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The Financial Challenges and Opportunities in Foreign Direct Investment (FDI): A Case Study of Federal Democratic Republic of Ethiopia

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Abstract

The principle objective of this study is to evaluate Foreign Direct Investment in Ethiopia and to access the growth and opportunities. It is accepted by economist that real Gross Domestic Product (GDP), Human Capital Development, and Domestic Investment are the main important indicator for the economic development of country. Foreign Direct investment is beneficial for the investment for host country. Some of the others argue that dependence on foreign capital is harmful for the host country. This paper has been written using primary information collected during personal interviews and site visits, Government reports. The role of FDI is presented in terms of enhancing capital formation, overflow effects, linkage, technology transmission, growth and thereby curing development problems. The present study highlights the pattern of FDI flow and challenges ahead in the period of power transitions and challenges. This is evidence that there is a positive and significant relationship between FDI and real GDP growth between export performance and FDI in Ethiopia. Since from 1992, the Ethiopia has taken enormous efforts to attract FDI. The Ethiopian government policies play a significant role in determining economic development and FDI inflow in Ethiopia. FDI in Ethiopia has a positive and significant impact on economic growth of manufacturing, services sector and lot many opportunities are available to invest funds in Ethiopia. This paper highlight some of the challenges associated with raising private sector financing for sustainable development in /Ethiopia and identifying the role for public sector policies for investment in sustainable development in Ethiopia.

Keywords: Foreign Direct Investment, Economy, Development, Fund Inflows, Real Gross, Domestic Product (GDP), Human Capital Development (HCD), Domestic Investment (DI).

Introduction

Foreign direct investment is one of the key economic features of the modern globalized world. As per United Nations Conference on Trade and Development's (UNCTAD) World Investment Report 2014, foreign direct investment (FDI) have increased by 1.7 trillion USD in 2015 and 1.8 trillion USD in 2016 globally. In the year 2013, 54% (778 USD billion) of the total global FDI flow went to developing countries. In East Africa, FDI increased by 15% to 6.2 billion USD because of rising flows to Ethiopia and Kenya. The attitude of many developing countries towards the importance of FDI has changed remarkably and they have taken steps to ease restrictions on FDI inflow.

Definition of FDI

As there is no universal and clear-cut definition of Foreign Direct Investment, it is differ from organization to organization. The expected definition of FDI is that "the investment made must be by a resident entity of one country into a resident enterprise in another country to earn and maximize profit share. The International Monitory Fund (IMF) defines foreign direct investment as an investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor. However it is clear that, FDI is an investment involving a long term relationship as well as reflecting a long-term interest and control of a resident entity in one economy other than that of a foreign direct investor.

Aim of the Study

The developing countries like Ethiopia is presently working towards sectoral development. However, the aim of this paper is to know the challenges faced to attatract foreign investment. Therefore to overcome from these challenges and to keep more economic transperency in monetary transaction is the need of present Government.

FDI inflows to Ethiopia

In past few years the high level of economic growth, the provision of better infrastructure, successive growth of market sizes and the government's openness for FDI contributed to big investors targeting Ethiopia. In 2014-15, Ethiopia included in the Top-10 investment destinations in Africa - recording 100% change in FDI flow. Ethiopia has been registered its growth in manufacturing projects in double digit, in addition to parallel increases in manufacturing value added growth from 12% to 17%. FDI inflow to Ethiopia exhibited a continuous increase of more than 12% per annum, a fact which could be attributed to the country's favorable investment climate. In fiscal year 2017-18 in the first six month Ethiopia attracted 2.2 billion US dollars' Foreign Direct Investment (FDI). "Ethiopia has introduced incentives to attract foreign direct investment including tax breaks, construction of industrial parks, and provision of trained human capital and provision of water, banking and power services in one center"

Export & Import

Particularly in Ethiopia's performance of domestic and foreign direct investment (FDI) started way back during from 2009 to 2013 and recorded a positive growth trend in domestic savings with incredible improvement from 5.2% to 17.7% of GDP during these period. on the other hand, the investment gap remained widen in Ehiopia by inflows during the five years preceding the start of Growth Transformation Plan showed very limited increase. Even in 2012 it is noted that the percentage of GDP was very low (11.8%) as compared to other East Africa's (18.8%). In the meantime, ambitious growth goals were set under GTP I and II which required significant investments. FDI with other measures, it was regarded as essential tool to finance the national growth and development plans. The result shown significant increase both in the volume and size as well as the number of projects initiated or implemented.

