



**ST. MARY'S UNIVERSITY
SCHOOL OF GRADUATE STUDIES**

**THE IMPACT OF FOREIGN DIRECT INVESTMENT ON ETHIOPIAN
ECONOMY: THE CASE OF ETHIOPIA**

**BY
GETACHEW ATSIBHA**

**May 2019
ADDIS ABABA**

**THE IMPACT/EFFECT OF FOREIGN DIRECT INVESTMENT ON
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**BY
GETACHEW ATSIBHA**

**A THESIS SUBMITTED TO SAINT MARY'S UNIVERSITY, SCHOOL OF
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ST. MARY'S UNIVERSITY
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DEDICATION

This thesis manuscript is dedicated to those local companies who invested for import substitute but hindered and swamped by FDI before their maturity level or competency level.

STATEMENT OF DECLARATION

I, Getachew Atsibha, hereby declare that this thesis is my work and that all sources of materials used for this thesis have been duly acknowledged. This thesis has been submitted in partial fulfilment of the requirements for the award of the degree of Master of art in Developmental Economics at the Saint Merry University and deposited at the University Library to be made available to borrowers under rules of the Library.

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Submission Date: May 2019

ENDORSEMENT

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

GIRMA ESTIPHANOS (PhD)

SIGNATURE

St. Mary's University College, Addis Ababa

May, 2019

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The author served as senior engineer, Director of Training Institute and different top leadership positions in former Defense Industry Sector now called Metals & Engineering Corporation. He achieved his Master of Technology (M.Tech.) from California Institute of Technology in 2008. And currently he is working as D/CEO of Infrastructure Machinery Engineering Industry. He joined the School of Graduate Studies of Saint Merry University in September 2008 to pursue Master of Art degree (M.A.) in Development Economics. The author is married and has three children.

Contents	Page
DEDICATION	ii
STATEMENT OF DECLARATION	iii
ENDORSEMENT	iv
BIOGRAPHY	v
ACKNOWLEDGMENTS	viii
ABSTRACT	ix
LIST OF ABBREVIATIONS	x
LIST OF TABLES	xii
LIST OF FIGURES	xiii
CHAPTER ONE: INTRODUCTION	1
1.1. Background of the Study	1
1.2. Statement of the Problem	4
1.3. Research Questions	7
1.4. Objective of the Study	7
1.4.1. General Objective	7
1.4.2. Specific Objectives	7
1.5. Significance of the Study	7
1.6. Scope and Limitation of the Study	8
1.7. The Organization of the Study	9
CHAPTER TWO: OVER VIEW OF THE ETHIOPIAN ECONOMY	10
2.1. Overview of Ethiopian Economy	10
2.1.1. The Agriculture Sector	11
2.1.2. The Industrial Sector	11
2.1.3. The Service Sector	12
2.2. The FDI Regulatory Framework	12
2.2.1. Foreign Direct Investment in Ethiopia – Overview	13
2.2.2. Regional Distribution of FDI	15
2.2.3. Sectorial Distribution of FDI	16
2.2.4. FDI Flows by Country of Origin	18
CHAPTER THREE: LITERATURE REVIEW	20
3.1. Theoretical review	20
3.1.1. Main Concepts and Definitions of FDI	20
3.1.2. The Benefits and Costs of FDI	21
3.1.3. Pro-FDI Views	21

3.1.4. Anti-FDI Views	22
3.1.5. Theories of FDI	22
3.1.6. Micro-level Theories of FDI	23
3.2. Empirical Evidence	24
CHAPTER FOUR: DATA AND METHODOLOGY	34
4.1. Research Design and Approach	34
4.1.1. Type and Sources of Data	34
4.1.2. Primary Data	34
4.1.3. Secondary Data	34
4.1.4. Method of data analysis	35
4.1.5. Model specification	36
4.1.6. Variables and definition	38
CHAPTER FIVE: RESULT AND DISCUSSION	40
5.1. Trend analysis of all variables	40
5.1.1. Trends of Rea GDP	40
5.1.2. Consumption Trend	41
5.1.3. Trends FDI	42
5.1.4. Trends of Gross domestic Saving/GDS/	43
5.1.5. Trends of Employment	44
5.1.6. Domestic Investment	45
5.1.7. Trade balance	46
5.1.8. Trends of Inflation	46
5.2. Regression analysis: Impacts of FDI on Economic Growth	47
5.2.1. Unit Root Test	47
5.2.2. Long Run Test for Co-Integration	48
5.2.3. Lag Selection Test	48
5.2.4. Test for Autocorrelation	49
5.2.5. Normality test	49
5.3. Estimation Result: ARDL Model	50
5.4. Interview Analysis	52
5.4.1. Primary Data	52
5.4.2. Secondary Data	55
5.4.3. FDI status and loan performance	57
CHAPTER SIX: SUMMARY, CONCLUSION AND POLICY RECOMMENDATIONS	58
6.1. Conclusion	58
6.2. Recommendations and policy implications	58
REFERENCES	60

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ABSTRACT

The main purpose of this paper is to examine the impacts of foreign direct investment in Ethiopia based on time series data over the period 1992 to 2018 using aggregate national data. It measures particularly how FDI affects GDP growth; other control variables such as gross domestic saving, trade, government consumption, inflation, domestic Investment and Employment have been incorporated. In order to fully account for feedbacks, autoregressive distributed lag/ARDL/ model is utilized. The results show that there is short range as well as long-run relationship between foreign direct investment and economic growth and it is significant and affects positively. Results further show that the positive impact of domestic investment on economic growth becomes less when FDI assumes positive significant impact, implying the crawling out effect of FDI on domestic investment. Other major determinant of economic growth that was included in the model was domestic saving, government consumption and domestic investment; these variables also show that they have a positive and significant effect on GDP. Results in this study imply the need for the government to setup institutions with clear regulation to control after operation and avoid any damage and lags in utilizing benefits arise from FDI. Besides, the government should be able to create the right environment to realize the benefit from spillover effects of between domestic investment and FDI to adjust the crawling out effect. Hence, the researcher therefore recommends that, therefore, a host country that receives a diversified FDI or non-resource-seeking FDI when it has reached a certain minimum level of development. The implication of this for Ethiopia, resource poor least developed country, is that a certain minimum level of development is a necessary condition to attract and control negative impacts of FDI.

Key words: FDI, Impact, GDP, Ethiopia

LIST OF ABBREVIATIONS

ADBG:	African Development Bank Group
ARDL:	Auto Regressive Distributed Lag
AFDB:	African Development Bank
DBE:	Development Bank of Ethiopia
DCs:	DCs: Developed countries
DI:	DI: Domestic Investment
EEA:	Ethiopian Economic Association
EIA:	Ethiopian Investment Agency
EPA:	Ethiopian Privatization Agency
EPRDF:	Ethiopian People Revolutionary Democratic Front
FIAS:	Foreign Investment Advisor Service
FDI:	Foreign Direct Investment
FDRE:	Federal Democratic Republic of Ethiopia
GIZ	Gessellschaft fur Internationale Zusammenarbeit
GTP:	Growth and Transformation Plan
IMF:	International Monetary Fund
JVP:	Joint-Venture Proclamation
LDCs:	Less Developed countries
OECD:	Organization for Economic Co-operation and Development

LIST OF ABBREVIATIONS (Continued)

MDGs:	Millennium Development Goals
MOFED:	Ministry of Finance and Economic Development
MNCs:	Multinational companies
PPESA:	Public Enterprises Supervising Authority
PPER:	Project Performance Evaluation Report
PM:	Prime Minister
OLS:	Ordinary Least Square
MDGs:	Millennium Development Goals
SAP:	Structure Adjustment Program
UNCTAD	United Nations Conference on Trade and Development
WB:	World Bank

LIST OF TABLES

TABLE	PAGE
Table 4.1. unit root test of each variable -----	48
Table 4.2. Johansen Tests for Co-integration -----	48
Table 4.3. Lag selection test -----	49
Table 4.4. Durbin's Alternative Test for Autocorrelation -----	49
Table 4.5. VAR estimation result -----	51
Table 4.6 Loan Performance and Status of FDI -----	54
Table 4.7 Lost FDI and acquired by the Bank -----	56
Table 4.8 FDI Overdue Status -----	57

LIST OF FIGURES

FIGURE	PAGE
Figure 1.1. Conceptual framework -----	7
Figure 2. 1: GDP Composition by sector -----	16
Figure 2.2: Employment by sector -----	17
Figure 2.3: FDI flow from (1992 to 2018) -----	20
Figure 2.4: FDI flow from (1992 to 2018) -----	21
Figure 2.5: Sectorial distribution of FDI from (1992 to 2018) -----	22
Figure 2.6: FDI flow from (1992 to 2018) -----	23
Figure 4.1: Trends of real GDP -----	41
Figure 4.2: Trends of Growth rate -----	41
Figure 4.3 Trends of Consumption -----	42
Figure 4.4 Trends of FDI -----	43
Figure 4.5 Trends of gross domestic saving -----	44
Figure 4.6 Trends of employment -----	45
Figure 4.7 Trends of Domestic Investment -----	45
Figure 4.8 Trends of Trade balance -----	46
Figure 4.9 Trends of inflation -----	47

CHAPTER ONE: INTRODUCTION

1.1. Background of the Study

The world has increasingly recognized that private capital has a vital role to play in development. The UN's Millennium Declaration explicitly calls for greater foreign direct investment (FDI) to Africa. As stated by (WIR, 2018), Over the course of the 1990s, African countries significantly liberalized the environment for foreign investment. Nearly all countries revised their national laws governing FDI and the vast majority lifted controls on capital.

