ST. MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

DETERMINANTS OF FOREIGN DIRECT INVESTMENT IN ETHIOPIA

BY

SHAMBEL TESHOME

ID NO: SGS/0032/2005

JUNE, 2014

ADDIS ABABA, ETHIOPIA

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A THESIS SUBMITTED TO ST.MARY'S UNIVERSITY, SCHOOL OF GRADUATE STUDIES IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF DEGREE OF MASTER OF BUSINESS ADMINISTRATION (MBA GENERAL)

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DECLARATION

I, the under signed, declare that this thesis is my original work, prepared under the guidance of Dr. Tabor G/Medhin. All sources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

Shambel Teshome _____

Name Signature & Date

ENDORSEMENT

This thesis has been submitted to St. Mary's University, School of Graduate Studies for examination with my approval as a university advisor.

Tabor G/Medhin (Dr.) _____

Advisor Signature & date

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List of Abbreviations

EIA:	Ethiopian Investment Authority
EXCH:	Exchange Rate
EXP:	Export
FDI:	Foreign Direct Investment
GEXP:	Government Expenditure
GFCF:	Gross Fixed Capital Formation
ILLIT:	Rate of Adult Illiteracy
IMF:	International Monetary Fund
INF:	Inflation Rate
LFPR:	Labour Force Rate
LIB:	Liberalizations
MNE:	Multinational Enterprise
NGO:	Non-Governmental Organisation
RGDPPC:	Real Gross Domestic Product Per Capita
SSA:	Sub-Saharan Africa
TELE:	Telephone Line per 1000 People
TOP:	Trade Openness
UNCTAD:	United Nations Conference on Trade And Development
WDI:	World Development Indicators

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ABSTRACT

This study deals with identifying the determinants of foreign direct investment inflow into Ethiopia for the period of 1974 to 2012. The study used single regression equation model for testing the formulated hypothesis of each independent variable and multiple linear regression models are also used for analyzing the impact of all independent variable on foreign direct investment inflows. The main contribution and challenges of foreign direct investment to the country economic development has also evaluated. The existing government incentive directed towards foreign direct investment activities were examined and there is the Council of Ministers Regulations No.84/2003, as amended in 2008, which specifies the areas of investment eligible for investment incentives. The variables used in this study are trade openness, gross domestic product per capita, telephone line (per 1,000 people), rate of adult illiteracy, inflation rate, exchange rate, government expenditure, labour force participation rate, gross fixed capital formation and liberalization using dummy variable are the independent variables while foreign direct investment as a percentage of GDP is the dependent variable. The study findings show that trade openness, export, gross fixed capital formation, exchange rate, availability of skilled human capital, major improvements in infrastructure and trade liberalization are the most significant determinant of foreign direct investment inflow into Ethiopia. On the other hand, rate of adult illiteracy have negative impact on inflow of FDI.

Key word: Ethiopia

CHAPTER ONE: INTRODUCTION

1.1 Chapter Introduction

This study intended to examine the determinants of foreign direct investment inflow into Ethiopia. The purpose is to have the broad understanding of the determinants of foreign direct investment in the country. This chapter provides the background of the study, statement of the problem, main and specific objectives of the study, research questions, hypothesis, and definitions of terms, significance of the study, delimitation and finally organization of the research report

1.2 Background of the Study

Sustainable economic growth is highly determined by the rate of investment which in turn is mainly determined by the national saving level. The national saving level of countries in Africa is quite low. Foreign direct investment (FDI) is an alternative source of capital to bridge the gap between savings and the required investment level. Nevertheless, the developmental role of foreign direct investment is high debated. The proponents of foreign direct investment point out that FDI fills savings, foreign exchange and local revenue gaps of developing economies. FDI can also provide managerial, entrepreneurial and technological skills and increase export and integrate the country's economy into global economic network. Conversely, the other group argues that the benefits that can be derived from FDI inflows are quite small compared to the adverse effect. The major costs of FDI include stifling of infant domestic industries, loss of political sovereignty and deterioration of balance of payment due to the foreign investors' excessive capital good importation and repatriation of profit (Francis, International Business: Text and Cases, 3rd ed.).

In recent times, however, most empirical studies conclude that FDI enhances factor productivity, the efficiency of resources use and national income of the host country (OECD, 2002). A study on 58 developing countries also concludes that FDI enhances private domestic investments (Douglas et al, 2003). As a result of this, in the present globalized word, many countries spend enormous resources and time to design policies that encourage the inflows of FDI, as appropriately designed policy plays important role in promoting FDI inflows.

In 1992, Ethiopia's transition to a market oriented economy started (Ethiopian Investment Guide, 2013). Since then, the government has made a broad range of policy reforms, including liberalization of foreign trade regime, decentralization of economic and political power, deregulation of domestic price and devaluation of the national currency. In addition, the investment law has been revised over three times for the last twenty years (1992-2012) in order to meet the demand of both domestic and foreign investors. When we compare to other countries it need more jobs to attract foreign direct investment in Ethiopia. Therefore, it is essential to understand the principal determinants of FDI in these countries in general. Major positive changes regarding foreign investments have been introduced through Investment Proclamation No.280/2002 and Regulations No.84/2003. As a result of the implementation of the above mentioned policies and strategies, agricultural and industrial production, investment and export trade are growing steadily from year to year both in terms of variety and volume even though there is volatility.

1.3 Statement of the Problem

Foreign direct investment plays an extraordinary and growing role in global business. It can provide a firm with new markets and marketing channels, cheaper production facilities, access to new technology, products, skills and financing. For a host country or the foreign firm which receives the investment, it can provide a source of new technologies, capital, processes, products, organizational technologies and management skills, and as such can provide a strong impetus to economic development.

The trend of foreign direct investment in Ethiopia shows fluctuating values even though the recent one is the highest of the previous 38 years. The net inflow of foreign direct investment (% of GDP) in Ethiopia was 2.07 as of 2011. Its highest value over the past 39 years was 5.45 in 2003, while its lowest value was 0.00 in 1992(International Financial Statistics and BOP databases). With poor national saving level of Ethiopia, foreign direct investment is the alternative source of capital for the sustainable economic growth.

This research addresses the problem/challenges of foreign direct investment in the country's economic development, determinant of attracting foreign direct investment, contribution of FDI in the country's economic development, and measure to be taken in order to improve inflow of FDI into Ethiopia.

1.4 Objectives of the Study

1.4.1General Objective

The general objective of the study was to analyze the determinants factors contributing to inflow of Foreign Direct Investment (FDI) in Ethiopia

1.4.2 Specific Objectives

The study was guided by the following specific objectives:-

- ✓ To identify and assess the determinants of attracting FDI inflows to Ethiopia;
- ✓ To Review the economic and FDI performance of Ethiopia;
- ✓ To evaluate the existing government incentives directed towards FDI activities;
- ✓ To examine the problems/challenges of FDI in contributing to the country's economic development;
- ✓ To propose recommendations that could help for the improvement of FDI based on the findings.

1.5 Research Questions

1.5.1 General Research Question

The primary research question was; what are the determinants of Foreign Direct Investments (FDIs) in Ethiopia?

1.5.2 Specific Research Questions

To operationalize the main research question, the following specific research questions were used:

- ✓ What are the determinants attracting FDIs in Ethiopia?
- ✓ What are the contributions of FDI to the country's economic development?
- ✓ What are the problems/challenges of FDI in contributing to the country's economic development?

- ✓ What measures need to be taken in order to improve the FDI in Ethiopia?

1.6 Hypothesis

There is a large amount of literature analyzing the determinants of foreign direct investment inflows in a host country. Some main determinants of FDI such as real gross domestic product per capita, human capital, labour cost, export, taxes, political stability, corruption and openness are most supported in the empirical literature. A country with high infrastructure is most likely to attract foreign investment. Based on previous findings, this study identifies eleven main potentially important determinants of FDI inflows to Ethiopia. We formulated this hypothesis to test the relationship between each independents variable with foreign direct investment. The variables, research's hypothesis and their expected signs are as follows:

Hypothesis 1

H_O: Real exchange rate is not significant factors of FDI inflows and can be expected positive or negative sign.

H_1: Real exchange rate is significant factors of FDI inflows.

Hypothesis 2

H_O: Real gross domestic product per capita is not significant factors of FDI inflows and can be expected positive sign.

H_1: Real gross domestic product per capita is significant factors of FDI inflows.

Hypothesis 3

H_O: Government expenditure is not significant factors of FDI inflows and can be expected negative sign.

H_1: Government expenditure is significant factors of FDI inflows.

Hypothesis 4

H_O: Trade openness is not significant factors of FDI inflows and can be expected positive sign.

H_1: Trade openness is significant factors of FDI inflows.

Hypothesis 5

H_O: Inflation Rate is not significant factors of FDI inflows and can be expected positive or negative sign.

H_1: Inflation Rate is significant factors of FDI inflows.

Hypothesis 6

H_O: Infrastructure development is not significant factors of FDI inflows and can be expected positive sign.

H_1: Infrastructure development is significant factors of FDI inflows.

Hypothesis 7

H_O: Human capital is not significant factors of FDI inflows and can be expected positive sign.

H_1: Human capital is significant factors of FDI inflows.

Hypothesis 8

H_O: Liberalization of trade is not significant factors of FDI inflows and can be expected positive sign.

H_1: Liberalization of trade is significant factors of FDI inflows.

Hypothesis 9

H_O: Export is not significant factors of FDI inflows and can be expected positive sign.

H_1: Export is significant factors of FDI inflows.

1.7 Definitions of Terms

1.7.1 Foreign Direct Investment (FDI)

UNCTAD's world Investment Report defines FDI as an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor enterprise or affiliate enterprise or foreign affiliate.

1.7.2 Infrastructure

The term typically refers to the technical structures that support a society, such as roads, water supply, sewers, power grids, telecommunications, and so forth .

1.7.3 Exchange Rate (EXCH)

It is a rate at which one currency can be converted into another.

1.7.4 Real Gross Domestic Product Per Capita (RGDPPC)

Real Gross Domestic Product (real GDP) is a macroeconomic measure of the value of economic output adjusted for price changes (i.e., inflation or deflation). (en.wikipedia.org)

1.7.5 Government Expenditure (GEXP)

Government spending is spending by central government and local authorities on the provision of goods and services, transfer payments and debt repayments. It is also called public expenditure. (www.alanpedia.com)

1.7.6 Trade Openness (TOP)

Trade openness refers to the level which countries or economies allow or have trade with other countries or economies. (www.ask.com)

1.7.7 Inflation Rate (INF)

In economics, inflation is a sustained increase in the general price level of goods and services in an economy over a period of time.(en.wikipedia.org)

1.7.8 Gross Fixed Capital Formation (GFCF)

Statistically it measures the value of acquisitions of new or existing fixed assets by the business sector, governments and "pure" households (excluding their unincorporated enterprises) less disposals of fixed assets. GFCF is a component of the expenditure on gross domestic product (GDP), and thus shows something about how much of the new value added in the economy is invested rather than consumed. (en.wikipedia.org)

1.7.9 Labour Force Participation Rate (LFPR)

The labor force participation rate is the percentage of working-age persons in an economy who: are employed and unemployed but looking for a job (economics.about.com)

1.7.10 Trade Liberalization (LIB)

The removal or reduction of restrictions or barriers on the free exchange of goods between nations. (www.investopedia.com)

1.8 Significance of the Study

Saving and investment gap is a common problem in most of developing countries, especially in Sub-Saharan Africa countries characterized by poor economic performance. In this situation countries may see FDI as one of the options to fill this saving-investment gap and improve their economic performance. The study helps to understand the determinants of foreign direct investment in Ethiopia. It can contribute as a reference and opens up a way for students and teachers who may wish to conduct further studies on the issues related to the determinants of Foreign Direct Investment in Ethiopia. On the other hand the study enables the researcher to meet one of a necessary condition of being awarded a degree of Master of Business Administration.

