provides every investment facilities inside the agency to boost efficiency.

5.1. Data on the primary respondents

The chart, derived from the study, shows that 41 percent of the respondents were at the top level management in foreign firms comprising of the general manager, president, CEO and directors. 30 percent of the respondents were in the middle level management and the rest 29 percent comprises of lower levels; technical experts.



Source: Author's elaboration on the basis of respondents of the study

The study also revealed that 71 percent of the respondents were not expatriates. However, 79 percent had foreign experience before joining the entity. The respondents with foreign experience had worked in different places mainly in Asia, Europe and African countries*. 82 percent of the employees had less than 10 years in their current positions and 62 percent were involved in the establishment of the entity in Ethiopia (Table 2).

Table 1: respondents Character in %

	Expatriates		Experience		No. of years in position				establishments	
	yes	no	foreign	local	<5	5-10	10-20	>20	Yes	No
#	10	24	27	7	14	14	5	1	21	13
%	29	71	79	21	41	41	15	3	62	38

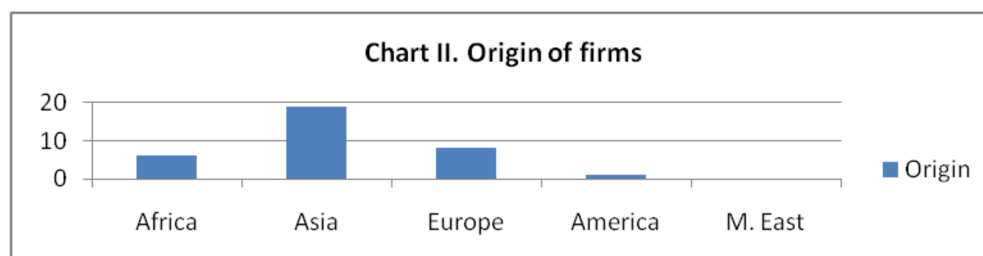
Source: Author's elaboration on the basis of respondents of the study

* Interview made with EIA staff, Mr. Tilahun Gemechu, *Senior Investment Promotion Expert,* Email: gemechu_til@yahoo.com Tel: (251) 11 551 0033 Mob: (251) 911 683427 Addis Ababa Ethiopia, P.O.Box 2313

** This service was started in the beginning of 2012. The new investment proclamation that approved this service was passed by the council of minister but the publication was not yet made till the time this research is completed.

5.2. Parent entity before its operation in Ethiopia

The study shows that the majority of firms investing in Ethiopia had their origin from Asia. Whereas European and African firms, by origin, were also involved in the research (chart II). However, as shown from the EIA (2012) unpublished data, the majority of firms had their origin from Asia and America.



Source: Author's elaboration on the basis of respondents of the study

Prior to their operation in Ethiopia, some firms have a contact with the local customers. This takes various form. Some firms established sales representative office in Ethiopia (18 percent); others firms exported their product to Ethiopia (Table 2).

Table 2: Firm's contact in Ethiopia prior to its operation		
Nature/form of contact	Contact	
	Yes (#)	%
Franchise		
Sales representative office	6	18
Imported	3	9
Sale via local agent	3	9
Other	1	3

Source: Author's elaboration on the basis of respondents of the study

Majority of the firms have consulted various government agencies in Ethiopia, prior to their operations. 88 percent of the firms had prior contact, of which 47 percent found it very helpful. Only 9 percent of them responded that the contact was not helpful at all (Table 3).

Table 3: contact with public agency and usefulness of the information									
Contact					Usefulness of information				
	#	%			1	2	3	4	5
Yes	30	88		#		3	2	16	9
No	4	12		%		9	6	47	26
1= too difficult to access; 2= Available but not helpful at all; 3 of some use; 4 very Helpful but also needed additional information; 5 sufficient on its own									

Source: Author's elaboration on the basis of respondents of the study

Firm's top most important sources of information to invest in Ethiopia are; specialized site selection companies, national investment promotion agency and research done by the firms themselves, respectively. Majority of the firms got this information while at home and in Ethiopia. Among the types of FDI information, the most valuable information were general country and regional economic information which accounted for 44percent and FDI laws and regulations of Ethiopia that accounted for 30percent (table 4). The study reveals that investment incentive, taxation and labor information were among the least valuable information types (see table below).