Review of Literature

De Mello (1999) and Borensztein (1998) said that there is a relationship between foreign direct investment and economic growth, though this tends to be so because of the host country characteristics such as human capital. Thus, the favorable growth enhance impact of FDI is dependent on the conditions and characteristics of a host country enabling environment. FDI host countries along with better benefaction of human capital and strong institutional capacity are supposed to benefit more from FDI encouraged technology transfer and thereby productivity gain.

According to Damooei, (2006) supportive policies towards FDI increases the country's output, productivity and achieves economic growth and technology transfer.

Investment Opportunities

In African continents, Ethiopia is one of the oldest independent countries among the most stable countries in the region. Despite of multi political party from 2012 the new Prime Minister has proven peaceful transition of power and the stability of Ethiopia's parliamentarian form of government. Ethiopia is most known for its social stability and least crime rate, as well as strong public institutions and reliable police service. As per Global Competitive Report 2016-17 Ethiopia stood 34th rank for impartial public decision making and no tolerance to corruption. Therefore, now a day's many foreign investors are ready to invest their funds in Ethiopia because of following reasons. Such as;

1. Abundant and Affordable Labor
2. Improved Economic Infrastructure
3. Admirable Climate and Fertile Soils
4. Maintained Political and Social Stability
5. Fastest Growing Economy
6. Strong Guarantees and Protections
7. Regional Hub with Access to a Wide Market
8. Competitive Incentive Packages

Leather Shoes and Leather Product

In Ethiopia cattle population whose skins and hides are the basis for some of the world's best leather are available. From 1992, more than forty international investors have established leather and leather product companies in Ethiopia. They are supplying to some of the most important international brands such as Guess and Clavin Klein. Accordingly to the report India and UK ranked 3rd and 4th, respectively for destinations for Ethiopian processed leather. One of the largest shoe exporters in China – Huajian – set up a factory in Ethiopia in 2011, as part of a plan to invest US$2 billion over 10 years. The company produces shoes for brands such as Guess and Calvin Klein, and hopes to see its exports from Ethiopia reach US$4 billion within ten years. *(Source: Deloitte, "Ethiopia, a Growth Miracle," 2014)* The Japanese manufacturer Hiroki Co. Ltd is setting up a US$400,000 manufacturing operation in Ethiopia, where it will produce shoes and other luxury accessories made from leather. The same company has already started training Ethiopian workers at its Chinese plant, and has brought experts from Japan to train the rest of the staff in Ethiopia.

Textile and Garments

In Ethiopia availability of human resource is very cheap and at a competitive wage scale. wages in Ethiopia are a fifth of China's and half of Vietnam's. Ethiopian workers are produces as many polo shirts of the same quality per day as workers in Vietnam when using similar technology.

Ethiopia is located at the center of the world with easy access to international value chains, and has access to a container port (Djibouti). There is a high potential to develop a competitive cotton or textiles industry due to suitable climatic and soil conditions. The Ethiopian garment and apparel industry has grown-up by on an average of 51% over the last 6 years. Since from 1992, nearly 65 textile investment projects from international investors have been licensed in Ethiopia with retailers namely H&M and Primark. They are already sourcing clothing from Ethiopia. Apart from this spinning, weaving and finishing of textile fabrics, Production of garments, the manufacturing of knitted and crocheted fabrics, carpets, and sportswear are the opportunity for export from Ethiopia. Ayka Addis, one of the Ethiopian subsidiary of the Turkish textile giant Ayka Textile, already inaugurated in 2010 its factory by investing US$140 million at Alemgena, just 20km west of Addis Ababa. The company has created nearly more than 10,000 jobs to Ethiopian people. Export capacity of the company is nearly US$100 million a year per annum and even Tesco PLC and the British arm of Wal-Mart Stores Inc. are also buying clothing from Ethiopian manufacturing plants.

Horticulture

In Ethiopia ultimate conditions for growing a wide group of fruits, vegetables, flowers and spices given the existence of diverse agro-climatic zones, long growing seasons, and availability of water for irrigation 122 billion cubic meters of surface water and 2.6 billion cubic meters of ground water. Although only a decade old, horticulture is the fifth foreign revenue earner for Ethiopia, generating US$245 million in 2013/14 compared to US$28.5 million in 2004/2005. The industry creates nearly 180000 jobs, out of which 85% are for women. Total land area available for agriculture is around 1000,000 km^2 with nearly 11% of this land being developed for horticulture. Currently, over 130 international investors are operating in Ethiopia's horticulture sector, exporting to the Netherlands, Germany, Saudi Arabia, Belgium, UAE, France, Japan Italy and the United States, among others.