Foreign Direct investment (FDI) is an increasingly important channel for resource flows between the industrial and developing countries. Several real and potential benefits apparent from these flows that include technological spillovers, job creation, improved managerial skills and productivity (Blomstrm and Kokko, 1997). Given the capital deficient nature of least developed countries and the benefits accruable from these activities, FDI is essential for growth and development.

One of the economic problems of developing countries is that they do not have enough national savings to finance their investments. They are in constant need of foreign capital in forms of both direct and indirect investments. Initially, they took loans from international commercial banks. But the gradual drying-up of commercial bank lending, because of debt crises, forced many countries to reform their investment policies so as to attract more stable forms of foreign capital, and FDI appeared to be one of the easiest way to get foreign capital without undertaking any risks linked to the debt. Thus, it became an attractive alternative to bank loans as a source of capital inflows.

Foreign Direct Investment (FDI) affects economic growth of developing countries positively through transfer of capital, know-how, and technology (Li and Liu (2005)). It increases activity not only in FDI beneficiary firms. The effect can spread to other firms in the country and sectors through technology spillover, human and capital formation and increasing competition, thus raising productivity for the whole economy. FDI can also accelerate growth in the ways of generating employment in the host countries, fulfilling saving gap and huge investment demand and sharing knowledge and management skills through backward and forward linkage in the host

countries (Frenkel, Funke et al. (2004)). Some points which supports the concept that FDI promotes growth are explained by, Agrawal and Khan (2011).

According to OECD, the policy frameworks for FDI of Africa countries on average are not restrictive than other developing countries (OECD, 2005). However, although the African continent has made notable efforts to attract FDI, the inflows of FDI are very small compared to other developing nations. For instance, among the FDI inflows to developing countries between the periods 2005 to 2010, African share was only around ten percent and also characterized by uneven distribution among countries in the region (UNCTAD, 2011).

For almost all developing countries the size of domestic saving is not sufficient to finance domestic investment and the gap is bridged by sourcing capital from the rest of the world by any means. One of the most common ways to access such external capital is by promoting foreign investment and Ethiopia is not exception.

The Federal Democratic Republic of Ethiopia investments are designed to improve the living standards of the peoples of Ethiopia through the realization of sustainable economic and social development, create wide employment opportunities for Ethiopians and to foster the transfer of technical know-how, of managerial skills, and of technology required for the progress of the country as stated on proclamation No 280/2002. Although Ethiopia is one of the countries with the fast growing economy, still there is a persisting poverty and unemployment both in rural and urban areas (MOFED, 2012). Currently the country is undertaking the second growth and transformation plan which is an extension of the first robust plan GTP that requires significant capital investment and technology transfer. However, due to the low saving of the country there is financial inadequacy constraining in achieving development goals. The government recognizes the role of private investment in particular foreign direct investment to fill the gap of the capital constraint and revised the investment proclamations several times.

The role of foreign direct investment (FDI) in stimulating economic growth is one of the controversial issues in the development literature. In the standard Solow type growth model, FDI enables host countries to achieve investment that exceeds their own domestic saving and

enhances capital formation. According to this theory, the potential beneficial impact of FDI on output growth is confined to the short run.

In the long run, given the diminishing marginal returns to physical capital, the recipient economy could converge to the steady state growth rate as if FDI had never taken place leaving no permanent impact on the growth of the economy (De Mello,(2014)). On the other hand, endogenous growth models e.g. Romer, page 28; and Lucas, page 24; that highlight the importance of improvement in technology, efficiency, and productivity suggest that FDI can positively influence the growth rate in so far as it generates increasing returns in production via externalities and production spillovers.

Foreign direct investment is one of the most noticeable features of the global economy today. Sustainable economic growth is highly determined by the rate of investment which in turn is mainly determined by the national savings level. The national savings 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 FDI is highly 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 increases 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 (Li and Liu (2005)).

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. Consequently, most developing countries were uncertain about the benefits of FDI.

Most African countries have undertaken numerous policy measures to create hospitable investment climate for FDI. The major policy measures are: Liberalizing controls on foreign exchange & price, liberalizing investment regulations & privatization of public enterprises and creating a stable macroeconomic environment. OECD (2005), indicated that the policy frameworks for FDI of African countries are on average not more restrictive than other

developing nations. Despite their notable efforts, FDI flows to Africa are extremely small compared to the other developing nations.

The rapid growth in FDI over the last few decades has encouraged a large body of empirical literature to examine the Impact of FDI on growth enhancing effects of FDI. The effects of FDI can be wide ranging since FDI typically encompasses packages of capital as well as technical, managerial and organizational know-how.

Considering the benefits of FDI for growth and development, most African countries have undertaken various policy reforms to create conducive investment environment in order to attract a considerable amount of FDI.

1.2. Statement of the Problem

Ethiopia's transition to a market oriented economy started in 1992. Since then, the government has made a broad range of policy reforms, including liberalization of foreign trade regime, decentralization of economic & political power, deregulation of domestic price and devaluation of the national currency. In addition, the investment code has been amended several times in order to meet the demands of both domestic and foreign investors.

The Government of Ethiopia revised the investment proclamations several times and opened economic sectors to foreign investors with few restrictions. The government has also issued several investment incentives, including tax holidays, duty free import of capital goods, export tax exemption and bank loans to encourage foreign investment. Furthermore, Ethiopia Investment Agency (EIA) the present Ethiopia Investment Commission (EIC) has been established to service investors and streamline the investment procedures. There are far fewer private businesses in Ethiopia than the country's size and potential can accommodate. Businesses in Ethiopia are smaller in scale by international standards and have not managed to enter international markets or attract foreign capital (2011, WIR).

According to the EIC (2018) report, the total number of foreign direct investments in Ethiopia that took the license until June 2018 is **5,125** and among them there are only **1,612** FDI (34%) of the projects which started the operations with investment capital of 110,251,136,000 birr. The total employments created by those projects are **462,231**. These facts reveal that FDI in

Ethiopia is too smaller in numbers from the FDI inflow submitted their proposal with fascinate capital and proposed employments and also there is a failure to commence the operation. The most important issue to notice here is that whatever the number of inflow FDI, what is the status and performance after commencing operation. Is there an institution which follows FDI? As compared to the privileges given to the FDI by the government institutions.

Among the more important time series studies, the following studies may be mentioned: Mori Kogid et.al (2010), Louzi et.al (2010), Awasantha.P (2003), Oyatoye et.al (2011), Najia Saqib et.al(2013), Soltani Hassen and Ochianis(2012), Kyuntae Kim and Hokyung Bang(2008), Sarbapriya Ray(2012),and Getinet and Hirut(2005). Mori Kogid et.al(2010) investigated the empirical relationship between economic growth and foreign direct investment.

Some of the studies shows that the growth effect of FDI is strongly dependent on the institutional circumstances of the host or receiving countries (Hermes and Lensink 2003) as cited by Jebessa Gerba, (2017). Still others find that FDI inflow is positively associated with economic growth only when countries have previously achieved a certain level of development ((Blomstrom et al, 1994), Education and leadership skill (Borenzstein et al, 1998), or financial development (Alfaro et al, 2004); Hermes and Lensink 2003)). On the other hand, Carkovia and Levine (2002) finds that this results are not robust when controlling bias, while Townsedn (2003) confirms this result using data for less developed countries.

The study considered FDI net inflows as an indicator for FDI and real Gross Domestic Product (RGDP) as indicator to economic growth. The methodology used is time series vector autoregressive model. The study result shows, the existence of long-run co-integration relationship between FDI and real gross domestic product (RGDP). In addition, they investigated the causality analysis based on Granger causality and found a causal effect exists running from FDI to RGDP, implying that FDI does influence economic growth.

Most of the above stated studies focused strictly on the relationship between FDI and economic growth while others added additional variables in concurrence such as human capital or labor, exports, technology gap, financial development, exchange rate, expenditure, education, economic freedom and so forth.

To summarize, there have been various empirical evidences that investigated the impact of foreign direct investment on economic growth and shows mixed finding. For instance, the

study by Baharumshah and Thanoon, 2006; Mithani et.al, 2008) shows that FDI has a positive impact on economic growth of a host country but the size of its impact may vary from country to country depending on for instance the level of human capital, domestic investment, infrastructure, macroeconomic stability and investment policy. Beatrice and Mansur (2010). Generally the coexistence of positive as well as negative finding of relationships between FDI and growth indicates the generalization problem and look for further study on the subject.

This particular research is of special interest to assess the Impact of FDI in Ethiopia in terms of contribution to RGDP, Net Import Export, contribution to Inflation, Loan paying performance, employment, government expenditure, government saving and other important parameters which are not covered in the previous studies. On top of that, the study gives an extensive account of the theoretical explanation of FDI as well as analyses the relationship between FDI and domestic investment whether it augmenting the local investment or crawling out in the past decade in Ethiopia. The FDI regulatory framework and institutional set up in the country, explicitly Benefit and adverse conditions over the study period are assessed to some extent. It also undertakes empirical analysis to establish the impact of FDI on economic growth in Ethiopia.