1.9 Delimitation of the Study

The study focused on the determinants of Foreign Direct Investment (FDI) in Ethiopia. In completing this study, the samples that have been used are based on 39 years data in yearly basis. Data on foreign exchange rate is obtained from National Bank of Ethiopia, data on foreign direct investment are obtained from Ethiopian Investment Agency and data on import, export, rate of adult illiteracy, foreign direct investment and telephone line per 1000 people are obtained from World Bank development indicator database and UNCTAD, UNCTADstat website.

1.10 Organization of the Research Report

This thesis has five chapters. After the above introduction, chapter two provides a review of theoretical and empirical literature related to FDI. Chapter three provides research design and methodology. The data types and sources, model specification and estimation techniques are discussed in this chapter. Chapter four reports the results of the empirical analysis and summary of findings, conclusions and recommendations are presented in chapter five.

CHAPTER TWO: REVIEW OF RELATED LITERATURE

2.1 Chapter Introduction

This chapter provides an overview of global foreign direct investments, contributions of foreign direct investments on developing economies, overview of Ethiopia's recent economic and FDI performance, regulatory and institutional framework of FDI in Ethiopia, Ethiopian investment incentives, challenges of foreign direct investment and d**e**terminants of Foreign Direct Investments in Ethiopia. The last section reviews empirical studies on the determinants of FDI in emerging or developing countries and on Ethiopia in particular.

2.2 Definition of Foreign Direct Investment

A clear cut definition of Foreign Direct Investment (FDI) is very difficult (Haluk Sezer(Piggot and Cook,2006)). Definitions of FDI were formulated depending on its international characteristics and Multinational Corporation's (MNC's) activities in host countries and some authors even contrast it with portfolio investment. The definition thus evolved and recognized, often has two common elements such as, involvement of two countries-which quite often described as the issue of ownership and management- which makes it entirely different from portfolio investment. FDI is therefore considered as the ownership and management of production activities abroad, where as foreign portfolio investment is the transfer of financial capital, loan or equity from one country to another. FDI stand aside due to its complexity, because it involves transfer of managerial and organizational ability and technical know-how. The definition of FDI is not isolated. The FDI being a part of MNC's activities, a single and isolated definition is not possible. Therefore the definition of MNC's is somewhat similar to that of MNC's (Haluk Sezer(Piggot and Cook,2006)).

Despite of its difficulty many definitions have evolved. According to the IMF balance of payment manual defines FDI "as an investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management of the enterprise" Imada Moosa(2002). Brooks, Fan & Sumulong, 2003) defined foreign direct investment as the flow of capital from one firm in one economy to another firm in another economy. This constitutes the general

concept of foreign direct investment. OECD (2008) defined foreign direct investment as a form of investment made with the objective of creating a long-term interest by a direct investor or direct enterprise based in one economy to a direct investment enterprise based in another economy. Long-term interest implies significant control, but not necessarily controlling interest, gained by direct investors or direct enterprises. This constitutes the specific conceptualization of foreign direct investment. UNCTAD's world Investment Report defines FDI as an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor enterprise or affiliate enterprise or foreign affiliate.

By keeping in mind all the above said definitions, we can define FDI as the investment made by a firm (MNC's) in another country to utilize the resources available in that country so as to expand internationally and to gain long-term profits.

2.3 Theoretical Framework on Foreign Direct Investment

A number of theories have been developed to explain the determinants of FDI. Extensive reviews of the main FDI theories and determinants of FDI range from the economic theories of Vernon (1966), the internationalization theories of Rugman (1981) and Dunning's (1993) eclectic paradigm. The search for FDI theories is a recent phenomenon, despite the domination of world production and trade by the MNEs in the post Second World war period. It was in 1960, when Stephen, H. Hymer, in his doctoral dissertation. MNEs existence owed to the local firms wielding market power, and who acted as their agents.

The approaches which explain the activities of multinational enterprises may broadly be classified into four groups.

Firstly, there is market imperfection approach whose theoretical framework considers certain specific advantages, also known as ownership advantages, enjoyed by an enterprise.

Secondly, there is Vernon's product life cycle theory which is another explanation of FDI worthy of some discussion. This theory focuses on the role of innovation and economies of scale in determining trade patterns. It states that FDI is a stage in the life cycle of a new product from its invention to maturity. A new product is first manufactured in the home country for the home market. When the home market is saturated, the product is exported to

other countries. At later stages, when the new product reaches maturity and loses its uniqueness, competition from similar rival products becomes more intense. At this stage producers would then look for lower cost foreign locations. This theory shows how market seeking and cost reduction motives of companies lead to FDI. Product Life Cycle model examines the various stage of the firm. There are sequential stages in the life cycle of the products innovated by a particular company.

Thirdly, the failure of the orthodox theories of international trade and capital movements based upon the assumption of perfect competition and its prevalence in different segments of international market provide adequate explanation for the substitution of the FDI. It gave rise to the transaction cost theory of the FDI that the firms undertake foreign investments for raising their efficiency and reducing the transaction costs.

Fourthly, the eclectic theory developed by professor Dunning is a mix of three different theories of Foreign direct investments (O-L-I):

1. "O" from Ownership advantages: This refer to intangible assets, which are, at least for a while exclusive possess of the company and may be transferred within transnational companies at low costs, leading either to higher incomes or reduced costs. But TNCs operations performed in different countries face some additional costs. There by to successfully enter a foreign market; a company must have certain characteristics that would triumph over operating costs on a foreign market. These advantages are the property competences or the specific benefits of the company. The firm has a monopoly over its own specific advantages and using them abroad leads to higher marginal profitability or lower marginal cost than other competitors. (Dunning, 1973, 1980, 1988). There are three types of specific advantages:
   a) Monopoly advantages in the form of privileged access to markets through ownership of natural limited resources, patents, trademarks;

   b) Technology, knowledge broadly defined so as to contain all forms of innovation activities

   c) Economies of large size such as economies of learning, economies of scale and scope, greater access to financial capital;

2. "L" from Location: When the first condition is fulfilled, it must be more advantageous for the company that owns them to use them itself rather than sell them or rent them to foreign firms. Location advantages of different countries are de key factors to determining

who will become host countries for the activities of the transnational corporations. The specific advantages of each country can be divided into three categories:

a) The economic benefits consist of quantitative and qualitative factors of production, costs of transport, telecommunications, market size etc.

b) Political advantages: common and specific government policies that affect FDI flows

c) Social advantages: includes distance between the home and home countries, cultural diversity, attitude towards strangers etc.

3. "I" from Internalization: Supposing the first two conditions are met, it must be profitable for the company the use of these advantages, in collaboration with at least some factors outside the country of origin (Dunning, 1973, 1980, 1988). This third characteristic of the eclectic paradigm OLI offers a framework for assessing different ways in which the company will exploit its powers from the sale of goods and services to various agreements that might be signed between the companies. As cross-border market Internalization benefits is higher the more the firm will want to engage in foreign production rather than offering this right under license, franchise. Eclectic paradigm OLI shows that OLI parameters are different from company to company and depend on context and reflect the economic, political, social characteristics of the host country. Therefore the objectives and strategies of the firms, the magnitude and pattern of production will depend on the challenges and opportunities offered by different types of countries.

2.4 Overview of Global Foreign Direct Investments

Global foreign direct investment (FDI) fell by 18 per cent to $1.35 trillion in 2012. This sharp decline was in stark contrast to other key economic indicators such as GDP, international trade and employment, which all registered positive growth at the global level. Economic fragility and policy uncertainty in a number of major economies gave rise to caution among investors. Furthermore, many transnational corporations (TNCs) reprofiled their investments overseas, including through restructuring of assets, divestment and relocation. The road to FDI recovery is thus proving bumpy and may take longer than expected.

UNCTAD forecasts FDI in 2013 to remain close to the 2012 level, with an upper range of $1.45 trillion – a level comparable to the pre-crisis average of 2005–2007 (figure 1). As macroeconomic conditions improve and investors regain confidence in the medium term, TNCs may convert their record levels of cash holdings into new investments. FDI flows may

then reach the level of $1.6 trillion in 2014 and $1.8 trillion in 2015. However, significant risks to this growth scenario remain. Factors such as structural weaknesses in the global financial system, the possible deterioration of the macroeconomic environment, and significant policy uncertainty in areas crucial for investor confidence might lead to a further decline in FDI flows. (UNCTAD, 2013)

FDI flows to developing economies proved to be much more resilient than flows to developed countries, recording their second highest level – even though they declined slightly (by 4 per cent) to $703 billion in 2012 (table 1). They accounted for a record 52 per cent of global FDI inflows, exceeding flows to developed economies for the first time ever, by $142 billion. Africa saw a year-on-year increase in FDI inflows in 2012 (table 1).

Table 1. FDI flows by region, 2010–2012
(Billions of dollars and per cent)

Region	FDI inflows			FDI outflows		
	2010	2011	2012	2010	2011	2012
World	**1 409**	**1 652**	**1 351**	**1 505**	**1 678**	**1 391**
Developed economies	696	820	561	1 030	1 183	909
Developing economies	637	735	703	413	422	426
Africa	44	48	50	9	5	14
Asia	401	436	407	284	311	308
East and South-East Asia	313	343	326	254	271	275
South Asia	29	44	34	16	13	9
West Asia	59	49	47	13	26	24
Latin America and the Caribbean	190	249	244	119	105	103
Oceania	3	2	2	1	1	1
Transition economies	75	96	87	62	73	55
Structurally weak, vulnerable and small economies	**45**	**56**	**60**	**12**	**10**	**10**
Least developed countries	19	21	26	3.0	3.0	5.0
Landlocked developing countries	27	34	35	9.3	5.5	3.1
Small island developing States	4.7	5.6	6.2	0.3	1.8	1.8
Memorandum: percentage share in world FDI flows						
Developed economies	49.4	49.7	41.5	68.4	70.5	65.4
Developing economies	45.2	44.5	52.0	27.5	25.2	30.6
Africa	3.1	2.9	3.7	0.6	0.3	1.0
Asia	28.4	26.4	30.1	18.9	18.5	22.2
East and South-East Asia	22.2	20.8	24.1	16.9	16.2	19.8
South Asia	2.0	2.7	2.5	1.1	0.8	0.7
West Asia	4.2	3.0	3.5	0.9	1.6	1.7
Latin America and the Caribbean	13.5	15.1	18.1	7.9	6.3	7.4
Oceania	0.2	0.1	0.2	0.0	0.1	0.0
Transition economies	5.3	5.8	6.5	4.1	4.3	4.0
Structurally weak, vulnerable and small economies	**3.2**	**3.4**	**4.4**	**0.8**	**0.6**	**0.7**
Least developed countries	1.3	1.3	1.9	0.2	0.2	0.4
Landlocked developing countries	1.9	2.1	2.6	0.6	0.3	0.2
Small island developing States	0.3	0.3	0.5	0.0	0.1	0.1

Source: UNCTAD, World Investment Report 2013.

Developing economies' outflows reached $426 billion, a record 31 per cent of the world total. Despite the global downturn, TNCs from developing countries continued their expansion abroad. Asian countries remained the largest source of FDI, accounting for three quarters of the developing-country total. FDI outflows from Africa tripled while flows from developing

Asia and from Latin America and the Caribbean remained at the 2011 level.