Table 4: Company's most important sources & location of information

Source of information						Location of the source of information		
	#	%		#	%		Yes #	%
Research done	8	24	General management consultancies	8	24	Ethiopia	12	35
National investment promotion agency	9	26	Investment banks	3	9	Home	2	6
Contact with existing firms	7	21	others	-		Both Home and Ethiopia	20	59
Specialized site selection firms	11	32						

Most important type of FDI information

	#	%		#	%
General country/regional economic information	15	44	Specific investment or privatization project opportunity	4	12
FDI laws and regulations	13	30	Incentive information	5	15
Potential suppliers or Joint venture partners	6	18	Labor information	4	12
Tax information	5	15	others	-	-

Source: Author's elaboration on the basis of respondents of the study

The government plays a crucial role in offering different forms of assistance to many parent companies. 76percent of companies contacted the government for assistance. 38percent of the companies found government's assistance very important. Only 3percent of the companies that contacted the government found its assistance as of no effect (table 5).

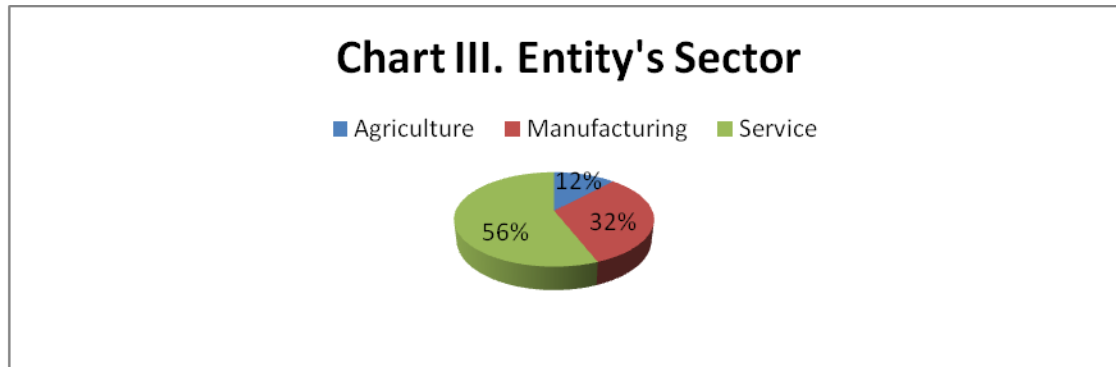
Table 5: Government's assistance to the parent companies

Contact for assistance				Helpfulness of contact				
	#	%		1	2	3	4	5
Yes	26	76	#		1	5	13	7
No	8	24	%		3	15	38	21
(1= Not important at all; 2= no effect; 3 =somewhat important; 4 =Very important; 5 =critical**)**								

Source: Author's elaboration on the basis of respondents of the study

5.3. Parent entity in Ethiopia

The study comprised of firms from different sectors. 12percent of them were from the agricultural sector, 56 percent from manufacturing and the rest 32percent were from the service sector (Chart III).



Source: Author's elaboration on the basis of respondents of the study

The study also analyzed the years of establishment of firms in Ethiopia. 64 percent of the firms had their operation in the year 2001 onwards (table 6). A very few number of firms responded that their operation took before the year 1990. Thus most of the firms in Ethiopia were operated parallel to the time that the country undertook a liberalization measures since 1992.

Table 6: Years of establishment

	Pre1990	1991-1995	1996-2000	2001-2005	2005 onward
#	5	4	3	15	7
%	15	12	9	44	20

Source: Author's elaboration on the basis of respondents of the study

Different firms adopted different modes of entry to Ethiopian market. Majority of them followed full acquisition. Other form of entry includes partial accusation, Greenfield, joint venture, franchise and branch office. Most of these companies are private owned firms (table 7).