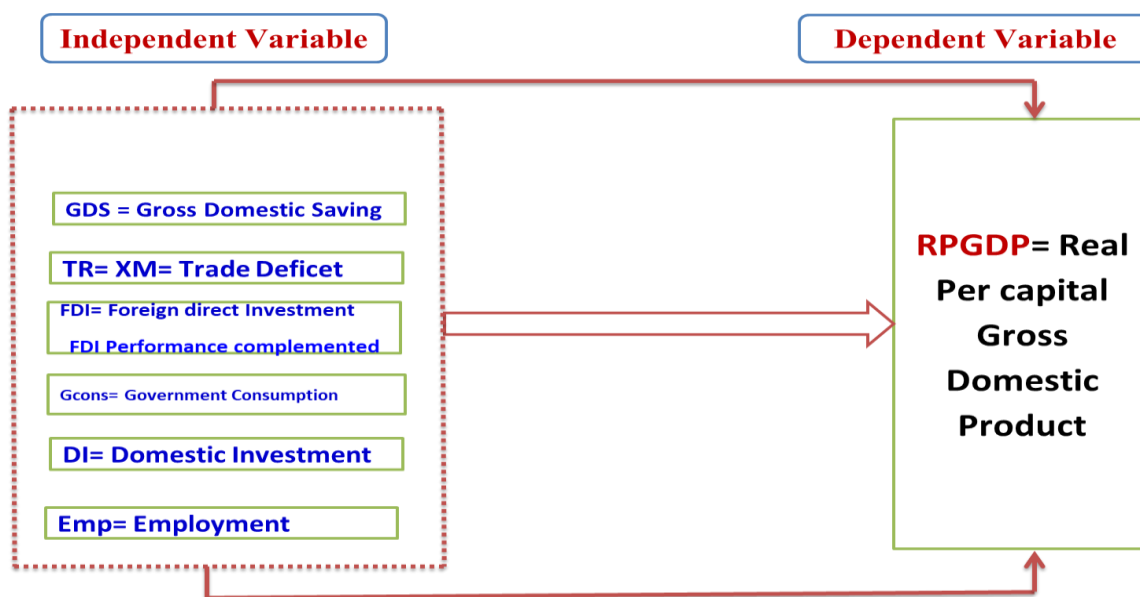


Fig 1.1. Conceptual framework

Source:- own design and model.

1.3. Research Questions

1. What is the impact of foreign direct investment on economic growth of Ethiopia?
2. Do linkages exist between foreign direct investments and economic growth?
3. To what extent domestic investment determine economic growth?
4. What is the relationship between FDI and Domestic Investment?

1.4. Objective of the Study

1.4.1. General Objective

The ultimate objective of this study is identifying the impact of FDI on economic growth in case of Ethiopia.

1.4.2. Specific Objectives

- To understand the long run and short run relationship between FDI and economic growth and contribution of FDI to the economic growth.
- To investigate the spillover effect of FDI on domestic investment.
- To investigate the relationship between FDI and domestic investment whether it augmenting the local investment or crowding out.
- To examine causal relationship between FDI and major macroeconomic variables.

1.5. Significance of the Study

The impact of FDI on the economic growth has been the concern of development economists, international business scholars, scientists, governments, international organizations and the civil society with the desire to understand what drives increases in FDI inflow and their impact on their host economies (Mencingar, 2003; Makki & Somwaru, 2004; Kottaridi, 2005; Li & Lu, 2005; Lin, 2010). These authors often assume that once FDI enters into an economy, it would either stir economic growth, increase employment and reducing poverty or it stimulates unfavorable competitions, resulting in crowding-out local companies and other businesses, high unemployment and increasing poverty. The consequence is that such analysis often focus on the impact of foreign capital on a few local firms and their employees, but misses its effect on the greatest number of people who works in the informal employment, whether in agriculture or trade services. It means that, we need to consider the impact of

foreign capital on a larger group that might benefit or lose as a result of foreign capital inflow into their economies. FDI has been highly recognized by the government of Ethiopia for its contributions to employment opportunity and in the achievement of capital formation. There is an increasing trend in population and unemployment and hence investments that absorbed labor intensively which required reducing the growth of unemployment rate are the highest priority in Ethiopia.

As a result this study will help policy makers to take appropriate measures while putting the necessary incentives measures that promote FDI and helps to monitor the contribution of FDI for short term and long term development objectives of the country. Without proper governance an increase in investment may aggravate or reinforce existing pattern of greedy consumption by the rich, marginalization of the poor and environmental devastation all which today characterize the global economy. This research also tries to investigate the challenges and negative externalities associated with foreign direct investment. Hence this research can help the government to take some corrective measures in managing foreign direct investment for better implementation especially after operation. This paper contributes to the existing literature by enhancing the understanding about the impact of FDI on their recipient economies. Lastly it provides policy makers in the low income countries with additional insight required to carefully weigh the impact of the FDI in order to achieve economic growth and also the study can serve as a reference to subsequent research works.

1.6. Scope and Limitation of the Study

The study focuses on the analysis of the impact of FDI on Ethiopian economy and thus it is country specific study. For this reason the conclusions derived from the analysis reflects the facts of Ethiopia. Moreover the study used secondary data from different sources which may be subjected to some abstractions that involves human element. The research used aggregate data at national level; as a result it fails to reflect the role of specific sector of the economy for the economic growth that is induced by the attraction of foreign investors to the country. Furthermore because the study used aggregate data the analysis do not address the role of FDI in terms of revenue generation in terms of technology transfer that are the major channels through which the benefit from inflows of FDI are reflected on the economic growth of Ethiopia. On top of that both the theoretical aspect and empirical evidence show that FDI is

wider in concepts and in application that can be dealt both with macro level and micro level issues. So, this research is designed to assess the impact of foreign direct investment on economic growth and other macro-economic variables within the given period.

As researches conducted so far on FDI in Ethiopia is limited, the study was constrained by the availability of empirical literature. Relating to the nature of the business there were fear and reservations in revealing all necessary information regarding revenue generation and import export impacts of FDI. In addition to these some of the respondents were reluctant to give information due to lack of sufficient time and other reasons. Even though these limitations are inevitable the researcher tried to handle the difficulties by different mechanisms. Such as face to face interview, briefly explaining to the respondents the purpose of the study to be for academic, applying efficient use of time and other resources and attempting to triangulate data to avoid data inconsistency and exploring different data sources for empirical literatures. The difficulties involved in managing raw data collected from the multiple sources to make them usable was to pose some limitations given the short period of time available for this study.

1.7. The Organization of the Study

The paper is organized in Five chapters. The first chapter deals with the introduction part under which the background, the objectives, significance, scope and limitations of the study are comprised. Chapter two briefly discusses about the theoretical and empirical literatures with an Overview of the Ethiopian Economy. The methodology, Model specification, data source and method of collection, sample size and sampling techniques and data analysis are included in chapter Three. Chapter Four provides data presentations as well as the summary of the findings. The last chapter dealt with, conclusion and possible recommendations.

CHAPTER TWO: OVER VIEW OF THE ETHIOPIAN ECONOMY

2.1. Overview of Ethiopian Economy

Ethiopia is a land locked country, located at the horn of Africa. Agriculture is the back bone of its economy; accounting for about 47 percent of the GDP and 85 percent of the labor force engage in this sector accounting for the greatest share of the total employment in the country. It is with total area of 1.2 million square kilometer (K²) and total population of over 110 million in 2018, is the second populous country in Africa next to Nigeria. “Ethiopia is a federal democratic republic composed of 9 national regional states: Tigray, Afar, Amhara, Oromia, Somali, Benishangul-Gumuz, Southern Nations-Nationalities and Peoples Region (SNNPR), Gambella and Harari, and two Administrative states: Addis Ababa city administration and Dire Dawa Council” (EIC, 2008). It is now close to two decades since Ethiopia started to build a market economy after 17 years (1974-1991) of a state centered and controlled economy.

Numerous macroeconomic reforms have been implemented with the objective of achieving macroeconomic stabilization and growth since 1991. The macroeconomic reforms include privatization of state owned enterprises, liberalization of trade policy, reduction of import tariff rates, elimination of non-tariff barriers, devaluation and deregulation of price & exchange rate controls (UNCTAD, 2002).

The structure of the economy can be decomposed into three main economic sectors: the agriculture sector, the industrial sector and the service sector. In the next few paragraphs, I will try to briefly discuss the performance of these three main economic sectors.