2.5 Contributions of Foreign Direct Investments on Developing Economies

Foreign direct investment could improve welfare in developing economies. First benefit of foreign direct investment is the increase in output and income of the host economy. The investment of capital to different economic sectors increases the levels of production resulting to growth and expansion of business. This creates employment opportunities that in turn translate into income for households. With household incomes, spending increases that supports revenue generation for businesses. This goes on in a growing cycle of growth. Second benefit of foreign direct investment on developing economies is technological transfer. Since investors seek to optimize productivity of their investments, these are likely to introduce advanced equipment and systems in local business firms to boost performance. Third benefit of foreign direct investment is the enhancement of competition in the receiving economy. The increase in industry output relative to demand has a lowering impact on price, adding welfare to consumers. Fourth benefit is concurrent growth in domestic investment. Business growth influencing a cycle of growth encourages local investments. Fifth benefit is access to export markets via the investor when foreign investments pour into manufacturing operations targeting local consumption and exports. Sixth benefit is the mitigation of the foreign exchange gap, which occurs because of limited savings or limited foreign exchange. Foreign direct investment can influence both causes to stabilize foreign exchange (Markusen & Venables, 1999). In addition to this, beyond the economic benefits, FDI may help improve environmental and social conditions in the host country by, for example, transferring - cleaner - technologies and resulting in more socially responsible corporate policies.

2.6 Foreign Direct Investment (FDI) in Africa

FDI inflows to Africa rose for the second year running, up 5 per cent to $50 billion, making it one of the few regions that registered year-on-year growth in 2012. FDI outflows from Africa almost tripled in 2012, to $14 billion. TNCs from the South are increasingly active in Africa, building on a trend in recent years of a higher share of FDI flows to the region coming from emerging markets. In terms of FDI stock, Malaysia, South Africa, China and India (in that order) are the largest developing-country investors in Africa.

FDI inflows in 2012 were driven partly by investments in the extractive sector in countries such as the Democratic Republic of the Congo, Mauritania, Mozambique and Uganda. At the

same time, there was an increase in FDI in consumer-oriented manufacturing and services, reflecting demographic changes. Source: UNCTAD, World Investment Report 2013.

2.7 Overview of Ethiopia's Recent Economic and FDI Performance

The Ethiopian economy is based on agriculture, which accounts, in 2010/11, for about 41.10 percent of the gross domestic product (GDP), 90 percent of foreign currency earnings, and 85% of employment. Generally, the overall economic growth of the country has been highly associated with the performance of the agriculture sector.

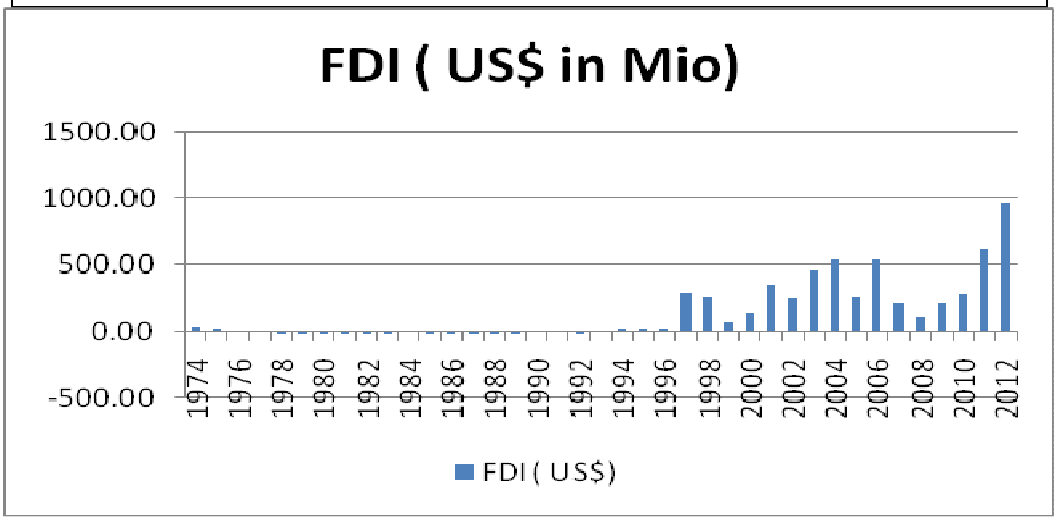
Coffee is critical to the Ethiopian economy. It earned US$ 841.8 million in exports in 2010/11. Other important export products (2010/11) include gold, oil seeds, chat, flowers, live animals, pulses, leather and leather products, meat and meat products, fruits and vegetables. The industrial sector, which mainly comprises small and medium enterprises accounts for about 13 percent of GDP. Similarly, the service sector comprised of social services, trade, hotels and restaurants, finance, real estate, and transport and communication etc. accounts for about 46 percent of GDP.

Real GDP grew by an average of 10.4 percent in year 2010/11, which places Ethiopia among the top performing economies in Sub-Saharan Africa despite world economic meltdown and global financial crisis. All sectors contributed to this relatively high economic growth. Accordingly, agriculture, industry and services grew by an annual average of 9, 15 and 12.5 percent, respectively during the indicated period. During, 2008/09, 2009/10 and 2010/11, the general annual inflation was 36.4, 2.8, and 18.1 percent respectively. It was predominantly due to the hike in price of food items. At the end of 2010/11, the average marginal exchange rate in the inter-bank foreign exchange market was Birr 16.53 to US$ 1 as compared to Birr 13.68 to US$ 1 in 2009/10.(Ethiopian Investment Guide,2013)

The latest value for Foreign direct investment, net inflows (BoP, current US$) in Ethiopia was $970,356,559.5 as of 2012. Over the past 39 years, the maximum value $970,356,559.65 in 2012. FDI inflows into the agricultural sector account for 32% of the total Ethiopian FDI inflows. FDI inflows remain quite constant after 2005. When regarding the FDI inflows into the agricultural sector according to the Federal Investment Bureau of Ethiopia they have increased heavily after 2005. This is not consistent with the UNCTAD database anymore. A reason for this inconsistency between the two databases is that obviously the UNCTAD

database does not take the Pre-Implementation investments into account which account for 90% of the agricultural FDI inflows after 2005 (UNCTAD,2008).

Figure 2.1: Foreign Direct Investment inflows in Ethiopia.



Sources: National Bank of Ethiopia Report 2012

2.8 Regulatory and Institutional Framework of FDI in Ethiopia

2.8.1 The FDI Regulatory Framework

Under the current regulatory framework the areas of investment which are open for foreign investors are the following:

1.Manufacturing
Food industry ,Beverage industry ,Textiles and textiles products industry , Leather and leather products industry ,Wood products industry ,Paper and paper products industry ,Chemical and chemical products industry ,Basic pharmaceutical products and pharmaceutical preparations industry ,Rubber and plastics products industry Other non-metallic mineral products industry ,Basic metal industry (excluding mining of minerals) ,Fabricated metal products industry (excluding machinery and equipment) Computer, electronic and optical products industry ,Electrical products industry Machinery and equipment industry ,Vehicles, trailers, and semi trailer industry Manufacturing of office and household furniture (excluding those made of ceramic) Manufacturing of other equipment (jewellers and related articles, musical instruments, sports equipment, games and toys and similar products) ,Integrated

manufacturing with agriculture
2. Agriculture
Crop production ,Animal production ,Mixed (crop and animal) farming ,Forestry
3 .Information Communication Technology (ICT)
4 .Generation, transmission and supply of electrical energy
5 .Hotel and tourism
Star designated hotel and resort, motel, lodges and restaurant Grade one tour operation
6 .Construction contracting
Construction contracting, water well and mineral exploration drilling grade one
7 .Real estate development
8 .Education and training
Secondary and higher education by constructing own building Technical and vocational training service including sport
9 .Health services
Hospital service by constructing own building
10 .Architectural and engineering works and related technical services, technical testing and analysis
11 .Publishing
12 .Import trade
Importation of LPG and bitumen
13 .Export trade
Export trade (excluding raw coffee, chat, oil seeds, pulses, precious minerals, natural forestry products, hides and skins bought from the market, and live sheep, goats, camel, equines and cattle not raised by the investor.)
14 .Whole sale trade Supply of petroleum and its by-products as well as whole sale of own products

Sources: Ethiopian Investment Guide 2013

2.8.2 The FDI Institutional Framework

The government of Ethiopia has established the Ethiopian Investment Authority (EIA) to promote, coordinate and facilitate foreign investment in the country. According to the Investment Guide (EIA, 2013), the major activities of the EIA and the one-stop shop services it renders to foreign investors are the following: promoting the country's investment opportunities and conditions to foreign and domestic investors; issuing tax identification number (TIN), investment permits, business `licenses and construction permits; notarizing memorandum and articles of association and amendment; issuing commercial registration certificates and effecting renewal, amendment, replacement or cancellation; effecting registration of trade or firm name and amendment, replacement or cancellation; issuing work permit, renewal, replacement, suspension or cancellation; grading construction contractors; 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; and advising the Government on policy measures needed to create an attractive investment climate for investors.

The EIA also provides additional services on behalf of investors' request to process acquisition of land and utilities (water, electrical power and Telecom services), loan, residence permit, approval of Environmental Impact Assessment (EIA) studies for their investment projects.

The Ethiopian Investment Agency and Regional Investment Offices licensed 62,068 investment projects with an aggregate capital of Birr 1.2 trillion in the period between 1992/93 – 2011/12. Of these projects, 52,462 (84.5 percent) were domestic, 9,498 (15.3 percent) foreign and 108 (0.2 percent) public. In terms of capital, Birr 483.4 billion (39.5 percent) was from to domestic investors, Birr 466.2 billion (38.1 percent) from foreign investors and Birr 275.2 billion (22.5 percent) from the public sector (Table 7.1).

In 2011/12, a total of 5,649 investment projects with a combined capital of Birr 146.2 billion were approved. Domestic investment accounted for more than 89 percent of the total projects approved during the review period. The number of foreign projects reached 604 which were 36.6 percent lower than the same period last year. With regard to investment capital, domestic

private projects which made up Birr 59.3 billion or 41 percent while foreign investment projects accounted for Birr 84 billion (or 57.5 percent) of the total approved investment capital the rest investment was carried out by the government. Upon commencement of operation, the approved investment projects are expected to create job opportunities for 147,400 permanent and 375,657 casual workers.

2.9 Ethiopian Investment Incentives

The Council of Ministers Regulations No.84/2003, as amended in 2008, specifies the areas of investment eligible for investment incentives.

a) Custom Duty

To encourage private investment and promote the inflow of foreign capital and technology into Ethiopia, the following customs duty exemptions are provided for investors (both domestic and foreign) engaged in eligible new enterprises or expansion projects such as agriculture, manufacturing, agro-industries, construction contracting, etc.

- 100% exemption from the payment of customs duties and other taxes levied on imports is granted to all capital goods, such as plant, machinery and equipment and construction materials;
- Spare parts worth up to 15% of the total value of the imported investment capital goods, provided that the goods are also exempt from the payment of customs duties;
- An investor granted with a customs duty exemption will be allowed to import capital goods duty free any time during the operational phase of his enterprise; and
- Investment capital goods imported without the payment of custom duties and other taxes levied on imports may be transferred to another investor

b) Income Tax Exemption

If an investor engaged in new manufacturing, agro-processing, the production of agricultural products and investment areas of information and communication technology (ICT) development:

- Exports 50 percent his products or services, or supplies 75 percent of his products or services as production or service input to an exporter will be exempted from income tax for 5 years. Under special circumstances, the Board may grant income tax exemption up to 7 years and the Council of Ministers may pass a decision to grant income tax exemption for more than 7 years;

- Exports less than 50 percent of his products or services, or supplies his products or services only to the domestic market will be exempted from payment of income tax for 2 years; and

- Exports, through the expansion or upgrading of his existing enterprise, at least 50 percent of his products or services and increases, in value, his products or services by over 25 percent will be exempted from income tax for 2 years.

For each case mentioned above, the length of the tax exemption period may be extended for one additional year when the investment is made in relatively under-developed regions of the country. However, investors who export hides and skins after processing below crust level are not eligible for income tax exemption.

