
DETERMINANTS OF FOREIGN DIRECT INVESTMENT IN ETHIOPIA

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Abstract- Foreign Direct investment (FDI) plays an important role in bringing growth opportunities in recipient countries particularly; it served as a vehicle for the transfer of technologies and capital, and export development, job and skill creation in developing countries. FDI is investing by citizens and government of a country in the productive assets (domestic structures, organizations and equipments) of another country.

The objective of the present study was to assess the trends of FDI flow and to examine determinants responsible for FDI flow to Ethiopia for the past three decades (1981-2009). Secondary data were employed. Variables which are adopted by the present study in order to assess the determinants of FDI flow to Ethiopia were derived from a number of studies which were conducted before to assess the same for majority of successful countries in FDI flow. Linear regression model, annual percentage growth rate model were used to analyse the data. Analysing the trend and identifying the determinants of FDI inflow to Ethiopia is a key step to draw sound policy implications. This would help policy makers as an input to develop investment framework, which can boost the share of FDI inflow to Ethiopia and building up foreign investors' confidence. In addition, to policy implications, the present study can help academicians and researchers to further conduct studies in this vital area of development.

It is found that, the FDI inflow to Ethiopia from 1980-1995 was insignificant with stagnant growth mainly because of the political instability of the country. However, soon after Ethiopia declared as a democratic country, starting from 1995 onwards the share of FDI inflow to Ethiopia exhibited a tremendous growth. Generally, the trend shows that, the FDI inflow to Ethiopia grew 2791.68% between the years 1981 to 2009 at a rate of 96.26 percent annually. The present study proved that, FDI inflow to Ethiopia is highly influenced by the country's political stability at 1% significance level and Implementation of privatization program at 0.99% significance level and positively related to FDI inward flow. However, the contributions of the other variables like country's cleanness from corruption, investment incentives, trade openness, trade and bilateral FDI agreements, market size (population size) and GDP of the country being the determinant for FDI inflow to Ethiopia is not significant. Accordingly, recommendations and policy implications have been drawn based on the findings of the present study.

Keywords: Ethiopia, FDI, FDI inflow, Foreign Direct Investment, FDI flow, Investment

Introduction: Pace in globalisation for the last two decades has led to strong growth of international business activity and Foreign Direct investment (FDI). The continuous inflow of capital to developing countries can bring a great contribution by increasing efficiency and productivity. Additionally, it is important to further growth opportunities in recipient countries such as technology transfer, export development, job and skill creation. Given the above advantage each and every country should identify particular determinants that would enhance the flow of FDI to the country in order to better realise the benefit which can be derived out of it.

For the past four decades Ethiopia is being involved in FDI transaction. However, the share of FDI inflow to the country accounted insignificant while, comparing with some other African countries and even with some of neighbouring countries of East Africa. Therefore, identifying the determinants of FDI to Ethiopia would help policy makers to take corrective action and to streamline the investment frame work accordingly.

Statement of the Problem: Due to its importance to alleviate the existing economic, technological and

lack of managerial skill problems in developing countries, FDI has risen sharply over the past two decades. This has been observed by several researchers since the early 1980s (Lall , 1983 and UNCTAD, 2004).

The Government of Ethiopia has taken several measures and issued several investment incentives to attract foreign investors, to ensure sustainable economic growth. In addition, Ethiopian Investment Authority (EIA) has been established to service investors and simplify the investment procedures. However, the share of FDI inflow to Ethiopia for the past three decade is low compared to many of African countries.

At this juncture, identifying the determinants of FDI in Ethiopia is a key step to draw sound policy implications which would help policy makers as an input to develop investment framework which can boost the share of FDI inflow to Ethiopia and building up foreign investors' confidence. In addition, to policy implications, the study can help academicians and researchers to further conduct studies in this vital area of development.

Objectives of the Study: The objectives study were

to assess the trend of FDI flow and to identify the major determinants of FDI in Ethiopia.

Materials and Methods: In order to assess and analyze the trends of FDI inflow to Ethiopia, secondary data of FDI inflow to Ethiopia have been collected and analyzed. The results got were justified with the governmental measures as well as other developments in Ethiopia to attract foreign investors' and to boost the share of FDI inflow.