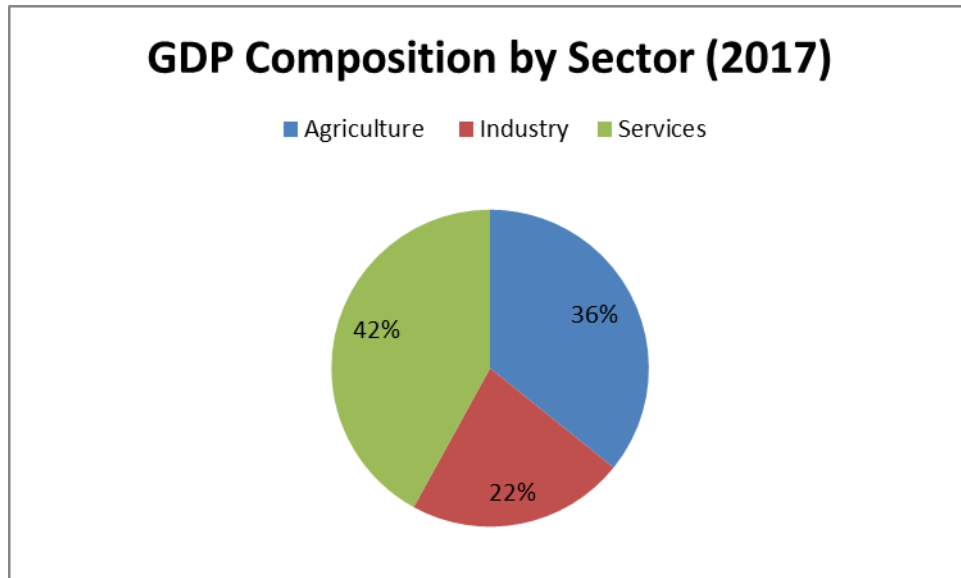


Figure 2. 1: GDP Composition by sector

Source: own computation from EIC Data.

2.1.1. The Agriculture Sector

The backbone of the Ethiopian economy is Agriculture. The sector’s contribution to the GDP of the country is 36%, and more than 73% of the population engaged in some form of agricultural activities. Furthermore, agriculture generates 60% of foreign exchange earnings. Coffee is the major source of foreign exchange. As a result, the sector overwhelmingly influences the performance of the economy. The performance of the agriculture sector, however, is highly determined by poor productivity and dependability of natural weather condition. Recurrent drought and traditional cultivation practices, land fragmentation, low level of fertilizer application and high population growth rate are the prime problems of the sector (EEA, 2007).

2.1.2. The Industrial Sector

Ethiopia is one of the least industrialized economies in the world. Close to half a century, the industrial sector contribution to the GDP 22% and the growth rate of the sector is very little compared to the agricultural sector. The employment contribution of the industrial sector is nearly 7 percentage points in 2017 (EEA, 2017). Surprisingly, manufacturing goods export accounted for less than 1% of the total exports (UNCTAD, 2002).

2.1.3. The Service Sector

The service sector is the largest sector. This sector includes trade, hotels & restaurants, transport & communication, banking & insurance, public administration & defense, education, health and other services. From 1991 - 2018, the service sector accounted for 42% of the GDP of the country, and the employment share of the sector is slightly higher than 20% (EEA, 2007). In general, the Ethiopian economy is highly dependent on the agriculture sector, next to service sector and the role of industrial sector is quite limited. This clearly highlights structural weakness of the economy. For most development economists, development is synonymous with industrialization. Thus, the size of the industrial sector should increase so as to ensure sustainable and rapid economic growth.

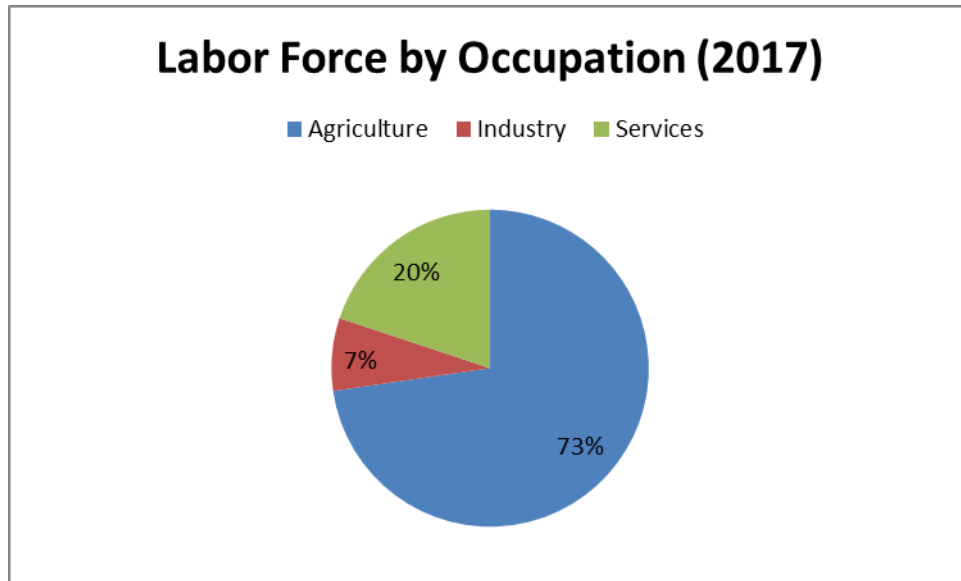


Figure 2.2: Employment by sector

Source: own computation from EIC Data.

2.2. The FDI Regulatory Framework

Ethiopia's transition from a state-controlled to a market-oriented economy started in 1991 after the current government took power from the former socialist and military government. Since then, the national investment code has been amended several times. The present regulatory regime governing FDI in Ethiopia is based on a series of Investment Proclamations issued between 1996 and 1998, principally Proclamations 71/1996, 37/1996, 351/1998, 361/1998 and 116/1998. Although other proclamations were in acted since then the basis for

FDI regulatory framework are the proclamations mentioned above. Investment Proclamation 769 /2012 is also provides the regulatory regime. In combination, these establish the economic sectors open to FDI; the financial limits and requirements for FDIs; the monitoring and reporting requirements; and the financial incentives that are available. The series proclamations enacted revised the economic sectors open to FDI. It is worth briefly summarizing the main features the present regulatory regime in each of the above areas.

Foreign investors can invest in all economic sectors other than some sectors exclusively reserved for national investors and the government. Sectors exclusively reserved for the government include transmission and supply of electricity, large domestic air transport, postal service excluding the courier services. As FIAS (2001) indicated, “the government rationale for most of the restrictions is based on largely on national security considerations.” Investment in telecommunication services and manufacturing of weapon & ammunition is allowed only in joint venture with the government. To encourage indigenous entrepreneurship and the domestic private sector, the financial sector, import trade, small air transport (less than 50 passengers), commercial water & road transport and several small businesses are reserved for national investors(UNCTAD, 2002). The government is the sole owner of land, and “no land can be obtained or transferred other than on a leasehold basis” (FIAS, 2001).

Foreign companies should obtain an approval from Ethiopian Investment Commission or regional investment authorities to invest in Ethiopia. With regards the initial capital requirement, a wholly foreign-owned enterprise should invest a minimum of USD 100,000. But wholly foreign-owned consultancies and publishing companies can obtain the investment license with USD 50,000. To invest jointly with Ethiopian investors, foreign investors should invest a minimum of USD 60,000 and the national investors should acquire at least 27 percent of the equity. To encourage export-oriented FDI, foreign enterprises that export at least 75% of their output are not required to meet the minimum capital requirement. Nevertheless, the investment code does not indicate the initial investment is whether in cash or in kind (UNCTAD, 2002).

2.2.1. Foreign Direct Investment in Ethiopia – Overview

The government of Ethiopia has recognized the importance of FDI for the country and opens many economic sectors for foreign investors. Despite the numerous attempts by the government to encourage foreign investors, the flows of FDI are quite low. The average

annual FDI flows to Ethiopia from 1992 to 2003 were only 634 million Birr. Ethiopia accounted for only 1% of Africa's inward FDI stock, while representing close to 10% of the population of the continent. Ethiopia's per capita inflows were \$5 in 2006, compared with \$39 for African countries as a whole. FDI as a percentage of GDP of Ethiopia was 0.81% in 2006, compared with 1.6% for African countries as a group (EIC, 2008).

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 and apply any depreciation methods for their financial statement. Besides, all foreign investors are exempted from profit tax for two years. This exemption is extended to 5 years for investors exporting at least 50% of their product and supply 75% of their product as input to exporters. With regards 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. Except in major cases of public interest, the investment code also provides guarantee against expropriation (EIC, 2008; EEA, 2007).

FDI flows to Ethiopia increased in absolute terms from an annual average of 562 million Birr in 1995-2000 to 3380 million Birr in 2001-2006 although there are fluctuations. The unstable political environment of the country may be one of the reasons of the fluctuations/Ruling government split/. As we can see from Figure 2.3, during the Ethio-Eritrea war (1998-2000) the inflow of FDI had fallen to a large extent. Besides, in 2005, during the country's election crisis time, the FDI flows declined to 2803 million Birr from 3588 million Birr in the preceding year of 2004. The pick value of FDI flow is achieved from 2006 to 2012 with an annual average of 8950 Million Birr due to the increase in government commitment to attract FDI with special incentive including loan. However from 2013 to 2018 FDI flow declined with negative slope to annual average of 2815 million Birr and the last two years FDI flow looks constant with average 49 Million Birr which is almost null due to the political instability of the country (EIC, 2008).