Investors who invest in priority areas (textile and garments, leather products, agro-processing, etc.) to produce mainly export products will be provided land necessary for their investment at reduced lease rates.

The non- fiscal incentives given to all exporters are the following:

- Investors who invest to produce export products will be allowed to import machinery and equipment necessary for their investment projects through suppliers credit;

- Investors who invest in areas of agriculture, manufacturing and agro-industry will be eligible to obtain loan up to 70 percent of their investment capital from the Development Bank of Ethiopia (DBE) if their investment is sound to be feasible; and

- The Government of Ethiopia will cover up to 30 percent of the cost of infrastructure (access road, water supply, electric and telephone lines) for investors investing in industrial zone development.

Business enterprises that suffer losses during the income tax exemption period can carry forward such losses, following the expiry of the exemption period, for half of the tax exemption period.

C. Export Incentives

The fiscal incentives given to all exporters are the following:

- With the exception of few products (e.g. Semi-processed hides and skins-150%), no export tax is levied on export products of Ethiopia;
- Duty Drawback Scheme: It offers investors an exemption from the payment of customs duties and other taxes levied on imported and locally purchased raw materials used in the production of export goods. Duties and other taxes paid are drawn back 100 percent at the time of the export of the finished goods;
- Voucher Scheme: A voucher is a printed document having monetary value which is used in lieu of duties and taxes payable on imported raw materials. The beneficiaries of the voucher scheme are also exporters; and
- Bonded Manufacturing Warehouse Scheme: Producers not eligible for voucher scheme but having licensed for bonded are entitled to operate such warehouse in importing of raw materials duty free.

The non- fiscal incentives given to all exporters are the following:

- Exporters are allowed to retain and deposit in a bank account up to 20 percent of their foreign exchange export earnings for future use in the operation of their enterprises and no export price control is imposed by the National Bank of Ethiopia;
- Franco-valuta import of raw materials are allowed for enterprises engaged in export processing; and
- Exporters can benefit t from the export credit guarantee scheme which is presently in place in order to ensure an exporter receives payment for goods shipped overseas in the event the customer defaults, reducing the risk of exporters' business and allowing it to keep its price competitive. (Ethiopian investment guide, 2012).

2.10 Challenges of Foreign Direct Investment

The following are the main challenges or problems of foreign direct investment.

Negative wage spillovers

Wage spillovers of the FDI are considered to be mostly positive as workers of MNEs can leave their workplace and become entrepreneurs in future, which will increase the competitiveness of domestic firms. However, it might cause negative consequences as well,

especially, if MNEs hire the best workers due to their high wages and thereby leave lower-quality workers at the domestic firms (Lipsey and Sjoholm, 2004). In response to that domestic firms can increase or copy MNEs' wages artificially to prevent their high-quality employees from changing the workplace in favour of foreign firms. But this action can lead to competitiveness decrease of them as MNEs have productivity advantages over the domestic firms.

Profit repatriation

When MNEs make investments in foreign countries their main objective is to maximize their profit. Some advantageous characteristics of these countries, such as cheap labour force, natural resource abundance or high quality expertise, allow MNEs to enhance their economic performance. MNEs regularly repatriate their profits from investment to the account of their parent companies in the form of dividends or royalties transferred to shareholders as well as the simple transfer of accrued profits. It also helps them avoid larger taxes by using transfer prices. However, this profit repatriation results in huge capital outflows from the host country to the home country and negatively affects the balance of payment of the former. Thus the host countries often set limits on the amount of profits that MNEs can repatriate in order not to have balance of payment deficits or reduced foreign exchange reserves. Such policy can induce these MNEs to invest profits in different projects within the host country (Billet, 1991).

Dual economy effect

FDI, especially, made in the developing countries can lead them to have a dual economy, which has one developed sector mostly owned by foreign firms and underdeveloped sector owned by domestic firms. Since the country's economy becomes overly dependent on the developed sector, its economic structure changes. Often this developed sector is the capital-intensive, while another one is labour-intensive. Therefore, dual economy effect hampers the economic development of countries as most of their citizens are located in the non-developed labour-intensive sector.

Balance of payment effect

Empirical studies reveal that a bidirectional relationship exists between foreign investments and imports. An increase in FDI inflows from the home country will result in an increase in imports in the host country from the home country. It can be due the fact that the MNE purchases inputs from its traditional suppliers or increased inflation rate speeded up by foreign capitals in the home country. As more investment flows in, the host country economy

becomes more and more dependent on the production technology of MNE's home country. The host country will have to import more inputs and intermediate goods from the MNE's home country, which might constrain the development in the domestic industry. If these investments are not export-oriented, the host country can suffer from trade deficits (Chaisrisawatsuk S. and Chaisrisawatsuk W, 2007).

Infrastructure development constraint

FDI constrains basic infrastructure development by diverting resources from public investment in infrastructure. Since FDI is attracted mostly to wealthy parts of the host country, the infrastructure in these regions will require a greater effort to be improved, especially take away the poorer regions and the rural regions (Yamin and Sinkovics, 2009).

Environmental issues

A large volume of FDI is concentrated in natural resource sectors of developing and less developed countries. Most of these countries have a less strict or non-existent regulatory regime. Sometimes countries deliberately attempt to exempt or loosen their regulatory requirements to attract FDI. However, while these countries can benefit from positive effects of investment, the negative effects of FDI on host country's ecosystems and environment might bring disaster in the long run (Gray, 2002).

The solution to these problems is to raise host country capacity to regulate and construct international environmental standards. NGO's and other civil society groups from home and host countries can also play a significant role in the improvement of government regulations and increase of MNE's responsibility on environmental issues (Mabey and McNally, 1998).

2.11 Determinants of Foreign Direct Investment (FDI)

These are some of the factors that determine FDI inflows into a given geographical region, or country. They give investors the confidence needed to invest in foreign markets. The list of these determinants may be very long, but not all determinants are equally important to every investor in every location at all times. Some determinants may be more important to a given investor in a given location at a given time than to another investor (UNCTAD World Investment Report, 1998).

Globally, many empirical studies were conducted to identify the factors that influence the inflow of FDI. Nevertheless, the variables which were identified as determinants of FDI vary from study to study and from country to country. Therefore, in reviewing these studies it is

difficult to drive one list of determinants of FDI, especially as some have gained or lost importance over time studies conducted on determinants of FDI in developing countries and Africa.

John H. Dunning (1995), for example, suggested that one of the dominant influences on foreign direct investment was the growth and size of the host country market in terms of population growth.

Schneider and Frey (1985) research on 80 developing countries concludes that a country's level of development is the major determinant of FDI. Moreover, they explain that political instability in a country leads to a sharp decline in the inflow of FDI. Noorbaksh et al (2001) find that human capital is the chief determinant in export-oriented and labour-intensive industries.

Root and Ahmed (1979) study the determinants of non-extractive FDI in 70 developing countries and find that urbanization , better infrastructure and higher GDP per capita increase FDI inflows. Dr. khondoker (2004) study the determinants of FDI and its impact on economic growth in developing countries and find that countries with larger GDP and high GDP growth rate and maintain business friendly environment with abundant modern infrastructural facilities can successfully attract FDI and FDI on the other hand ,significantly affect economic growth of a country.

Getinet Astatike and Hirut Assefa (2005) study the nature and determinants of foreign direct investment in Ethiopia over the period 1974-2001. The study gives an extensive account of the theoretical explanation of FDI as well as reviewing the policy regimes, the FDI regulatory framework and institutional set up in the country over the study period. It also undertakes empirical analysis to establish the determining factors of FDI in Ethiopia. Their findings show that growth rate of real GDP, export orientation, and liberalization, among others, have positive impact on FDI. On the other hand, macroeconomic instability and poor infrastructure have negative impact on FDI. Based on their finding they suggest 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.

It is evident from the theoretical review that a number of factors are important in attracting foreign direct investment by host countries. Understanding the specific ownership,

internalization and locational advantages of multinational firms will aid in the comprehension of the behaviour of firms as countries seek to attract the right kind of foreign investment. MNEs could seek resources, large markets or low cost production as motives driving their international expansion across countries. It can be noted that various factors of FDI affect different countries differently depending on their individual country characteristics, policies and location. Whilst a number of studies on FDI have been carried out for developing countries, there is no consensus as to particular factors that affect a group of countries or individual countries. Mixed results are evident with regards to the importance of certain variables in determining FDI. Variables considered include growth, skills, labour, market size, openness, infrastructure, exchange rate and international interest rates. Other broad factors include national policy frameworks and government incentive policies. The empirical review established that the importance of each of these factors varies across regions, countries and time. Only growth rate of real GDP, export orientation, infrastructure development and liberalization are determinants of FDI in previous studies considered for Ethiopia. Therefore the lack of knowledge on other factors determining inward FDI provides a rationale for this study for Ethiopia.

CHAPTER THREE: RESEARCH DESIGN & METHODOLOGY

3.1 Chapter Introduction

This chapter discusses the research design, population, types of data and tools, procedure of data collection, method of data analysis, model specification, variable selection and the estimation methods used in the study. Particularly, model selection criteria and the respective proxies for the variables chosen are motivated. Lastly, the correlation coefficient, coefficient of determination, T-statistics and F-statistics employed in the study are explained.

3.2 Research Design

This study employed time series research design method. It is a research design in which measurements of the same variables are taken at different points in time. For this reason such designs are sometimes also known as trend designs and are distinguishable from 'one shot' cross-sectional designs in which measurements are taken only once.

3.3 Population and Sampling Target Population

The population target for this study is the entire economy of Ethiopia. The samples that have been used are based on time interval starting from 1974 to 2012 data in yearly basis. The data collected were related to market size, trade openness, macroeconomic stability, infrastructure, human capital and corruption. The dependent variable of foreign direct investment is measured by inflow of foreign direct investment (FDI). All the variables are in terms of United State Dollar (USD).

3.4 Types of Data and Tools

Quantitative and qualitative types of data are used for this study and the data collected are secondary data. Secondary data can be referred to as the information gathered from sources already existing. The tools used to collect those data are reading document, asking historical data from concerned people orally and online searches. The study employs annual data from 1974-2012. Annual data is used because FDI is a long term phenomenon which flows infrequently during the course of a year. The major data sources are National Bank of Ethiopia (NBE), Ethiopian Investment Agency (EIA), World Bank database and World

investment reports. Average annual foreign direct investment inflows, FDI inward stock, FDI as percentage of GDP, FDI per capita are the main indicators used for the analysis of the proposed study.

3.5 Procedures of Data Collection

As this study use secondary data, the procedures used to collect them include asking concerned people orally face to face through appointment, reading annual report from library and online database searches. This pertains to the concurrent processes of collecting, integrating, classifying, interpreting and analyzing data from secondary sources. This is the appropriate strategy because the requirements and scope of the study encompasses the entire economy and the operation of foreign direct investment in Ethiopia. The type of data required includes articles and books discussing the pertinent concepts, the results of previous studies, and official reports and statistics.

3.6 Method of Data Analysis

For this study, Statistical Package Social Science (SPSS) is used to present and analyze all the data collection and interpret the result findings. The raw data collected in the field must be transformed into information that will answer the researcher's questions in order to identify the relationship and correlation between foreign direct investment with market size, macroeconomic stability, human capital, infrastructure and corruption. Regression analysis is a statistical technique that attempts to explain movement of one variable called the dependant variable as a function of movement in a set of other variables called independant variable through the quantification of a single equation. The objective is to build a regression model or prediction equation that can be used to describe, predict, and control the variables. There are two types of regression analysis namely single regression and multiple regression analysis but in this study, both regression model has been employed to estimate the relationship between foreign direct investment and its potential determinants. This study uses the following variables that are commonly used in studies of FDI.