To identify the major determinants responsible for FDI inflow to Ethiopia, the variables which were adopted by most of successful countries in FDI were considered. This includes; cleanness of the country from corruption, international FDI agreements, investment incentives, implementation of privatization programmes, openness to FDI or trade openness of the country, and market size and political stability of the country. The above determinants become the major source for attracting foreign investors in different countries. Hence, present study also intended to assess the impact of the above determinants on FDI inflow to Ethiopia.

Secondary sources of data were used for present study from UNCTAD statistics for data related to FDI, from Transparency International for data related to Corruption perception Index of Ethiopia, from World Bank data related to GDP, Market size (population). In order to identify determinants of FDI inflow to Ethiopia variables like FDI inflow, market size (total population size), trade openness (the ratio of total trade (import plus export) to GDP) data from 1981-2009 and corruption perception index of the country from 2002-2009 were taken in to account. Additionally, pre and post of impact of investment incentives, the number of trade and bilateral FDI agreements agreements(treaties), political stability of the country (when the country become democratic) and implementations of privatisation program in Ethiopia have been taken in to account. Accordingly, linear regression model, annual percentage growth rate model were used to analyse the data.

Results and Discussion:

Trends of FDI inflow to Ethiopia: Ethiopia experienced unstable political environment for a long time. From 1974-1987 the country ruled by Derg /provisional military government of socialist Ethiopia, followed by 1987 to 1991 ruled by people democratic republic of Ethiopia, from 1991-June 1995 ruled by transitional government of Ethiopia and later from 1995 onwards to date (2013) Ethiopia become a democratic country being ruled by Federal Democratic Republic of Ethiopia.

From the year 1980 to 1995 the share of FDI inflow to Ethiopia was insignificant and was stagnant for a long time.

$$PR = \frac{(V^{present} - V^{past})}{V^{past}} \times 100 \text{ -----1}$$

Where: PR = Percent Rate

V_{Present} = Present or Future Value

V_{Past} = Past or Present Value

The annual percentage growth rate:

$$PR = \frac{(V^{present} - V^{past})}{V^{past}} \times 100 \text{ -----2}$$

Where, N= is the number of years.

$$\text{Trade openness} = \frac{(\text{Import} + \text{Export})}{\text{GDP}} \text{ -----3}$$

However, after the change in the existing political system in 1995, privatisation programme of state owned enterprises were introduced in 1995. After the implementation of privatisation the share FDI inflow to Ethiopia increased radically.

However, due to political instability with neighbour country, from 1998-2000, the FDI inflow to the country drastically decreased. FDI inflow to Ethiopia for the year 1997 accounted US\$ 407.07 million with 11.85 annual percentage growth rates, which is before the political instability. However, for the year 2000 the total FDI inflow was only US\$ 170.45 million with 0.9 annual percentage growth rates.

In addition to political stability in the country, there are several measures taken by the government of Ethiopia in order to attract foreign investors. Some of those measures are; implementation of government reforms in the public sector that addressed the improvement of efficiency among civil servants since 1992 and come in to force till 1994. Secondly, the introduction of anti-corruption initiatives including the Federal Ethics and Anti-corruption Commission in 2001, Thirdly, issuance of the investment proclamation no. 280/2002, which introduced several changes like reducing the minimum investment capital required for foreign investors, allowing foreign investor or foreign national treated as domestic investor, the right to own a dwelling house and other immovable property required for investment and allowing investors to employ duly qualified expatriate experts required for the operation of their business are some of the reason lay FDI to increase.

Generally, due to the effort made by the government of Ethiopia to settle conducive investment environment for foreign investors led to register a remarkable increase in the economy. The trend shows that, the FDI inflow to Ethiopia grew 2791.68% between the years 1981 to 2009 at a rate of 96.26 percent annually.

Determinants of FDI inward flow to Ethiopia

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.918 ^a	.842	.790	1.05713

a. Predictors: (Constant), Number of Bilateral and trade Agreement, Real GDP , Trade Openness, Investment Incentive, Market Size (Population) , Implementations of privatization, Cleanness from Corruption (based on Corruption perception Index (CPI), Political stability

R square value as a measure of goodness-of-fit, in the present study, 84 % of total variance in FDI inflow to Ethiopia is explained by the linear regression model.