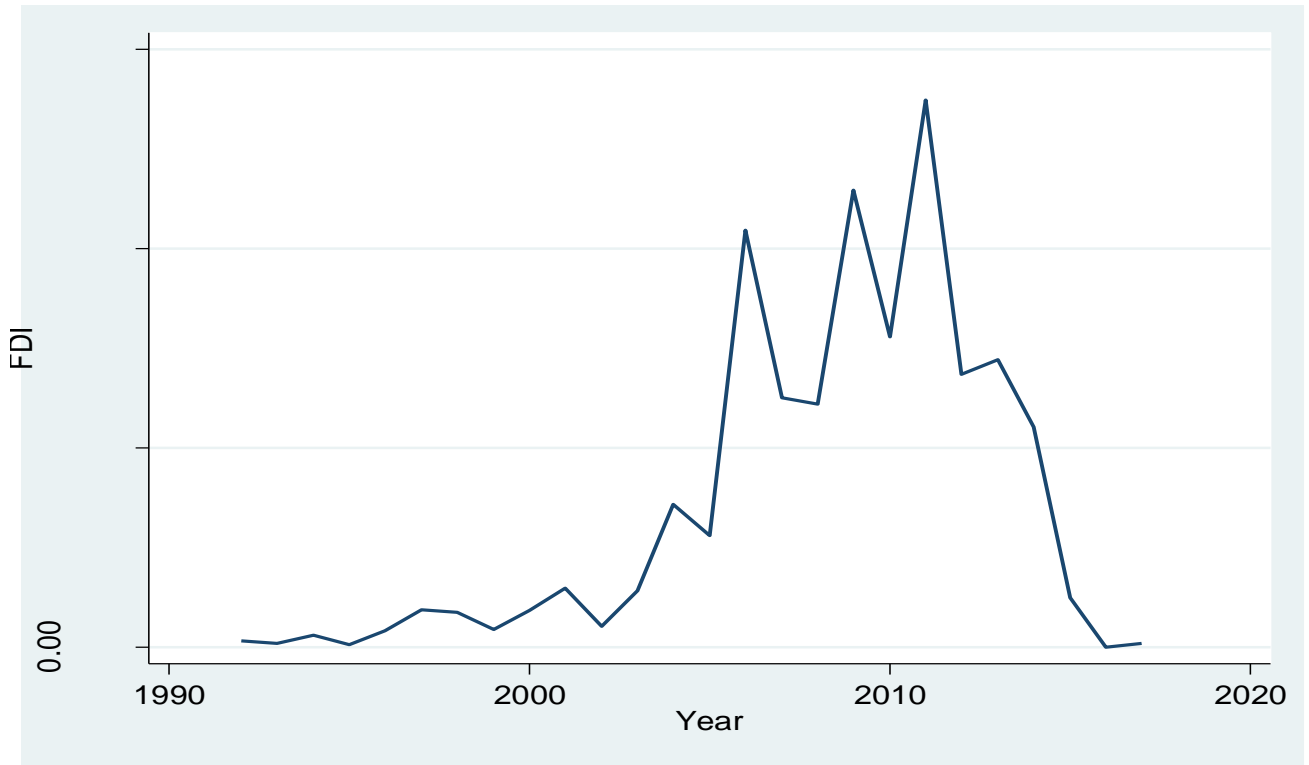


Figure 2.3: FDI flow from (1992 to 2018)

Source: own computation from EIC Data.

2.2.2. Regional Distribution of FDI

Looking at Table 4.2, it can be seen that Addis Ababa (the capital city), Oromia (the most populous region) and Amhara regions take the largest share of FDI flows to Ethiopia. For the period from July 1992-July 2005, in terms of planned capital, Addis Ababa, Oromia and Amhara regions have attracted 36%, 28% and 15% of the total FDI inflows to Ethiopia respectively. In other words, these three regions accounted for 80% of FDI flows to the country. Conversely, Gambella, Afar, Somali and Benishangul-Gumuz performance in attracting FDI is very poor. Benishangul-Gumuz Region, for instance, has not yet attracted any foreign investment since the country opened its door to foreign investors. In general, FDI flows to Ethiopia have been unevenly distributed among the regions. Even though the incentive system encourages foreign investors to invest in the least developed regions (Gambella, Afar, Somali and Benishangul-Gumuz) of the country by providing especial benefits including provision of land free of any charge, their performance in attracting FDI is

very poor (EIA, 2008 and Tagesse, 2001). Addis Ababa is the major destination for FDI flows to Ethiopia, as it has better infrastructure, stable political environment and better supply of trained manpower. Oromya Region has attracted sizable amount of FDI due to its proximity to Addis Ababa, availability of natural resource (arable land) and market (FIAS, 2001). I argue that regional imbalance in attracting FDI cannot be corrected by investment incentives unless the regions have certain stock of basic economic resources like market, infrastructure and skilled workforce. This is because these factors are highly determined the profit possibilities and the productivity of investments and hence the location decision of investors.

Table 2.4: Regional Distribution of FDI flows to Ethiopia, Since August 22, 1992-April 22, 2018.

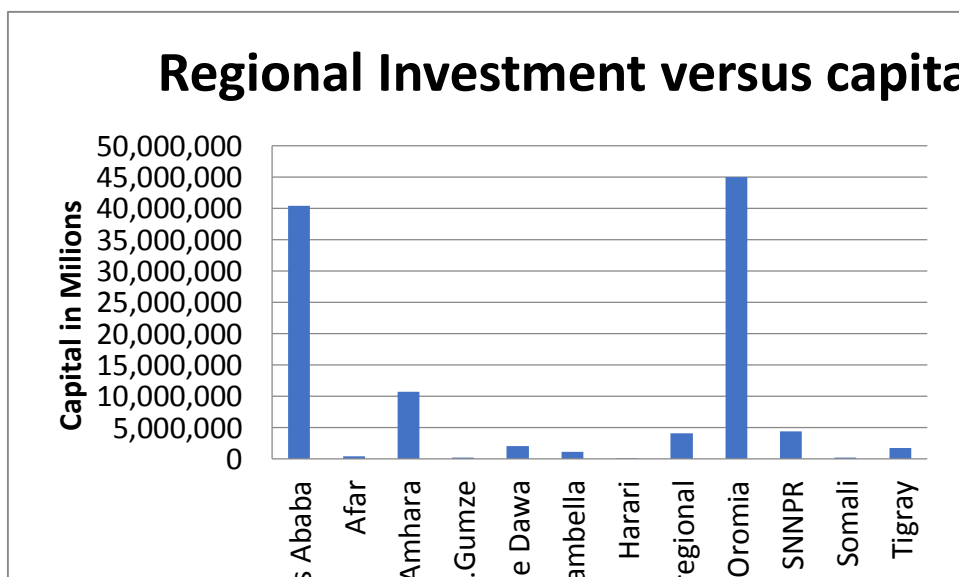


Figure 2.4: FDI flow from (1992 to 2018)

Source: own computation from EIC Data.

2.2.3. Sectorial Distribution of FDI

The FDI flows to Ethiopia are fairly diversified into the three main sectors: The primary sector, the secondary sector and tertiary sector. The primary sector includes all types of agricultural activities and mining & quarrying. The secondary sector encompasses all kinds of industrial activities. The tertiary sector includes electricity generation, construction, real estate development, trade, hotel and tourism, transport service, education and health service. As we can see from Figure 2.4, the secondary sector and the tertiary sector accounted for about 86%

each of the total FDI flows to Ethiopia in August 1992 to April 2018, while the primary sector accounted for 14%. Unlike many African countries, FDI flows to the mining and quarrying subsector are very small, as the country does not have sufficient deposit of some important minerals like petroleum. A close look at the sectorial composition of FDI flows to the country reveals that the share of the mining and quarrying sub-sector was only 2% of the total FDI flows from August 1992 to April 2018.

According to the statistics provided by Ethiopian Investment Commission (EIC), cash crop farming is the most attractive sector for foreign investors in Ethiopia. It accounted for 85% of the primary sector approved investment capital or 12% of total FDI inflows in the same period. The country is endowed with large number of livestock population (the largest in Africa). Nevertheless, the total FDI inflows into livestock farming, tanneries and footwear subsectors are not more than 2% of total FDI flows to the country. The industries accounted for 48% of the total capital expected to be invested in the secondary sector. In the tertiary sector, real estate development, construction and construction material leasing, health service and hotel & tourism attract significant amount of FDI which is about 38% of the total FDI inflows.

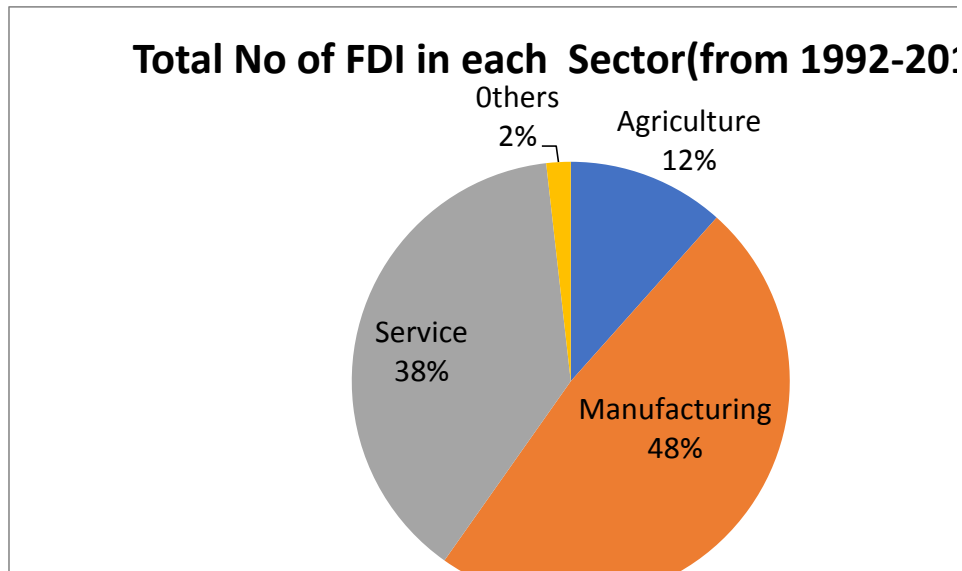


Figure 2.5: Sectorial distribution of FDI from (1992 to 2018)

Source: own computation from EIC Data.