Market Size:

The market size hypothesis states that multinational firms are attracted to a larger market in order to utilize resources efficiently and exploit economies of scale (Chakrabarti, 2001). A large market can help firms producing tangible products to achieve scale and scope economies. The domestic market growth rate which is measured in terms of population and GDP growth rate also determines the inflow of FDI into a country (UNCTAD, 1998). To

know the purchasing power of the society in Ethiopia, this study used real gross domestic product per capita as independent variable and it will help the foreign investors to select market entry. FDI is expected to be positively related to this variable.

Trade Openness:

It is a standard hypothesis that openness promotes FDI (Hufbauer et al. 1994). In the literature, the ratio of trade to GDP is often used as a measure of openness of a country and is also often interpreted as a measure of trade restrictions. This proxy is also important for foreign direct investors who are motivated by the export market. Empirical evidences (Jun and Singh, 1996) exist to back up the hypothesis that higher levels of exports lead to higher FDI inflows. Addison and Heshmati, (2003) used export and imports as a percentage of GDP to analyse the impact of openness on FDI in 49 developing countries. Their findings indicate that FDI responds significantly to increased openness. Export shares of GDP and export growth variables in Ethiopia are also found to have significant effects on FDI (Haile and Assefa, 2005). We therefore include Trade/GDP in the regression to examine the impact of openness on FDI.

Macroeconomic Stability:

Inflation rates and exchange rates will be used as proxy variables for macroeconomic stability. When the domestic currency depreciates, there can be negative or positive effects on FDI inflows. On the one hand , a real depreciation of the currency of the host country may reduce FDI inflows into the host country , because a lower level of the exchange rate (measured in units of foreign currency per domestic currency) may be associated with lower expectation of future profitability in terms of the currency of the source country (Campa,1993). On the other hand, a depreciation of the currency of the host country increases the relative wealth of foreign entrepreneurs and therefore may increase the attractiveness of the host country for FDI (Benassy et al, 2000; Cleeve 2004). The high rates of inflation imply economic instability of the country. By and large high rates of inflation are associated with the lesser FDI inflows. Low inflation and stable exchange rates will be expected to have positive impact on FDI.

Infrastructure:

Infrastructure covers many dimensions ranging from roads, ports, railways and telecommunication systems to institutional development (e.g. accounting, legal services, etc.). According to ODI (1997), poor infrastructure can be seen, however, as both an obstacle and

an opportunity for foreign investment. For the majority of low-income countries, it is often cited as one of the major constraints. But foreign investors also point to the potential for attracting significant FDI if host governments permit more substantial foreign participation in the infrastructure sector. Jordaan (2004) claims that good quality and well-developed infrastructure increases the productivity potential of investments in a country and therefore stimulates FDI flows towards the country.

According to Asiedu (2002) and Ancharaz (2003), the number of telephones per 1,000 inhabitants is a standard measurement in the literature for infrastructure development. However, according to Asiedu (2002), this measure falls short, because it only captures the availability and not the reliability of the infrastructure. Taking this into account Gross fixed capital formation (percent of GDP) has been included to proxy infrastructure development in addition to number of telephones. These two variables are expected to be positively correlated with FDI.

Human Capital:

Human capital is considered to be an important factor for location strategies of multinational companies. When investing for the long term in another country, multinational companies have in mind the human resources in the host country. Large, efficient, educated population is a requirement for an attractive investment. The more educated the population is, the more likely it is for a country to attract more FDI (Lewis, 1999). In this study, human capital is measured by adult illiteracy rate (percent of people aged 15 and above). This indictor is expected to be negatively correlated with FDI.

Corruption:

Corruption is expected to have a harmful effect on FDI. The presence of corruption is highly correlated with other dimensions of government quality such as the extent of bureaucracy and red tape (Wei, 2000). Onyeiwu (2003) employ government expenditure as a percentage of GDP to approximate corruption and bureaucratic red tape. Good governance in terms of less corruption and bureaucracy is a positive determinant (Urata and Kawai, 2000). Salisu 2003) examines the effect of corruption on FDI in Negeria and finds that corruption has a significant detrimental effect on FDI. In this study, we use government expenditure as a percentage of GDP to approximate corruption and bureaucratic red tape.

Model Specification

This model employs independent variables to foreign direct investment. And therefore, we used ordinary least square (OLS) method in this study. On the basis of the data gathered two models were developed and tested, in Model1 the impact of each individual factor on the FDI inflows to Ethiopia was analyzed in order to get a micro view about the individual factors determining the FDI inflows and their level of significance. In model 2, all the independent variables were classified into five different categories based on their relationship among themselves. A regression error in estimated equation is tested for multicollinearity with the help of variance inflation factor (VIF). The general form of the model estimated has the following form:

FDI = f (RGDPPC, EXP, TOP, INF, EXCH, ILLIT, TELE, GFCF, GEXP, LFPR, LIB) …… (1)

Table 1: Description of Variables

Independent Variables	Expressed As	Testing	Expected Sign
Real GDP Per Capita	RGDPPC	Market Growth	+
Annual rate of inflation based on consumer price index	INF	Macroeconomic Instability	-+
Exchange Rate fluctuations	EXCH	Macroeconomic Instability	-+
Government expenditure %GDP	GEXP	Corruption	-
Gross Fixed Capital Formation	GFCF	Infrastructure	+
Telephone lines and Mobile Subscribers per 1000 people	TELM	Infrastructure	+
Labour Force Participation Rate	LFPR	Human Capital	+
Rate of Adult Illiteracy	ILLIT	Human Capital	-
Import Plus Export as % GDP	TOP	Trade Openness	+
Export %age of GDP	EXP	Market	+

In order to assess the influence of the variables described, a foreign direct investment equation may be built up in the following linear form.

For model one:

$y_{i,t} = \alpha + \beta x_{i,t} + \xi_{i,t}$ ----------(1)

Where y_{it} is FDI, x_{it} is independent variables, β is unknown parameter of the independent variables and ξ_{it} is the error term. i = 1... 11 and t = 1… 39. Since the number of independent variables is 11 and the number of years is 39.

For Model two:

$$LogFDI_t = \beta_0 + \beta_1 LogRGDPPC_t + \beta_2 LogTOP_t + \beta_3 LogEXCH_t + \beta_4 LogINF_t + \beta_5 LogILLIT_t + \beta_6 LogTELE_t + \beta_7 LogGFCF_t + \beta_8 LogGEXP_t + \beta_9 LogLFPR_t + \beta_{10} EXP_t + \beta_{11} LIB_t + \xi_t \quad (2)$$

We undertake test of correlation coefficient, which measures the linear association between independent and dependant variables. The coefficient changes from +1 to -1. Coefficient of determination which is denoted by R^2 can be used to test the entire regression of the equation. The value of R- square is range from zero to one. If the value is close to zero, it indicates a weak relationship between dependant and independent variables and if it closes to one there is strong relationship between dependant and independent variables. If the value is 1, it indicates that all changes in the dependant variables are explained by the variation in independent variables included in the regression. Test of significance using T-test and F-statistics are presented under chapter four. T- Statistic is used to determine if there is a significant relationship between the independent variable and dependent variable. In order to test the significant of T-Statistics, the comparison between the absolute value of the T-Statistics to the tabulated value of T-distribution table with degree of freedom (df) will be done. Normally it is calculated at 5% level of significant (95% of confidence interval).

The formula used is as follows: df = n-k-1. Where, df = degree of freedom, n = no of observation, k = no of independent variable. Therefore, the decision rule is at 95%, confidence interval;

Computed T-value > Critical T-value, reject Ho
Computed T-value < Critical T- value, accept Ho

If the calculated T-value is greater than the critical T-value, the independent variable is said to be statistically significant. If the calculated T-value is less than the critical T-value , the

independent variable is said to be statistically insignificant. This study will also use the F-test in order to analyze how reliable the overall model is. It provides an overall appraisal of the regression equation to evaluate the significance of each individual component to the entire regression model. In other words, it is used to test the hypothesis in which variation in independent variable explained a significant proportion of the variation in the dependent variable. The formula of F-Statistics is defined as follows:

$$F = [R^2 / k-1] / [(1 - R^2) / (n - k)]$$

Where ; F : F-statistics, R^2 : Coefficient of Determination, n : no of observation, k : no of independent variable. Otherwise, the critical value of F is defined as :

$F = \alpha (k - 1, n - k - 1)$, Where ; α = Significant level at 0.05, k = no of independent variable,n = no of observation. Therefore, the decision rule is :

Calculated F-value > Critical F-value, reject Ho
Calculated F-value < Critical F-value, accept Ho

If the calculated f-statistic is higher than the critical value of f, the overall model has significant relationship between all of the independent variables together with the dependent variable.

CHAPTER FOUR: RESULTS AND DISCUSSION

4.1 Chapter introduction

This chapter presents and discusses the results of the study. The chapter is divided in to four sections including the introduction. The second section focuses on the finding of the study. The third section provides graphical trend analysis for each independent variable. Regressions analysis and interpretations are presented in section four.

4.2 Finding of the Study

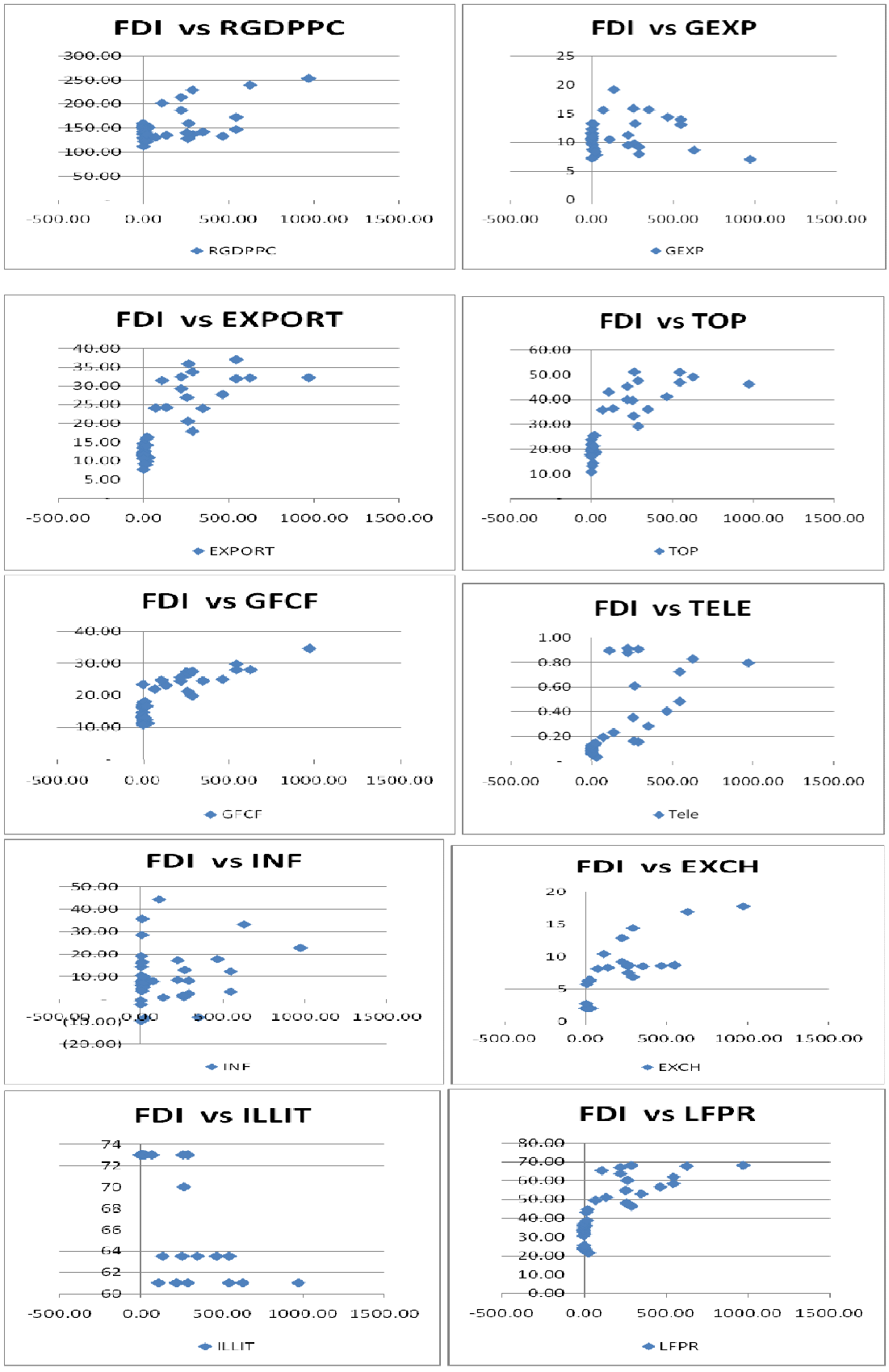
In this chapter the findings, analysis and discussion are presented. The analysis and discussion in this chapter is based on the responses from secondary data information. The research intended to find out the determinants of Foreign Direct Investments in Ethiopia. Main areas of concern in the research are the identification of the determinants for attracting FDI, the economic and FDI performance, the existing government incentives directed towards FDI activities, and recommendations based on the findings and this was according to the research objectives.