Table 7: Parent's company's choice of entry and type of ownership

Modes of Entry

	Franchise	Full acquisition	Partial accusation	Greenfield	Joint venture	merger	other
#	3	14	6	4	4	2	1
%	9	41	17.6	11.7	11.7	6	3

Type of ownership

	Private	public	corporate
#	26	1	7
%	76	3	21

Source: Author's elaboration on the basis of respondents of the study

Various forms of government assistance were given to firms in Ethiopia. The number one form of assistance is tax breaks, while import duty concession and guarantee of repatriations are the second and third. However, few responded no assistance at all (table 8).

Table 8: Form of government assistance					
Form of assistance	#	rank		#	Rank
Tax Breaks/Holidays	10	1	Subsidies/Cash Payments	4	4
Import duty concessions	9	2	Reduction of land rents/Utilities	4	5
guarantee of profit and repatriation	8	3	none	3	6

Source: Author's elaboration on the basis of respondents of the study

There are many factors that determine FDI in Ethiopia. The study analyzed the main drivers of FDI in Ethiopia. Lists of the main drivers of FDI were summarized from literatures and were put in the table below. From the lists of determinants listed in the table, the top most ranked factor was the need to exploit both domestic and regional market opportunity. Thus, Ethiopia's role and its strategic location in the horn of Africa make it preferable. Also government's investment incentive targeted for foreign investors, which accounted for 9percent, was among the main driving factor. Other determining factor includes political and social stability, and favorable climate (table 9).

Table 9: Reasons for parent companies investing in Ethiopia					
Determinants of FDI	%	rank		%	rank
Domestic and regional Market opportunity	19	1	bilateral trade agreements	5	7
Investment incentives in Ethiopia	9	2	Availability of cheap labor	5	8
Political and social Stability	8	3	Easy of business doing	4	9
Reliability and quality of infrastructure and utilities	7	4	geographic proximity	3	10
Favorable Climate	7	5	Macro-economic stability and growing economy	2	11
Availability of natural resource	6	6	others	-	

Source: Author's elaboration on the basis of respondents of the study

The potential to invest in a country can be hindered by different factors. This study identified several factors that present potential risks to foreign firms and may hinder their investment decision in Ethiopia. Factors were listed in table 10 below. Based on this table, 10 percent of the respondents consider the existence of Exchange rate volatility in Ethiopia as the single most important factor that hinders foreign investment in Ethiopia. Thus, government's controlled mixed exchange rate regime/both fixed and free-floating/ was identified as a potential risk for investors. 8percent of the respondents identified corruption as the second most important factor

that hinders foreign investors. Other reasons for low foreign investment in Ethiopia includes, delay in license and work permits and lack of clear policies and regulatory impediments.

Table 10: impediments/risks/of foreign direct investment in Ethiopia					
Factors	%	rank		%	rank
Exchange rate volatility/Currency risk	10	1	High cost of production	4	7
Corruption	8	2	Lack of law enforcement/weak legal infrastructure	4	8
Delays in licenses& Work permits	7	3	Lack of skilled labor	3	9
Lack of clear policies and regulatory impediments	7	4	Political instability	2	10
Unreliable infrastructure	5	5	Crime and Insecurity	1	11
Competition	4	6	Other	-	-

Source: Author's elaboration on the basis of respondents of the study

Firm's future expansion plan and strategies were also analyzed under the sample period. The study shows 88percent of the firms have an expansion plan in Ethiopia. Those firms will expand their operation through different strategies. Among these strategies 53percent of them will expand the existing plant and 32percent of them will build or lease new facilities (Table 11).

Table 11: Company's Expansion strategy in Ethiopia %							#	%
Expansion plan		Yes	No		**Expansion strategy**	Build or lease a facility	11	32
	#	30	4			Merger or acquisition	1	3
	%	88	12			Expand an existing	18	53

Source: Author's elaboration on the basis of respondents of the study

Chapter VI

Recapitulation and Conclusion

6.1. Recapitulation and Conclusion

This study attempts to study the determinants and impediments of FDI in Ethiopia. To this end, I have reviewed theoretical explanations and empirical studies relating to the determinants of FDI in Africa. Major derivers of FDI inflows were summarized; questionnaire was developed from those literatures and was administered to 50 firms. The empirical finding of the study shows that domestic and regional market opportunity seeking, political and social stability and favorable climate are the three main drivers of FDI to Ethiopia. While exchange rate volatility, corruption and lack of clear policies and regulatory impediments were identified as the three main factors that have the potential to deter foreign investment in Ethiopia. Other findings of this paper are summarized as follows:

- ✓ From the sampled firms' majority of them have non expatriate top level managers with foreign experience. This could show that Ethiopia has a competitive labor force with the

rest of the world. Majority of this labor have an experience below 10 years and have a large proportion of involvement in the establishment of the firm in Ethiopia.