2.2.4. FDI Flows by Country of Origin

Figure 2.6, depicts that Saudi Arabia accounted for half of the FDI flows to Ethiopia for the period from August 1992-April 2018. The second largest source is the Turkey. Sudan, USA, China and India are the other major source countries in the period.

Worldwide, Developed countries are the major source of FDI flows. Nevertheless, more than 60% of FDI flows to Ethiopia are originated from developing economies (Saudi Arabia, Turkey, India and China). This might indicate that Ethiopia could not provide an attractive business environment for FDI originates from developed economies.

Here, one can raise a question why investment from Saudi Arabia dominates the FDI flows to Ethiopia. Ethiopian Economic Association (2007) reported that one company - MIDROC group investment dominates FDI flows originated from Saudi Arabia. According to this report, the MIDROC's investments are counted as a special case. Even if the owner is foreign national, his mother is Ethiopian and the motive of the investment is more than profits (helping the people).

If the investments of this company take away, FDI flows from Saudi Arabia are very little and Ethiopia's record in terms of attracting FDI is quite disappointing.

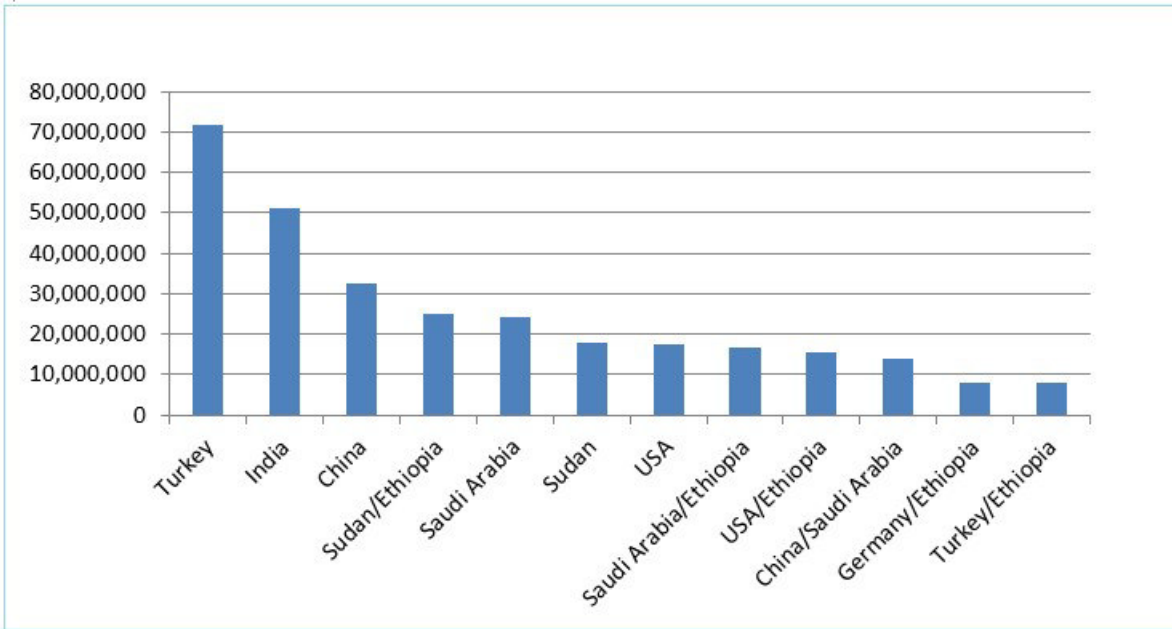


Figure 2.6: FDI flow by country of Origin.

Source: From Dejene Gizaw (2016) Journal.

CHAPTER THREE: LITERATURE REVIEW

3.1. Theoretical review

3.1.1. Main Concepts and Definitions of FDI

Foreign direct investment is not just a capital movement. In addition to capital, a controlled subsidiary often receives direct input of managerial skills, technology and other tangible and intangible assets. Unlike portfolio investors, direct foreign investors have substantial control over the management of foreign subsidiary. As stated by Thomas and Peter (2000), balance of payment accountants define FDI as any flow of lending to, or purchase of ownership in, a foreign enterprise that is largely owned by the residents (usually firms) of the investing country.

According to the IMF (1993) Balance of payment manual, an investment by a foreign investor is regarded as FDI if the direct investor holds at least 10 percent of the ordinary share or voting power of a firm.

There are different types of FDI. These include Greenfield investment, cross border merger and acquisition, and reinvested earnings. Greenfield investment refers to the establishment of a new firm that in turn enables to create productive assets in a host country. Usually, it is financed by capital coming from the investor's country. A transfer of ownership of local productive assets to a foreign investor is referred as international or cross border merger and acquisition. Reinvested earnings refer part or all of the profit that is not repatriated to the investor's country but reinvested in the host country (UNCTAD, 1998).

FDI can also be classified into market-seeking, export- oriented and government initiated FDI.

A market-seeking FDI is highly determined by the growth potential and the size of national market, access to regional & global markets and country-specific consumer preferences. When a foreign firm produces raw materials, intermediate and final goods and sells these products for non-local market, this FDI is referred as export-oriented FDI. An investment is called government initiated FDI, when governments of developing countries invite and give incentives to direct foreign investors to invest in specific sectors and industries with a view to addressing socio-economic problems like unemployment, regional disparities and deficits in

the balance of payment (Accolley et al, 1997). In a similar vein, again based on the primary motives of the direct foreign investors, FDI can also be classified into the following three groups: Market seeking, resource/asset-seeking and efficiency seeking (UNCTAD, 2007). A resource/asset seeking FDI is attracted by availability of low-cost unskilled & skilled labor, strategic natural resources and raw materials. An efficiency-seeking FDI is significantly determined by productivity of labor resource, costs of inputs and intermediate goods (UNCTAD, 1998).

3.1.2. The Benefits and Costs of FDI

Understanding the benefits and the drawbacks of FDI is imperative to formulate a sound policy. Even if, in recent times, the policy that favors FDI dominates, there are two opposing views as to the role of FDI in developing economies. On the one hand, it is argued that FDI benefits the host country, for instance by creating employment opportunities and bringing new technologies. In contrast, the other group argues that the adverse effects of FDI outweigh its benefits.

3.1.3. Pro-FDI Views

Economic growth depends on the rate of investment which in turn largely depends on savings. However, gross domestic savings are too low in the least developed countries (LDCs). Foreign direct investment is an alternative source to fill the gap between savings and the required investment. Foreign firms bring not only financial capital but also managerial techniques as well as, entrepreneurial and technological skills that lack in LDCs and these skills can be transferred to domestic firms through different channels. The government's budget deficits can also be filled by profit-tax may be collected from transnational companies (Todaro, 1992).

The total amount of foreign exchange that can be obtained from export and net public foreign aid falls short of foreign exchange that is required by LDCS. FDI can help to fill this gap by reducing part or the entire deficit in the balance-of-payments. Moreover, multinational companies manufacturing products that can be exported are able to generate net positive export earnings (Todaro, 1992). FDI can also play important role by creating employment opportunities and by integrating the host-country economy in to the world economy (OECD, 2002).

3.1.4. Anti-FDI Views

However, there is a group of scholars that strongly disagrees with the positive view on FDI that has been explained above. Their arguments are presented in the following. The first counter argument says that Multinational Corporations (MNCs) increase income for low income groups, which have low propensity to save. If individuals do not save enough, the gap between savings and investments cannot be closed. Besides, foreign firms may also fail to reinvest the profit they generate in the host country; hamper the growth of domestic enterprises and domestic investment by importing the input and intermediate product from their subsidiaries in other countries. FDI might also inhibit the development of indigenous skills as the result of multinational companies' dominance over local enterprises (Todaro, 1992).

Certainly, initial investment of foreign firms improves the current and the capital account of the host country. However, in the long run, substantial import of intermediate and capital goods, repatriation of profit, interest, royalties and management fees may harmfully affect the foreign exchange position of the host country (OECD, 2002). Transnational companies contribute to close the gap between locally collected tax and targeted revenue. However, governments often enter in to exclusive agreements with foreign firms and provide tax holidays, tariff protections, and investment allowances. Due to these reasons, the taxes that can be collected become quite small. Moreover, these firms can avoid local taxation by transfer pricing techniques -a method used to reduce local profit level by paying artificially inflated prices to the intermediate products purchased from abroad subsidiaries (Thomas A. and Peter H. 2000).