4.3 Trend Analysis

The first part of the finding shows the trend analysis between dependent variable (inflow of FDI) and the independent variables (RGDPPC, GEXP, OP, TOP, INF, TELE, GFCF, EXCH, LIB, ILLIT, EXPORT and LFPR). Trend analysis is used to study the trend of inflow of FDI in Ethiopia as the dependent variable. Besides dependent variable, it is also used to examine the trend of the independent variables which are real gross domestic product per capita, government expenditure, trade openness, inflation, telephone line per 1000 people, gross fixed capital formation, exchange rate, liberalization, rate of adult illiteracy rate, export and labour force participation rate. This analysis is done based on 39 years data commencing from the year 1974 to 2012.

As the trend shows trade openness ,exchange rate , gross fixed capital formation, telephone line per 1000 people, labour farce participation rate and export have positive strong relationship with inflow of foreign direct investments.

Figure 4.3.1 : Trend Analysis between FDI and all independant variables



4.4 Interpretation of the Results of Regression Analysis

The relationships between foreign direct investments (FDI) with the independent variables could be identified based on single linear regression (Model 1) and multiple linear regressions (Model 2). This analysis proves the main determinants factors of foreign direct investment. Based on the results derived from the programs, the interpretation has been done by a number of statistical methods such as Coefficient of Correlation (R), Coefficient of Determination (R^2), T – Statistics and F – Statistics. The summary of estimated regression analysis results for each individual variable are presented as follows:

Model One:

Table 4.4.1 Result of Regression Analysis for Exchange Rate against Foreign Direct Investment

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.813[a]	.661	.652	1.10211	.767

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations
		B	Std. Error	Beta			Zero-order
1	(Constant)	-4.110	.388		-10.579	.000	
	LEXCH	1.974	.232	.813	8.493	.000	.813

Coefficients[a]

Model		Correlations		Collinearity Statistics	
		Partial	Part	Tolerance	VIF
1	(Constant)				
	LEXCH	.813	.813	1.000	1.000

a. Predictors: (Constant), LEXCH

b. Dependent Variable: LFDI

The linear coefficient of correlation (R) measures the type and strength of correlation. In the above table no.1, coefficient of correlation (R) is at the percentage of 0.813. This indicates that the independent variables and dependant variables (FDI) have strong positive linear correlation (0.75 <R<1). The coefficient of determination (R^2) is used to test the explanatory power of the explanatory variable. Based on the above regression the coefficient of determination is 0.661. These indicate that 66.1% of the changes in inflow of FDI are explained by exchange rate variable. Based on this result we can reject the null hypothesis of hypothesis 1.

Table 4.4.2 Result of Regression Analysis for Real Gross Domestic Product Per Capita against Foreign Direct Investment

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.260[a]	.067	.042	1.82776	.283

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	8.939	1	8.939	2.676	.110[b]
	Residual	123.606	37	3.341		
	Total	132.545	38			

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations
		B	Std. Error	Beta			Zero-order
1	(Constant)	-14.271	8.014		-1.781	.083	
	LRGDPPC	2.607	1.594	.260	1.636	.110	.260

a. Dependent Variable: LFDI

b. Predictors: (Constant), LRGDPPC

As per the result in table 4.2 the coefficient of correlation for real gross domestic product per capita is 0.26. This indicates that RGDPPC and FDI have weak correlation among them. The coefficient of determination for this variable is 0.067, which means 6.7% the change in inflow of FDI are explained by RGDPPC variable. The coefficient of the variable is positive sign as expected even though statistically not significant. One possible explanation could be that the low level of per-capita income has a discouraging effect on market seeking FDI to Ethiopia. Based on the above result we can accept our null hypothesis of hypothesis 2.

Table 4.4.3 Result of Regression Analysis for Government Expenditure against Foreign Direct Investment

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.221[a]	.049	.023	1.84609	.290

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	6.448	1	6.448	1.892	.177[b]
	Residual	126.097	37	3.408		
	Total	132.545	38			

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations
		B	Std. Error	Beta			Zero-order
1	(Constant)	-5.231	2.967		-1.763	.086	
	LGEXP	1.719	1.250	.221	1.375	.177	.221

a. Dependent Variable: LFDI

b. Predictors: (Constant), LGEXP

Based on the above table 4.3, the coefficient of correlation between government expenditure and foreign direct investment show 0.221. These indicate that the two variables have weak correlation. From the coefficient of determination (R^2) government expenditure explain the variation in average inflow of FDI by 4.06%. The value of the t-statistics and f-statistics are 1.375 and 1.892 respectively and tell us it is not significant. From this result we can accept our null hypothesis of hypothesis 3.

Table 4.4.4 Result of Regression Analysis for Trade openness against Foreign Direct Investment

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.826[a]	.682	.674	1.06686	.776

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	90.432	1	90.432	79.451	.000[b]
	Residual	42.113	37	1.138		
	Total	132.545	38			

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations
		B	Std. Error	Beta			Zero-order
1	(Constant)	-12.751	1.310		-9.731	.000	
	LTOP	3.555	.399	.826	8.914	.000	.826

a. Dependent Variable: LFDI

b. Predictors: (Constant), LTOP

The above regression result on table 4.4 shows that, the coefficient of correlation with 0.826. This means trade openness and foreign direct investment have strong positive relationship. The variation in average inflow of foreign direct investment is explained by variablity in trade

openness with 68.2% and as we have seen from the t-statistics and f-statistics are 8.914 and 79.451 respectivelly. Which tell us the variables is significant and the null hpothesis of hypothesis 4 is rejected.

Table 4.4.5: Result of Regression Analysis for Inflation rate With Foreign Direct Investment

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.176[a]	.031	.005	1.86324	.331

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	4.093	1	4.093	1.179	.285[b]
	Residual	128.452	37	3.472		
	Total	132.545	38			

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations
		B	Std. Error	Beta			Zero-order
1	(Constant)	-2.239	1.029		-2.177	.036	
	LINF	.379	.349	.176	1.086	.285	.176

The above regression result on table 4.5 shows that, the coefficient of correlation with 0.176. This means inflation rate and foreign direct investment have weak positive relationship. The variation in average inflow of foreign direct investment is explained by variability in inflation rate with 3.1%. As we have seen from the t-statistics and f-statistics are 1.086 and 1.179 respectivelly. Which tell us the variables is not significant as per the result of the analysis and this lead us to accepted the null hpothesis of hypothesis 5.

Table 4.4.6 Result of Regression Analysis for GFCF against Foreign Direct Investment

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.753[a]	.568	.556	1.24438	.597

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	75.251	1	75.251	48.596	.000[b]
	Residual	57.294	37	1.548		
	Total	132.545	38			

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations
		B	Std. Error	Beta			Zero-order
1	(Constant)	-13.175	1.734		-7.600	.000	
	LGFCF	4.152	.596	.753	6.971	.000	.753

a. Dependent Variable: LFDI

b. Predictors: (Constant), LGFCF

Table 4.6 presents the regression analysis result of gross fixed capital formation with the dependent variable foreign direct investment. As shown in the tables the coefficient of correlation between GFCF and FDI are 0.753. This indicates that there is strong positive correlation among those variables. The value of R-square in table no.6 is 0.568, this indicate that 56.8 percent of the variation in average inflows of foreign direct investment can be explained by variability in gross fixed capital formation. The t-test statistics and f-test statistics shows the variable is significant determinant factor of foreign direct investment. Based on this the null hypothesis of hypothesis 6 is rejected.

Table 4.4.7 Result of Regression Analysis for Labour force participation rate against Foreign Direct Investment

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.711[a]	.506	.492	1.33088	.561

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	67.009	1	67.009	37.831	.000[b]
	Residual	65.536	37	1.771		
	Total	132.545	38			

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Correlations
		B	Std. Error	Beta			Zero-order
1	(Constant)	-14.077	2.109		-6.674	.000	
	LLFPR	3.507	.570	.711	6.151	.000	.711

a. Dependent Variable: LFDI, b. Predictors: (Constant), LLFPR

From the above table 4.7, we see that the F-test is statistically significant, which means that the model is statistically significant. The R-square is 0.711 indicates that approximately 71.1%of the variation of foreign direct investment inflows is accounted by labour force participation rate. The t-test for above regression analysis is equal 6.151, and is statistically significant, meaning that the regression coefficient for labour force participation rate is significantly different from zero. Based on this we rejected the null hypothesis of hypothesis 7.

Table 4.4.8: Result of Regression for Rate of Adult Illiteracy against Foreign Direct Investment

Variables Entered/Removed[a]

Model	Variables Entered	Variables Removed	Method
1	LILLIT[b]	.	Enter

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.707[a]	.500	.486	1.33853	.575

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	66.253	1	66.253	36.978	.000[b]
	Residual	66.292	37	1.792		
	Total	132.545	38			

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations
		B	Std. Error	Beta			Zero-order
1	(Constant)	69.229	11.579		5.979	.000	
	LILLIT	-16.623	2.734	-.707	-6.081	.000	-.707

a. Dependent Variable: LFDI

b. Predictors: (Constant), LILLIT

From the above table 4.8, we see that the F-test is statistically significant, which means that the model is statistically significant. The R-square is 0.50 means that approximately 50%of the variation of foreign direct investment inflows is accounted for by rate of adult illiteracy.

The t-test for above regression analysis is equal -6.081, and is statistically significant, meaning that the regression coefficient for rate of adult illiteracy is significantly different from zero. The coefficient for rate of adult illiteracy is negative as expected and significant. Based on this we reject the null hypothesis of hypothesis 7.

Table 4.4.9 Result of Regression Analysis for Liberalization of trade against FDI

Variables Entered/Removed[a]

Model	Variables Entered	Variables Removed	Method
1	LIB[b]	.	Enter

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.717[a]	.514	.501	1.31942	.682

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	68.133	1	68.133	39.138	.000[b]
	Residual	64.412	37	1.741		
	Total	132.545	38			

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations
		B	Std. Error	Beta			Zero-order
1	(Constant)	-2.674	.320		-8.356	.000	
	LIB	2.665	.426	.717	6.256	.000	.717

a. Dependent Variable: LFDI

b. Predictors: (Constant), LIB

From the above table no 4.9, we see that the F-test is statistically significant, which means that the model is statistically significant. The R-square is 0.514 means that approximately

51.4%of the variation of foreign direct investment inflows is explained by liberalization dummy. The t-test for above regression analysis is equal 6.256, and is statistically significant, meaning that the regression coefficient for liberalization dummy is significantly different from zero. The coefficient for liberalization dummy is 2.665, meaning that for a unit increase in trade liberalization leads to 2.665 increase inflows of foreign direct investment. This result suggests that liberalization of the Ethiopian economy has encouraged FDI inflows and it also supports the proposition that foreign investors are more likely to invest in countries have opened up to the outside world. Based on this result the null hypothesis of hypothesis 8 is rejected.