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.	
	B	Std. Error	Beta			
1	(Constant)	0.468	0.392		1.195	.245
	Market Size (Population)	0.020	0.019	.142	1.055	.303
	Trade Openness	-0.565	0.110	-.472	-5.155	.000
	Real GDP	0.015	0.084	.022	.174	.864
	Cleanness from Corruption CPI index	0.529	0.380	.273	1.393	.178
	Investment Incentive	0.654	0.721	.140	.906	.375
	Implementations of privatization	4.484	0.878	.989	5.105	.000
	Number of trade and Bilateral investment Agreement	-0.148	0.070	-.588	-2.107	.047
Political stability ^b	3.497	0.556	.771	6.296	.000	

Dependent Variable: FDI inward flow to Ethiopia (a)

Regression Equation: FDI = 0.468(constant) + 0.020 Market size (Total population) - 0.565 Trade openness + 0.015 Real GDP + 0.529 Cleanness from Corruption(CPI index) + 0.645 investment incentives + 4.484 Implementation of privatization - 0.148 Number of trade and Bilateral investment Agreement + 3.497 Political stability+μ(error term)

The present study found that, FDI inflow to Ethiopia is highly influenced by the country’s political stability, implementation of privatization program and trade openness at 1% significance level. Both political stability and implementation of privatization program are positively related to FDI inward flow whereas; trade openness of the country is negatively related to FDI inward flow.

FDI inflow to Ethiopia is also influenced by the number of bilateral and trade agreement at 5% level of significant and it is negatively related to FDI inward flow. Whereas, the contributions of the other variables like country’s cleanness from corruption, investment incentives, market size (population size) and GDP of the country being the determinant for FDI inflow to Ethiopia were not significant based on the result detected by the model.

Prior to implementation of privatisation program from the year 1980 to 1995 for a total of fifteen years the total FDI inflow to the Ethiopia was only US\$

101.65 million with a cumulative yearly average inflow of US\$ 6.78 million . Whereas, during post implementation of privatisation (1996 to 2009) for a total of fifteen years FDI inflow to Ethiopia registered a remarkable increase and it was US\$ 413.06 million with a cumulative yearly average inflow of US\$ 293.79 million.

The results are consistent with the arguments that political factors are important in explaining FDI flows. The finding of the present study is also supported by the study which was conducted by Nega and Moges (2003), transparent, stable, and reliable legal and regulatory frameworks of a country can promote both domestic and foreign investment. Similarly, a study which was conducted by UNCTAD (1998), which found that, if privatization programmes welcome foreign investors, then it broadens the scope of FDI.

A study on analysing the determinants of FDI in Malaysia which was conducted by Ahmed and Hassan (2013), they found that trade openness is negatively significant to contribute FDI.

However, the finding of the present study is contradicted with the study which was conducted by Asiedu (2002); Sahoo (2006), were found that trade openness is expected to be a positive and significant determinant of FDI however, the present study found

that trade openness is negatively related.

Conclusion and Policy Implications: The growth rate of FDI inward flow for the past three decades (1981-2009) was witnessed the government's effort in creating conducive business and investment environment for foreign investors. The trend of FDI flow to Ethiopia shows there is a remarkable increase with the growth of 2791.68% between the years 1981 to 2009 at a rate of 96.26 percent annually.

In order to increase the share of FDI inward flow to Ethiopia, it needs to give special attention to the major determinants of FDI inflow to the country, especially political stability and implementation of

privatisation program which worth the highest position. Since, Ethiopia is a country with enormous natural resources like vast area of fertile agricultural land for investment with less number of Agribusiness investors; vast area of water coverage for fishery investment, Mining sites, high tourism traffic hub but less international hotels and loge, and huge domestic market size but less specialised rural ventures. Therefore, the researchers recommend foreign investors to be benefited from the blessings of Ethiopian natural resources and with the existing investment demand through bridging the gap.

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