3.1.5. Theories of FDI

Theories of FDI can be split into two groups: micro-level determinants of FDI and macro-level determinants of FDI. The micro-level theories of determinants of FDI try to provide answer the questions why multinational companies prefer opening subsidiaries in foreign countries rather than exporting or licensing their products, how MNCs choose their investment locations and why they invest where they do. The macro-level determinants deal with the host countries situations that determine the inflow of FDI.

3.1.6. Micro-level Theories of FDI

3.1.6.1. The Early Neoclassical and Portfolio Investment Approaches

According to the early neoclassical approach, interest rate differentials are the main reason for the firms to become a multinational company. In this line of arguments, capital moves from a country where return on capital is low to a place where return on capital is high. This approach is based on perfect competition and capital movement free of risk assumptions (Harrison et al, 2000). “The portfolio approach to FDI reacted to this early theory of FDI by emphasizing not only return differentials but also risk” (Almayehu, 1999). However, the movement of capital is not unidirectional. Capital moves from countries where return on capital is high to countries where return on capital is low and vice versa.

3.1.6.2. The Product Life Cycle Theory of FDI

This theory was first developed by Vernon in 1966. A new product is first produced and sold in home market. At the early stage, the product is not standardized. i.e. per unit costs and final specification of the product are not uniform. As the demand for the product increases the product will be standardized. When the home market is saturated, the product will be exported to other countries. The firm starts to open subsidiaries in locations where cost of production is lower, when the competition from the rival firms intense and the product reaches its maturity. Therefore, FDI is the stages in the product lifecycle that follows the maturity stage (Dunning, 1993). Vernon’s product life cycle theory is a dynamic theory because it deals with changes overtime. However, it seems that the theory is not confirmed by empirical evidence, as some multinational companies start their operations at home and abroad simultaneously (Chen, 1983).

3.1.6.3. Internalization Theory of FDI

To increase profitability, some transactions should be carried out within a firm rather than between firms and this is one of the reasons why multinational companies exist. In other words, there are transactions that should be “internalized” to reduce transaction costs and hence increase profitability. This theory may answer the question why production is carried out by the same firm in different locations. One of the reasons of internalization is market imperfection. Any kind of economically useful knowledge can be called technology. Mostly,

technologies or knowhow can be sold and licensed. However, sometimes, there are technologies that are embodied in the mind of a group of individuals and not possible to write or sale to other parties.

This difficulty of marketing and pricing know how forces multinational companies to open a subsidiary in a foreign country instead of selling the technology. In addition, a number of problems may arise if an output of a firm is an input to other firm in other country. For instance, " if each has a monopoly position, they may get into a conflict as the buyer of the input tries to hold the price down while the firm that produces input tries to raise it"(p.173). Nevertheless, these problems can be avoided by integrating various activities within a firm rather than subcontracting the activities (Krugman and Obstfeld, 2003).

3.2. Empirical Evidence

A number of empirical studies have been carried out on the relationship between FDI and economic growth across different parts of the World with different methodological frameworks. Many empirical studies used time series method while some other used a cross-country approach to study the relationship between the variables.

Most studies focused strictly on the relationship between FDI and economic growth while others added additional variables in concurrence such as human capital or labor, exports, technology gap, financial development, exchange rate, expenditure, education, economic freedom and so forth. Majority of the literature used foreign direct inflows as a proxy variable for foreign direct investment and real per capita as a measure of economic growth to test the hypothesis of positive relationship between foreign direct investment and economic growth. Most of the empirical results reported have supported the proposition that foreign direct investment do indeed stimulate economic growth and development.

Among the more important time series studies, the following studies may be mentioned: Mori Kogid et.al(2010), Louzi et.al(2010), P.P.Awasantha (2003), Oyatoye et.al (2011), Najia Saqib et.al(2013), Soltani Hassen and Ochianis(2012), Kyuntae Kim and Hokyung Bang(2008), Sarbapriya Ray(2012),and Getinet and Hirut(2005). Mori Kogid et.al(2010) investigated the empirical relationship between economic growth and foreign direct

investment. The study considered FDI net inflows as an indicator for FDI and real Gross Domestic Product (RGDP) as indicator to economic growth. The methodology used is time series vector autoregressive model. The study result shows, the existence of long-run cointegration relationship between FDI and real gross domestic product (RGDP). In addition, they investigated the causality analysis based on Granger causality and found a causal effect exists running from FDI to RGDP, implying that FDI does influence economic growth.

E.Christian Imoudu (2011) investigated the impact of foreign direct investment on Nigeria's economic growth using a time series data running from 1980 to 2009. The study applied Johansen Cointegration technique and Vector Error Correction methodology in which FDI is disaggregated in to various components namely: agriculture, mining, manufacturing and petroleum, and telecom sectors. The re- searcher concluded that the impact of the disaggregated FDI on economic growth of Nigeria are very little with the exception of the telecoms sector which had a good and promising future especially in the long-run.

Kyuntae Kim and Hokyung Bang (2008) investigated the impact of foreign direct investment on economic growth of Ireland. The study applied bound testing approach to cointegration for the data covered the period from 1975 to 2006. The result indicate that foreign capital (FDI) is statistically significant in both the long-run and the short-run having positive effects on economic growth in Ireland. The causality analysis also suggests that, there is a bi-directional Granger causality between GDP and FDI, and thus , conclude that the FDI led growth hypothesis is valid for the Irish economy.

Soltani Hassen and Ochianis (2012) analyzed the relationship between foreign direct investment and economic growth in Tunisia using a cointegration approach. A time series analysis over the period 1975 to 2009 is used for the analysis using a cointegration Error Correction Model. The research result suggests that FDI could help boost the process of long-term economic growth. Among the important cross-country studies, we may mention those under taken by: E.Borenszteina et.al(1997), Shiva S.Makki(the World Bank), B.Seetanah and A.J.Khadaro.

B.Seetanah and A.J.Khadaro analyzed the relationship between foreign direct investment and growth: new evidences from Sub-Saharan Africa countries. The paper investigated the impact

of foreign direct investment on economic growth for a panel of 39 Sub-Saharan African countries for the period 1980 – 2000.

Results from the analysis suggest that FDI is an important element in explaining economic performance of Sub-Saharan African countries, though to a lesser extent as compared to the other types of capital. Moreover, the study confirms the presence of important endogeneity in FDI growth relationship as FDI is not only seen to lead growth but to follow growth as well.

Shiva S.Makki (the World Bank) investigated the impact of foreign direct investment and trade on economic growth based on cross-sectional data of a sample of 66 developing countries over three decades. The result indicates that FDI interacts positively with trade and stimulates domestic investment. Sound macroeconomic policies and institutional stability are necessary pre-conditions for FDI -driven growth to materialize.

E.Borenszteina et.al(1997) analyzed how foreign direct investment affect economic growth in a cross country regression framework, utilizing data on FDI flows from industrial countries to 69 developing countries over the last two decades. The study result suggests that FDI is an important vehicle for the transfer of technology, contributing relatively more to growth than domestic investment. However, the higher productivity of FDI holds only when the host country has a minimum threshold stock of human capital. And concluded that FDI contributes to economic growth only when a sufficient absorptive capability of the advanced technologies is available in the host country.

Shiva S. Makki's (2016) study analysis based on cross sectional data of a sample of 66 developing counties over three decades indicates that FDI and trade contribute significantly towards advancing economic growth in developing countries. His study shows that FDI interacts positively with trade and stimulates domestic investment. Sound macroeconomic policies and institutional stability are necessary pre-conditions for FDI-driven growth to materialize. His results imply that lowering inflation rate, tax rates, and government consumption would promote economic growth in developing countries.

While most of the empirical studies show a significant contribution of FDI on advancing economic growth the result of some studies on the impact of FDI on economic growth indicate lack of significant causality between them. Ewe-Ghee Lim (2001) finds that while

substantial supports exists for positive spillovers from FDI, there is no consensus on causality. On determinants his work finds that, market size, infrastructure quality, political/economic stability, and free trade zones are important for FDI, while results are mixed regarding the importance of fiscal incentives, the business/investment climate, labor costs, and openness.

Some studies made in Ethiopian context on spillover effects of FDI on economic growth shows insignificant relationship; according to Meskerem Daniel Menamo (2014) FDI after trade liberalization has positive but statistically insignificant effect on economic growth, Results further show that the positive impact of domestic investment on economic growth becomes less when FDI assumes positive significant impact, implying the crowding out effect of FDI on domestic investment. According to Abeba Nigussie Turi (2013) one percentage point increase in the weighted share of output in the upstream (or supplying) sectors produced by firms with foreign capital participation is associated with a 1.2 percent decline in the total output. Yet, she didn't find any significant Horizontal spillover effect.