Table 4.4.10: Result of Regression Analysis for Telephone line per 1000 people against Foreign Direct Investment

Variables Entered/Removed[a]

Model	Variables Entered	Variables Removed	Method
1	Ltele[b]	.	Enter

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.536[a]	.287	.268	1.59783	.371

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	38.081	1	38.081	14.916	.000[b]
	Residual	94.464	37	2.553		
	Total	132.545	38			

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations
		B	Std. Error	Beta			Zero-order
1	(Constant)	-2.301	.389		-5.919	.000	
	Ltele	.733	.190	.536	3.862	.000	.536

Based on the above table 4.10: regression analysis results, the coefficient of correlation is 0.536, which indicates that there is positive correlation between infrastructure development and FDI inflows. The coefficient of determination is 0.287 which indicate that 28.7% of the variation in average inflow of foreign direct investment is explained by the variability in infrastructure development. The t-test statistics and f-test statistics have show 3.862 and 14.916 respectively. Since the calculated t-value is more than the tabulated t-value , we can accept the null hypothesis. Therefore , infrastructure development is the determniant factor of foreign direct investment. This result to reject the null hypothesis of hypothesis 6.

Table 4.4.11 :Result of Regression Analysis for Export %age of GDP against Foreign Direct Investment

Variables Entered/Removed[a]

Model	Variables Entered	Variables Removed	Method
1	LEXP[b]	.	Enter

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.826[a]	.682	.673	1.06717	.808

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	90.408	1	90.408	79.385	.000[b]
	Residual	42.137	37	1.139		
	Total	132.545	38			

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations
		B	Std. Error	Beta			Zero-order
1	(Constant)	8.483	1.097		7.734	.000	
	LEXP	3.995	.448	.826	8.910	.000	.826

a. Dependent Variable: LFDI

b. Predictors: (Constant), LEXP

From the above table 4.11, we see that the F-test is statistically significant, which means that the model is statistically significant. The R-square is 0.682 which means that approximately 68.2%of the variation of foreign direct investment inflows is accounted for by export to gross domestic product ratio. The t-test for above regression analysis is equal 8.910, and is statistically significant, meaning that the regression coefficient for export to GDP ratio is significantly different from zero. The coefficient for export to GDP ratio is 3.995, meaning that for a unit increase in export to GDP ratio leads to 3.995 increase inflows of foreign direct investment. Based on this the null hypothesis of hypothesis 9 is reject.

Model Two:

The result of this model(table.13 presented in the appendix) also shows that, trade openness, exchange rate ,gross fixed capital formation, export, telephone line per 1000 people which is proxy of infrastructure, human capital and liberalization are the main determinants factor of foreign direct investment.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1Summary of Findings

This study set out to investigate the determinants of inward FDI to Ethiopia from 1974-2012 using annual data. Theoretical and empirical literature was reviewed. In this endeavour, four classes of theories were discussed i.e. market imperfections, internalization, product cycle and eclectic theories.

The theoretical review identified a number of factors important in attracting FDI by host countries and firm specific characteristics as multinational companies seek expansion beyond national borders. Understanding the specific ownership, internalization and locational advantages of multinational companies helps to comprehend the behavior of MNCs as countries seek to attract the right kind of FDI (Narula and Dunning 2000). The theory identified economic growth rates, skills, labour cost, market size, openness, infrastructure, exchange rate and international interest rates as major determinants of FDI.

This study employed single and multiple linear regression models to determine the determinant factors of FDI in Ethiopia. The variables used are: trade openness, gross domestic product per capita, telephone line (per 1,000 people), rate of adult illiteracy, inflation rate, exchange rate, government expenditure, labour force participation rate, gross fixed capital formation and liberalization using dummy variable are the independent variables while foreign direct investment as a percentage of GDP is the dependent variable.

Since in 1992, the Ethiopian government has opened several economic sectors to foreign investors and issued several investment incentives for domestic and foreign investors. The major incentives given to foreign direct investors include exemption from payment of export custom duties, income tax holidays from 2 to 7 years depending on the region and the sector of the investment, all imported capital goods and spare parts worth up to 15% of the value of the capital good are exempted from import tariffs and custom duties. In addition, the foreign investors can carry forward their initial operating losses. Besides, all foreign investors are exempted from profit tax for two years. This exemption is extended to 5 years for those investors who are exporting at least 50% of their product and supply 75% of their product as input for exporters. With regards to investment guarantees, the investment code provides

guarantee for repatriation of capital, interest payments on foreign loans, profit, dividends, asset sell proceeds and technology transfer payments.

The main challenges of foreign direct investment found are stifling of infant domestic industries, loss of political sovereignty and deterioration of balance of payment due to the foreign investors' excessive capital good importation and repatriation of profit.

From the historical trend analysis, FDI to developing countries has been increasing. However, in Ethiopia FDI inflow is still less. Only a few years were exceptional i.e. 2004, 2006, 2011 and 2012.

The empirical analysis we conducted and its findings show that increased trade openness, export orientation, infrastructure development, exchange rate and liberalization are significant positive impact on FDI, while unskilled human capital have a negative impact on the same.

5.2 Conclusion

As per our findings, Since 1992 market oriented economic reforms have taken place and emphasis has been given to attracting FDI (Ethiopian Economics Association, 2004). Especially for the agricultural sector, regulations on investments have been relaxed significantly. Foreign agricultural activities are exempted from the payment of custom duties and taxes on imports of capital goods. According to the export orientation of the foreign investor, they are exempted from income tax for a certain time period. Foreign investments are also exempted from the payment of sales and excise taxes for export commodities.

openness had a positive impact on FDI as well suggesting that an efficient environment that comes with more openness to trade is likely to attract foreign firms (this conclusion is also supported by Asiedu, 2002; Edwards, 1990), and that countries that embarked on trade liberalization were rewarded with more FDI. This is particularly important to the country because such investments, for instance investments in manufacturing and technologically intensive industries, enhance technological and fosters employment. The results also indicate that a 1% increase in the level of openness (import and export) will lead to FDI inflows 8.914%.

The factor human capital proxy with rate of adult illiteracy in Table 8 shows a negative and statistically significant sign. This indicates that improvement in the quality of human capital is essential for inflows of foreign direct investments.

The significantly positive coefficient of the infrastructure variable (telephone lines per 1000 people) with R-square 0.29 and gross fixed capital formation with R-square 0.57 highlights the need for investment in infrastructural development, which is essential for the creation of a productive business environment. There should be concerted effort to upgrade the country's poor infrastructure particularly in relation to transportation, power and telecommunication.

The significantly positive effect of liberalization on FDI indicates that an efficient environment that comes with liberalized economy is likely to attract foreign investors. With the regression models running in Log-Log form, the coefficient measures the elasticity of dependent variables with respect to each independent variable.

Export orientation has also positive and significant coefficient which signify the importance of implementing a more outward looking growth strategy.

The positive and significant of exchange rate encourages the foreign direct investment by decreasing the cost of international investment and by increasing returns to foreign investment relative to exports.

Hence, we can conclude that exchange rate, export orientation, trade openness, infrastructure development, skilled human capital, trade liberalization are the determinant of foreign direct investment.

5.2 Recommendation

The followings are the main recommendation of this study:

- The government should work toward increased openness to foreign trade so that the domestic enterprise sector can participate fully in the global economy. This approach should be undertaken jointly with efforts to increase business sector competition. A combined approach would allow a greater domestic and international openness to business, which works well with safeguards against the negative effects of a rise in concentration. Moreover, the successful elimination of global and regional trade barriers

makes participating countries more attractive for FDI, owing to the connected expansion of the "relevant" market.

- To get the maximum benefits from corporate presence in a national economy, domestic competences, technologies and infrastructure need to be sufficiently well developed to allow nationals to take full advantage of the overflows that foreign-owned enterprises generate. This is due to approximately 28.7% of the variation of inflow of foreign direct investment is accounted by telephone line per 1000 people, which is less and need more improvements (table 4.10). The improvement of such infrastructure is instrumental in attracting MNEs, in allowing national enterprises to integrate the technological spin-offs from foreign-owned enterprises in their production processes, and in facilitating their diffusion through the host economy.

- Our empirical finding shows that human capital is a statistically significant determinant of foreign direct investment inflows and the sign is also as expected. So to get benefit from foreign direct investment inflows, it is necessary to upgrade human capital.

5.3 Limitation of the Study

Unavailability of data on the important determinants like Political stability and labor costs may be considered as limitation of this study. To get a better result, future researchers are advised to take a longer period of time in carrying out the study. The time frame may influence the result of the study and in answering the objectives to be achieved. The longer period taken to carry out the study, the more accurate the result will be found.

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http://www.nbe.gov.et/

http://www.statistics.gov.my/

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APPENDIX

Table .3: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation	Variance
FDI(USD in MIO)	39	-2.59	970.36	147.5115	224.98127	50616.573
RGDPPC	39	111.89	253.07	154.8597	32.30538	1043.637
GEXP	39	7.03	19.12	10.9218	2.73626	7.487
EXPORT	39	7.62	36.96	18.9267	9.17494	84.179
TOP	39	10.83	51.09	28.4815	12.40535	153.893
INF	39	-9.81	44.39	9.9108	11.52744	132.882
TELE	39	.03	.92	.2821	.29710	.088
GFCF	39	10.71	34.58	19.0449	6.47587	41.937
EXCH	39	2.07	17.77	5.8785	4.43953	19.709
LIB	39	.00	1.00	.5641	.50236	.252
ILLIT	39	61.00	73.00	69.5513	5.14116	26.432
LFPR	39	21.52	68.08	42.4310	15.50978	240.553
Valid N (listwise)	39					

Sources: EXCH, FDI, LFPR from NBE, RGDPPC, GEXP, TOP, INF, FDI, TELE, GFCF, ILLIT from WDI and UNCTADstat.

Table no.13: Results of Multiple Regression Analysis

First Categories

Variables Entered/Removed[a]

Model	Variables Entered	Variables Removed	Method
1	LINF, LTOP, LGEXP[b]	.	Enter

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.828[a]	.685	.658	1.09205	.795

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	90.805	3	30.268	25.380	.000[b]
	Residual	41.740	35	1.193		
	Total	132.545	38			

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations
		B	Std. Error	Beta			Zero-order
1	(Constant)	-13.018	2.082		-6.254	.000	
	LTOP	3.516	.434	.817	8.109	.000	.826
	LGEXP	.027	.786	.004	.035	.972	.221
	LINF	.117	.211	.054	.554	.583	.176

Coefficients[a]

Model		Correlations		Collinearity Statistics	
		Partial	Part	Tolerance	VIF
1	(Constant)				
	LTOP	.808	.769	.887	1.128
	LGEXP	.006	.003	.886	1.129
	LINF	.093	.053	.937	1.067

Second Categories

Variables Entered/Removed[a]

Model	Variables Entered	Variables Removed	Method
1	LIB, LGEXP, LINF, LEXP[b]	.	Enter

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.896[a]	.803	.780	.87570	1.236

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	106.472	4	26.618	34.711	.000[b]
	Residual	26.073	34	.767		
	Total	132.545	38			

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations
		B	Std. Error	Beta			Zero-order
1	(Constant)	3.880	2.254		1.721	.094	
	LGEXP	.415	.627	.053	.662	.512	.221
	LINF	.069	.170	.032	.404	.689	.176
	LEXP	2.923	.446	.604	6.554	.000	.826
	LIB	1.487	.335	.400	4.445	.000	.717

Coefficients[a]

Model		Correlations		Collinearity Statistics	
		Partial	Part	Tolerance	VIF
1	(Constant)				
	LGEXP	.113	.050	.894	1.119
	LINF	.069	.031	.929	1.076
	LEXP	.747	.498	.680	1.470
	LIB	.606	.338	.714	1.400

Third Categories

Variables Entered/Removed[a]

Model	Variables Entered	Variables Removed	Method
1	LRGDPPC, LGEXP, LINF, LLFPR[b]	.	Enter

a. Dependent Variable: LFDI

b. All requested variables entered.