- ✓ Majority of the sampled firms has their origin from Asian and Europe. This could be linked to the specific promotion effort that EIA is pursuing. Those firms have prior contact with customers through their sales representative and export. Prior to their operation majority of the firms have contacted various public agencies for support and found the contact very helpful. Most of these companies relied on specialized site selection firms located at both home and Ethiopia. The most important type FDI information for investors was the general country's and regional economic information.
- ✓ Majority of the sampled firms concentrated in service and manufacturing sector. Till recent years, Ethiopia was seen as an agricultural dominant economy which is based on rain-fed and traditional farming system. However this figure is a good signal that Ethiopian economy is undertaking major transformation from agriculture to industrialization and service based. The dominant numbers of firms were established between a year 2001 and 2005. This can be the result of the improved investment environment since the introduction of policy reform in early 1992. Majority of those firms are PLCs that adopted different entry modes; however the majority entered through full accusation. Ethiopian government provides various forms of support to newly operating foreign firms. The major types of assistance are tax breaks, duty concession and guarantee of repatriations. The government, specifically EIA, in this regard is expected to strengthen its support and follow up service to encourage new entrants.
- ✓ The main determinants and deterring factors of FDI was also analyzed in the study. In Africa, there have been new motives for FDI in recent years next to the traditional ones such as resource seeking i.e. oil. The empirical study shows that most of FDI to Ethiopia has been targeted for domestic and regional market seeking. Investment incentives and political and social stability are also the main factors that attract foreign investors to Ethiopia. The three main factors that the government must address to attract more FDI includes, exchange rate volatility, corruption and delay in license and regulatory impediments. Finally, firm's expansion plan and strategy were analyzed. The result shows that majority of the firms have an expansion plan mainly through expanding the existing business and building new plant. This could suggest investors satisfaction of investing in Ethiopia, despite the existence of some obstacle.

Annex I.

All areas of investment are open for foreign investors other than the following:

Areas reserved exclusively for the government: - Postal services with the exception of courier services; - Transmission and supply of electrical energy through the integrated national grid system; and - Passenger air transport services using aircraft with seating capacity of more than 20 passengers.
Areas reserved for Ethiopian nationals: **-** Banking, insurance and micro credit and saving services; - Travel and shipping agency services; - Broadcasting services; and - Air transport services using aircraft with a 20 passengers seating capacity
Areas reserved for domestic investors: - Retail trade and brokerage; - Wholesale trade (excluding supply of petroleum and its by-products as well as wholesale by foreign investors of their products locally produced); - Import trade (excluding LPG, bitumen and up on the approval from the Council of Ministers, material inputs for export products); - Export trade of raw coffee, chat, oil seeds, pulses, hides and skins bought from the market and live sheep, goats and cattle not raised or fattened by the investor; - Construction companies excluding those designated as grade 1; - Tanning of hides and skins up to crust level; - Hotels(excluding star-designated hotels), motels, pensions, tea rooms, coffee shops, bars, night clubs and restaurants excluding international and specialized restaurants; - Travel agency, trade auxiliary and ticket selling services; - Car-hire and taxi-cabs transport services; - Commercial road transport and inland water transport services; - Bakery products and pastries for the domestic market; - Grinding mills; - Barber shops, beauty salons, and provision of smith workshops and tailoring services except by garment factories; - Building maintenance and repair and maintenance of vehicles; - Saw milling and timber making; Customs clearance services; - Museums, theaters and cinema hall operations; - Printing industries

Source: Ethiopian investment agency2010 http://www.ethioinvest.org/Investment_Regime.php

Annex II

Ethiopia has concluded bilateral investment and double taxation avoidance treaties with the following countries:

Bilateral Investment Treaties (BITs) 1994 – 2012				
Algeria Austria Belgium and Luxemburg China Denmark Djibouti	Egypt Equatorial Guinea Finland France Germany India	Iran Israel Italy Kuwait Libya Malaysia	Netherland Nigeria Russia South Africa Spain Sudan	Sweden Switzerland Tunisia Turkey United Kingdom USA Yemen

Double Taxation Avoidance Treaties (DTTs) 1996– 2008					
Algeria	Israel	Romania	Turkey	Kuwait	Italy
Yemen	France	South African Tunisia		Russia	Check Republic

Source: *Ethiopian Investment Agency, investment guide to Ethiopia 2012*

Appendix III FDI statistics

Summary of Licensed FDI Projects By Sector and Status Since August 22, 1992 - August 15, 2012										
Sector	**Implementation**		**Operation**			**Pre-Implementation**			**Total**	
	No.of Proj.	Capital in '000'Birr	No.of Proj.	Capital in '000'Birr	No.of Proj.	Capital in '000'Birr	No.of Proj.	Capital in '000'Birr	No of Proj	capital in '000'Birr
Agriculture	176	26,139,301	202	9,029,709	1,024	71,780,143	1,402	106,949,153	1402	106,949,153
Fishing	3	104,570			13	174,455	16	279,025	16	279,025
Mining	7	315,307	12	193,071	27	471,608	46	979,986	46	979,986
Manufacturing	325	73,356,241	568	22,181,875	1,118	87,220,523	2,011	182,758,639	2,011	182,758,639
Electricity, gas, steam and water supply					5	472,849	5	472,849	5	472,849
Education	18	362,304	35	363,075	96	1,018,670	149	1,744,048	149	1,744,048
Health	23	473,499	35	201,854	66	4,019,903	124	4,695,256	124	4,695,256
Hotels (Includng Resort Hotels,Motels and Lodges)and Resaurants	44	799,357	68	1,112,420	248	12,507,938	360	14,419,714	360	14,419,714
Tour Operation, Transport, storage and communication	19	88,400	40	82,711	213	835,027	272	1,006,137	272	1,006,137
Real estate,Machinery and Equipment Rental and Consultancy Service	75	1,839,154	355	4,940,730	932	26,180,482	1,362	32,960,366	1,362	32,960,366
Construction Contracting Including Water Well Drilling	39	1,578,529	88	4,158,444	249	34,554,582	376	40,291,555	376	40,291,555
Others*	14	160,448	41	462,982	57	702,778	112	1,326,208	112	1,326,208
Grand Total	743	105,217,110	1,444	42,726,870	4,048	239,938,958	6,235	387,882,938	6,235	387,882,938

* includes Import and Distribution of LPG, Export of Flowers, Fruits, Vegetables, Tomato Paste & Beverages, Spices, TIME Sharing Tourist Promotion, Recreation and Gymnasium Center etc