Fruits and Vegetables

In agricultural especially in Ethiopia, universal fruits cultivated like Mango, banana, papaya, avocado, citrus, grape, and pineapple. Pear and plum are also emerging as temperate fruits in Ethiopia. In emerging situation likewise temperate fruits it include green beans, snow peas, broccoli, okra, asparagus, cherry tomatoes, green chili, potatoes, cabbages cauliflower, eggplant and cucumber, pepper, onion, and asparagus. In Ethiopia most of the land available and cultivated for growing fruits and vegetables is appropriate for organic certification.

Extensive Development of Industrial Parks

Recently under the Chairmanship of Prime Minister, strong government support & investment policy led by Ethiopian Investment Board (EIB). In and around Ethiopia infrastructures such as airports, railway lines, dry ports, universities are available and also incentives are applicable to industrial parks.

Manufacturers

Following incentives and benefits are available to those investors who wish to invest funds in Ethiopia. Some of the incentives and benefits are listed below.

1. Exempted from income tax up to 8 - 10 years.
2. Exempted from duties & other taxes on imports of capital goods, construction materials, spareparts with a value of 15% of capital goods after business license, raw materials for the production of export commodities & vehicles.
3. One-stop government services within the parks premises.
4. Loss carry forward (for half on income tax exemption of period granted).
5. Land lease term: 60-80 years at nominal rate for factories & residential quarters.
6. Expedited procedure of securing entry, work permit and certificate of residency for expatriate personnel working in industrial parks and their dependents.
7. Customs facilitation - transport of imported raw materials straight from customs post to factory through bonded export factory scheme.
8. Investors also benefit from no taxes on exports.

Challenges

Increased violence across Ethiopia due to unrest against the policies of the government's economic and human rights issues. The tension is that the violence particularly on foreign investors have become prominent targets. Foreign establishments and businesses are being attacked in protest of the government's development approach, and grabs and unfair competition are the key issues. Eleven factories have been burned also nearly 90% of flower farms between Ziwag and Hawassa, in Oromia have been attacked by the people. It includes one American led flower firm and the Dutch owned, around 2,000 worker, fruit farm of Africa was newly started company with other Dutch and Israeli firms also attacked. Infect, Germany consumes nearly 30% of Ethiopian coffee and coffee is one of the major cash crop and source of foreign currency to the country. Even in these days these exports also threatened as unrest in agricultural areas continues. They are protesting farmers continue to hinder the movement of goods to the capital.

Result and Discussion

The FDI in Ethiopia is extremely diverse, from multimillion-dollar projects in the manufacturing sector to smaller scale projects by cluster with an initial investment below 1000 dollars. Given their small scale and the difficulty to capture their impact from a macroeconomic perspective, the latter form of foreign investors are often overlooked and maybe neglected within policy perspectives. However, foreign investors in Ethiopia, including those from other developing countries such as China, India, and Saudi Arabia have become increasingly important and active. They also prove to be a good match for Ethiopia in the sense that they are able to operate in challenging environments. It is true that majority of FDI projects are located in Addis Ababa and the nearby major region of Oromia, leaves most of the rest of the country without any foreign investment, which tends to perpetuate or even deepen Ethiopia's imbalanced economic growth and the accompanying social disparities. Many of the poor live in rural areas and are employed in the agricultural sector. The limited amounts of FDI in poorer regions means that FDI can only be of little help for Ethiopia in the fight to overcome poverty reduction (one of Millennium Development Goals), economic isolation, or stop migration to urban centers, which is the current biggest challenges of the capital city, Addis Ababa. Ethiopia faces stiff challenges in integrating into global value chain, because the direct participation of local firms or enticing MNCs to use them as production centers by affiliates is not possible. This is due to high operating and trading costs, poor infrastructure, limited human capital and shortage of potential local partners. By essence, participation in global value chains requires a high level of competitiveness, which most firms in Ethiopia have difficulty to in achieving when faced with competition from other developing economies that can offer low labor costs but benefit from higher productivity levels.

Conclusion

Foreign direct investment has a role in the developmental process of a country yet whether its effect is positive or negative is highly controversial. For the past 10 consecutive years, Ethiopia has been identified as one of the fastest growing economies in the world. For the last decade, GDP growth rate registered over 10.5%. Onwards from 2012-13 Ethiopia has made significant progress in achieving the Millennium Development Goals. The overall balance of payments deficit decreased significantly by 88% compared to the previous year. FDI has made a positive contribution to economic development in Ethiopia when it is measured in terms of real GDP growth. Finally it can be concluded that if correct strategies and policies are put in place through combined efforts of the Ethiopian government and with the active involvement of the private business sectors, FDI could be leveraged to a much larger extent in the coming years and decades.

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