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.723[a]	.522	.466	1.36488	.654

ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	69.206	4	17.302	9.287	.000[b]
	Residual	63.339	34	1.863		
	Total	132.545	38			

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations
		B	Std. Error	Beta			Zero-order
1	(Constant)	-14.230	6.923		-2.056	.048	
	LGEXP	.569	.998	.073	.570	.573	.221
	LINF	.258	.266	.120	.970	.339	.176
	LLFPR	3.422	.674	.694	5.079	.000	.711
	LRGDPPC	-.319	1.374	-.032	-.232	.818	.260

Coefficients[a]

Model		Correlations		Collinearity Statistics	
		Partial	Part	Tolerance	VIF
1	(Constant)				
	LGEXP	.097	.068	.857	1.167
	LINF	.164	.115	.922	1.085
	LLFPR	.657	.602	.753	1.327
	LRGDPPC	-.040	-.028	.750	1.333

Fourth Categories

Variables Entered/Removed[a]

Model	Variables Entered	Variables Removed	Method
1	LRGDPPC, LGEXP, LINF, LEXCH[b]	.	Enter

a. Dependent Variable: LFDI

b. All requested variables entered.

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.837[a]	.700	.665	1.08172	.925

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	92.761	4	23.190	19.819	.000[b]
	Residual	39.784	34	1.170		
	Total	132.545	38			

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations
		B	Std. Error	Beta			Zero-order
1	(Constant)	-2.292	5.889		-.389	.700	
	LGEXP	1.240	.758	.159	1.636	.111	.221
	LINF	.152	.212	.071	.719	.477	.176
	LEXCH	2.029	.259	.836	7.823	.000	.813
	LRGDPPC	-1.047	1.093	-.104	-.958	.345	.260

Coefficients[a]

Model		Correlations		Collinearity Statistics	
		Partial	Part	Tolerance	VIF
1	(Constant)				
	LGEXP	.270	.154	.933	1.071
	LINF	.122	.068	.914	1.094
	LEXCH	.802	.735	.774	1.293
	LRGDPPC	-.162	-.090	.745	1.342

Fifth Categories

Variables Entered/Removed[a]

Model	Variables Entered	Variables Removed	Method
1	LIB, Ltele, LGFCF, LILLIT[b]	.	Enter

a. Dependent Variable: LFDI

b. All requested variables entered.

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.844[a]	.712	.678	1.05936	.851

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	94.389	4	23.597	21.027	.000[b]
	Residual	38.156	34	1.122		
	Total	132.545	38			

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations
		B	Std. Error	Beta			Zero-order
1	(Constant)	44.013	23.184		1.898	.066	
	LILLIT	-12.224	5.088	-.520	-2.402	.022	-.707
	LGFCF	2.338	.977	.424	2.392	.022	.753
	Ltele	-.622	.258	-.455	-2.411	.021	.536
	LIB	1.393	.463	.375	3.011	.005	.717

Model		Correlations		Collinearity Statistics	
		Partial	Part	Tolerance	VIF
1	(Constant)				
	LILLIT	-.381	-.221	.181	5.532
	LGFCF	.379	.220	.269	3.716
	Ltele	-.382	-.222	.238	4.203
	LIB	.459	.277	.547	1.829

Table .14: Summary of Data

Table 14.Summary of Data												
YEAR	FDI (US$)	RGDPPC	GEXP	EXPORT	TOP	INF	TELE	GFCF	EXCH	LIB	ILLIT	LFPR
1974	28.90	151.00	7.80	10.83	18.83	8.59	0.03	11.20	2.07	0.00	73.00	21.52
1975	19.30	154.54	8.44	9.78	18.10	6.55	0.05	12.30	2.07	0.00	73.00	21.81
1976	4.30	153.67	8.74	11.02	19.05	28.54	0.05	12.50	2.07	0.00	73.00	23.42
1977	5.85	152.74	9.52	12.56	20.41	16.66	0.06	12.06	2.07	0.00	73.00	23.14
1978	0.03	150.17	10.67	12.10	19.74	14.31	0.06	13.02	2.07	0.00	73.00	23.82
1979	0.03	153.40	10.59	14.57	23.79	16.03	0.06	13.11	2.07	0.00	73.00	23.33
1980	1.00	158.00	10.62	13.39	21.95	4.48	0.06	13.50	2.07	0.00	73.00	24.03
1981	0.06	155.50	9.80	11.93	19.56	6.14	0.07	14.51	2.07	0.00	73.00	24.38
1982	2.04	152.63	10.68	12.37	19.17	5.89	0.07	14.69	2.07	0.00	73.00	25.54
1983	-2.59	160.24	11.56	11.31	17.80	-0.68	0.08	13.03	2.07	0.00	73.00	30.62
1984	5.06	150.81	11.54	13.89	21.50	8.42	0.09	17.77	2.07	0.00	73.00	31.56
1985	0.17	129.78	10.27	11.50	17.34	19.06	0.10	11.43	2.07	0.00	73.00	32.54
1986	-0.57	137.85	10.63	12.20	19.07	-9.81	0.10	16.97	2.07	0.00	73.00	33.59
1987	-2.57	151.98	10.58	11.65	17.62	-2.43	0.11	16.13	2.07	0.00	73.00	33.69
1988	1.70	147.86	12.30	11.56	17.44	7.08	0.11	23.38	2.07	0.00	73.00	34.74
1989	-0.50	142.50	13.27	10.54	17.15	7.82	0.12	13.54	2.07	0.00	73.00	35.79
1990	12.00	141.49	13.18	8.85	14.41	5.15	0.13	12.94	2.07	0.00	73.00	35.91
1991	6.00	126.90	11.02	9.18	13.24	35.72	0.13	11.07	2.07	1.00	73.00	36.07

YEAR	FDI (US$ in Mio)	RGDPPC	GEXP	EXPORT	TOP	INF	TELE	GFCF	EXCH	LIB	ILLIT	LFPR
1992	0.17	111.89	7.22	7.62	10.83	10.53	0.13	10.71	2.80	1.00	73.00	36.29
1993	3.50	122.24	7.29	14.40	20.18	3.54	0.13	16.53	5.77	1.00	73.00	37.34
1994	17.21	121.93	8.88	14.10	21.22	7.59	0.14	16.38	6.25	1.00	73.00	38.75
1995	14.14	125.27	8.44	15.73	25.42	10.02	0.14	17.96	6.32	1.00	73.00	43.05
1996	21.93	136.54	8.31	16.28	25.54	-8.48	0.15	16.60	6.50	1.00	73.00	44.63
1997	288.49	136.71	7.96	17.87	29.23	2.40	0.16	19.75	6.88	1.00	73.00	46.41
1998	260.67	128.24	9.78	20.51	33.38	0.89	0.16	21.15	7.51	1.00	73.00	48.00
1999	69.98	131.06	15.58	24.04	35.77	7.94	0.19	21.91	8.14	1.00	73.00	49.42
2000	134.64	135.09	19.12	24.20	36.35	0.66	0.23	23.09	8.33	1.00	63.50	51.06
2001	349.40	142.15	15.65	23.94	36.04	-8.24	0.28	24.50	8.54	1.00	63.50	52.89
2002	255.00	140.19	15.85	26.87	39.61	1.65	0.35	27.29	8.58	1.00	63.50	54.73
2003	465.00	133.27	14.34	27.70	41.14	17.76	0.40	24.98	8.62	1.00	63.50	56.57
2004	545.10	147.12	13.96	31.89	46.91	3.26	0.48	29.73	8.65	1.00	63.50	58.37
2005	265.11	159.97	13.25	35.84	51.09	12.94	0.61	26.51	8.68	1.00	70.00	60.14
2006	545.26	172.49	13.06	36.96	50.98	12.31	0.73	27.91	8.79	1.00	61.00	61.93
2007	222.00	187.11	11.23	32.38	45.24	17.24	0.88	24.44	9.24	1.00	61.00	63.67
2008	108.54	201.83	10.49	31.40	43.00	44.39	0.90	24.68	10.42	1.00	61.00	65.36
2009	221.46	213.86	9.50	29.20	39.88	8.47	0.92	25.56	12.89	1.00	61.00	66.94
2010	288.27	229.02	9.18	33.70	47.54	8.14	0.91	27.40	14.41	1.00	61.00	68.03
2011	626.51	239.42	8.62	32.11	49.09	33.22	0.83	27.94	16.91	1.00	61.00	67.65
2012	970.36	253.07	7.03	32.17	46.17	22.77	0.80	34.58	17.77	1.00	61.00	68.08

Sources: EXCH, FDI, LFPR from NBE, RGDPPC, GEXP, TOP, INF, FDI, TELE, GFCF, ILLIT from WDI and UNCTADstat.

Table 7.1: Number and Investment Capital of Approved Projects by Ownership since 1992/93

(Investment capital in millions of Birr)

Fiscal Year	Domestic projects		Foreign Projects		Public Projects		Total Projects	
	No. of Projects	Investment Capital	No. of Projects	Investment Capital	No. of Projects	Investment Capital	No. of Projects	Investment Capital
1992/93	542	3,750	3	233	0	0.00	545	3,983
1993/94	521	2,926	4	438	1	57.00	526	3,421
1994/95	684	4,794	7	505	2	39.00	693	5,338
1995/96	897	6,050	10	434	1	6.00	908	6,490
1996/97	752	4,447	42	2,268	1	7.00	795	6,722
1997/98	816	5,819	81	4,106	1	14.00	898	9,939
1998/99	674	3,765	30	1,380	9	4,915.00	713	10,060
1999/00	561	6,740	54	1,627	9	5,760.00	624	14,127
2000/01	635	5,675.7	45	2,923	7	257.00	687	8,856
2001/02	756	6,117.3	35	1,474	10	1,598.80	801	9,190.2
2002/03	1,127	9,362.9	84	3,369	6	706.11	1,217	13,437.9
2003/04	1,862	12,177.7	347	7,205	16	1,837.04	2,225	21,220
2004/05	2,240	19,571.7	622	15,405	10	1,486.48	2,872	36,463.3
2005/06	5,100	41,841.1	753	19,980	6	18,215.08	5,859	80,036.3
2006/07	5,322	46,630.1	1,150	46,949	0	0.00	6,472	93,579
2007/08	7,307	77,868.2	1,651	92,249	3	261.56	8,961	170,378.5
2008/09	7,184	83,630.2	1,613	73,111	10	82,783.52	8,807	239,524.8
2009/10	5,080	40,852.2	1,413	55,169	3	393.89	6,496	96,415.4
2010/11	5,360	42,093	952	53,357	10	154,019	6,322	249,469
2011/12	5,042	59,316	604	83,975	3	2,877	5,649	146,168
Average Annual	**2,625**	**23,248**	**515**	**21,868**	**5**	**13,638**	**3,103**	**61,241**
Cumulative	**52,462**	**483,427**	**9,498**	**466,156**	**108**	**275,233**	**62,068**	**1,224,818**

Source: Ethiopian Investment Agency