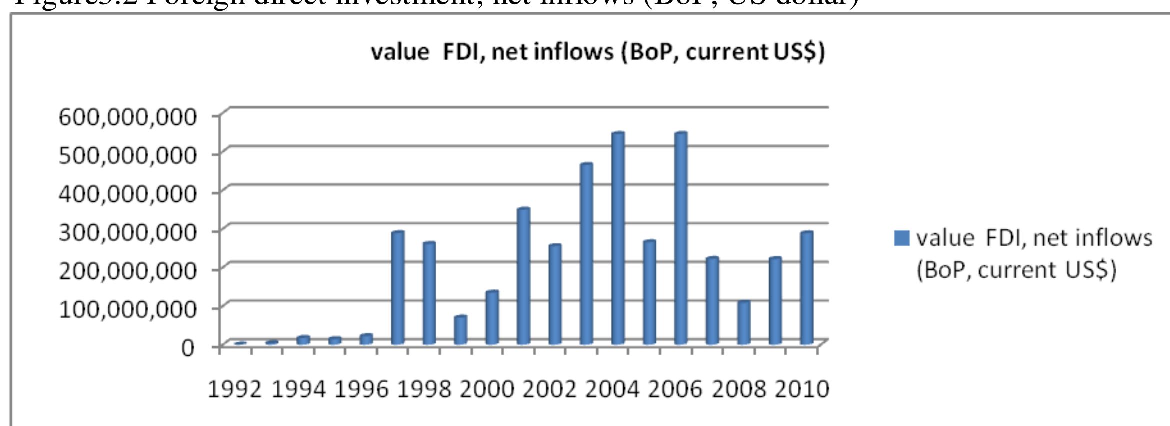
Source: EIA 2012unpublished

Table 3.1. General country profile

Official Name	Federal Democratic Republic of Ethiopia (FDRE)
Political System	Federal System with multi-party democracy
Regional States/City Administrations	Tigray; Oromia; Amhara; Afar; Southern Nations, Nationalities and Peoples Region; Benshangul Gumuz; Harari; Gambella; Addis Ababa City Administration; Dire Dawa Administrative Council.
Capital City	Addis Ababa
Area	1.14 million square kilometers
Population	80.1 million (July 2010)
Language	Ethiopia is a multi-ethnic state with diverse languages. Amharic is the working language of the Federal Government. English is widely used in business transactions, and as a medium of instruction in secondary schools and higher educational institutions.
Religion	Major religions are Christianity and Islam.
Calendar	Ethiopia uses a unique calendar which divides the year into 12 months of 30 days each. The remaining five or six days in a leap year constitute the short 13th month of "Pagumen". The calendar is seven years behind the Gregorian calendar with the Ethiopian new year falling in the month of September.
Financial Year	8 July – 7 July
Monetary Unit	1 Birr = 100 cents
Exchange rate	USD = 17.8393 ETB (As of May 6, 2012)
Internet domain	.et
Int'l dialing code	+251

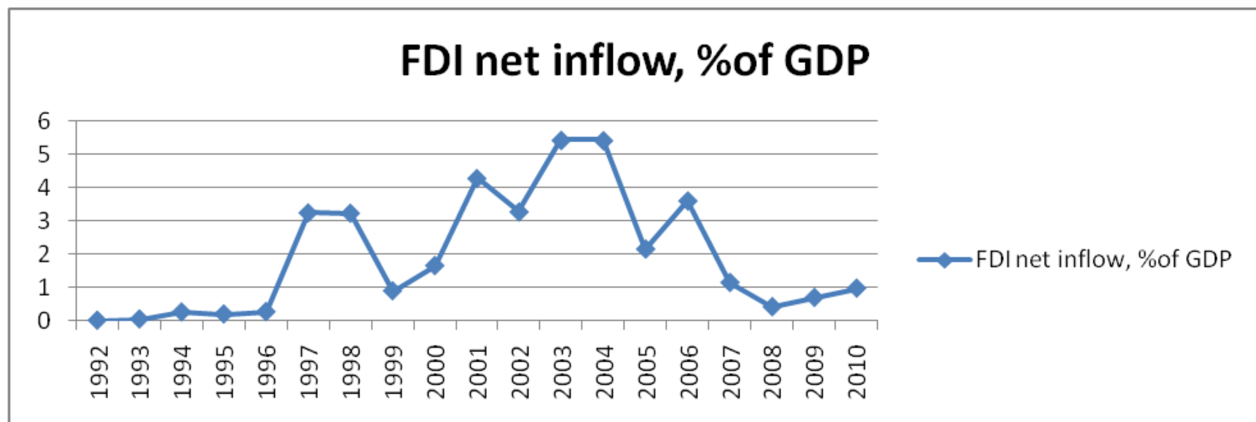
Source: EIA 2010 online publications http://www.ethioinvest.org/Investment_Regime.php

Figure3.2 Foreign direct investment; net inflows (BoP; US dollar)



Source: International Monetary Fund, International Financial Statistics and Balance of Payments databases, World Bank, Global Development Finance, and World Bank and OECD GDP estimates.

Figure3.3. Foreign direct investment; net inflows (% of GDP) in Ethiopia



Source: International Monetary Fund, International Financial Statistics and Balance of Payments databases, World Bank, Global Development Finance, and World Bank and OECD GDP estimates.

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