S.No	Title of the Literature	Authors & Year of Publication	Methodology and Findings
1	FOREIGN DIRECT INVESTMENT (FDI) DEVELOPMENT BETWEEN THE EUROPEAN UNION (EU) AND LEAST DEVELOPED COUNTRIES (LDCS) - BUSINESS OPPORTUNITIES IN ETHIOPIA	BIRUHE ESHETE THOMAS GEBRE (2012)	<p><i>The study was relied on reviewing secondary data. It also used primary sources i.e. structured interview and questionnaire. The research is descriptive which is characterized in simply puts the findings based on the facts gathered from the survey that was conducted from 12, july- 2011 to 07, May 2012.</i></p> <p><i>The Finding shows that Ethiopia is now becoming the major FDI inflow destinations from LDC's in Africa. Major factors that contribute to the growth of FDI include fertile land, conducive climate condition and availability of relatively cheap labor in the country.</i></p> <p><i>In comparison with other forms of capital flows, it is also more stable, with a longer-term commitment to the host economy. Major risks of FDI includes land grabbing, food insecurity and poor practice in environmental protection of the host country.</i></p>
2	IMPACT OF FOREIGN DIRECT INVESTMENT ON ECONOMIC GROWTH OF ETHIOPIA	MESKEREM DANIEL MENAMO (2014)	<p><i>This paper measures the impact of foreign direct investment (FDI) on economic growth in Ethiopia based on annual time series data over the period 1974 to 2011. It in particular examines how FDI affects GDP growth, both directly and also conditioning on trade liberalization that Ethiopia adopted in early 1990s.</i></p> <p><i>I estimate three different growth model specifications to investigate these relationships using Ordinary Least Square (OLS) method. Results show that two years lagged FDI has a positive and statistically significant effect on contemporary economic growth. On the other hand, FDI after trade liberalization has positive but statistically insignificant effect on economic growth. Results further show that the positive impact of domestic investment on economic growth becomes less when FDI assumes positive significant impact, implying the crowding out effect of FDI on domestic investment.</i></p>
3	FDI AND THE SPILLOVER EFFECT ANALYSIS: THE CASE OF ETHIOPIA	ABEBA NIGUSSIE TURI (2015)	<p><i>This thesis presents the spilling over effect resulting from the foreign direct investment with a focus on the manufacturing firms. A pooled,</i></p>

			<p><i>Fixed and Random Effect estimation techniques are employed for estimating the log transformed production function augmented for the spillover proxies: Backward, Forward and Horizontal.</i></p> <p><i>As a result, He used the Levinsohn-Petrin estimation technique, which used intermediate inputs as a proxy for unobservable shocks and the residuals from this estimate used as a measure of total factor productivity (TFP) of the firm. The TFP analysis from the LP estimation suggests that a one percentage point increase in the foreign presence in the downstream sectors is associated with a 1.1 percent rise in the total output of each supplying industries. Likewise, a one percentage point increase in the weighted share of output in the upstream (or supplying) sectors produced by firms with foreign capital participation is associated with a 1.2 percent decline in the total output. Yet, I have not found any significant Horizontal spillover effect.</i></p> <p><i>His analysis suggests that there is an econometric evidence for positive Backward spillovers and negative Forward spillovers to the total productivity of the manufacturing firms in the country.</i></p>
4	THE IMPACT OF FOREIGN DIRECT INVESTMENT ON ECONOMIC GROWTH. THE CASE OF ETHIOPIA	DEJENE GIZAW (2015)	<p><i>This study examines the impact of foreign direct investment on economic growth of Ethiopia using yearly time series data for 1974 through 2013. Economic growth is proxied by real per capita gross domestic product and foreign direct investment proxied by the inflow of foreign direct investment. Other control variables such as gross domestic saving, trade, government consumption and inflation have been incorporated. In order to fully account for feedbacks, a vector autoregressive model is utilized. The results show that there is a stable, long-run relationship between foreign direct investment and economic growth. The variance decomposition results show that the main sources of Ethiopia economic growth variations are due largely own shocks. The pair-wise Granger causality result show that there is a unidirectional causality that run from FDI to economic growth of Ethiopia.</i></p>
5	THE SPILLOVER EFFECTS OF FOREIGN DIRECT INVESTMENT (FDI) INFLOW ON THE	ERMIAS SHEWANGIZAW GETACHEW (2013)	<p><i>This study explores FDI spillover effects on the manufacturing sector of Ethiopia. For the purposes of this research, firm-level cross-sectional data for the manufacturing sector of Ethiopia was collected</i></p>

	PRODUCTIVITY OF DOMESTIC FIRMS: A CASE OF ETHIOPIAN MANUFACTURING FIRMS		<i>and analyzed from the Central Statistical Agency (CSA) of Ethiopia for the year 2009 for over 1,000 firms. The results suggest that domestic firms benefit, in terms of both Total Factor Productivity (TFP) and Labor Productivity, from foreign presence operating in the same sector, defined at the ISIC four digit level. On the other hand, the result failed to confirm the existence of geographical component in the productivity spillover. The spatial result suggested there are agglomeration effects in Addis Ababa generating positive spillovers towards the indigenous firms, suggesting that nearby firms reap more of the benefits than do distant firms.</i>
6	THE IMPACT OF FOREIGN DIRECT INVESTMENT ON TECHNOLOGY TRANSFER IN THE ETHIOPIAN METAL AND ENGINEERING INDUSTRIES	YARED LEMMA, DANIEL KITAW, GULELATGATEW (2014)	<i>This study examines the role of Foreign Direct Investment (FDI) on technology transfer in Ethiopian metal and engineering industries. A quantitative survey with a pre-coded standardize questionnaire was used to collect data for the research. From the survey the technological capabilities of local metal and engineering industries is weak to transfer technology horizontally or vertically from foreign firms. The result also supports that technology transfer and spillover is dependent on the absorptive capacity of the firms. This absorptive capacity mainly depends on the R&D activity and expenditure in local firms and the result shows the spending on R&D by Ethiopian firms is very low.</i>
7	CAUSAL RELATIONSHIP BETWEEN FOREIGN DIRECT INVESTMENT AND GROWTH: EVIDENCE FROM BRICS COUNTRIES	SRIDHARAN. P (2009)	<i>In this paper we examine the causal relationship between Foreign Direct Investment (FDI) and Growth of the BRICS countries. We employed Industrial Production Index (IPI) as a measure of Economic Growth. The stationery of the data series are checked using Augmented Dickey Fuller (ADF) Test and tested for the existence of co-integration. Johansen Co-integration model found that the Brazil alone co-integrated among the selected countries at levels. The Vector Error Correction Model (VECM) employed to trace the existence of long run relationship. The results of VECM found that Growth leads FDI bi-directionally for Brazil, Russia and South Africa and FDI leads Growth uni-directionally for India and China respectively.</i>
7	FOREIGN DIRECT INVESTMENT	SELAMAWIT BERHE	<i>The objective of the study is to theoretically and empirically</i>

	AND ECONOMIC DEVELOPMENT IN ETHIOPIA	WOLDEKIDAN (2015)	<p><i>investigate and quantify the relationship between FDI and economic development. Economic development in this thesis is measured in terms of real GDP growth, export, and spillover as FDI is said to affect economic development through these channels. Both quantitative and qualitative approaches have been conducted in order to complement and strengthen the analysis to capture different perspectives.</i></p> <p><i>The analysis conducted provides evidence that there is a positive and significant relationship between FDI and real GDP growth, a moderate positive association between export performance and FDI, and a negative and insignificant association between FDI and spillovers in Ethiopia.</i></p>
9	FOREIGN DIRECT INVESTMENT AND ECONOMIC GROWTH LITERATURE REVIEW FROM 1994 TO 2012	MOHAMMAD AMIN ALMFRAJIA,B*, MAHMOUD KHALID ALMSAFIRC (2013)	<p><i>Foreign direct investment (FDI) has been viewed as a power affecting economic growth (EG) directly and indirectly during the past few decades. This paper reviewed an amount of researches examining the relationships between FDI and EG, especially the effects of FDI on EG, from 1994 up to 2012. The results show that the main finding of the FDI-EG relation is significantly positive, but in some cases it is negative or even null. And within the relation, there exist several influencing factors such as the adequate levels of human capital, the well-developed financial markets, the complementarity between domestic and foreign investment and the open trade regimes, etc.</i></p>
10	IMPACT OF FOREIGN CAPITAL INFLOWS ON ECONOMIC GROWTH AND SELF-EMPLOYMENT IN ETHIOPIA	JAMES E. CONABLE NWEKE (2015)	<p><i>This paper examines the impact of foreign capital inflows on economic growth and self-employment in Ethiopia; using self-employment as a proxy for poverty reduction. It employs a descriptive statistics in the first part and Granger causality Wald tests in the second part. In the first part, 1961 to 2010, the findings indicate that there is an increase in the average growth rates. In the second part, 1992 and 2012, our results show that in the short run, foreign direct investment (FDI) has a direct positive effect on the real GDP, but no evidence that FDI has a direct positive effect on self-employment.</i></p>
11	THE EFFECTS OF FOREIGN DIRECT INVESTMENT	ABDULHAMID SUKAR, SYED AHMED,	<p><i>This paper examines the effect of foreign direct investment on economic growth in Sub-Sahara African countries. The methodology</i></p>

	ON ECONOMIC GROWTH: THE CASE OF SUBSAHARA AFRICA	SEID HASSAN (2010)	<i>involves estimating augmented endogenous growth model using panel data for the period 1975-1999. The results indicate that foreign direct investment has marginally significant positive effect on economic growth. Domestic economic conditions such as macroeconomic policy, openness, and domestic investment have significant positive effect on economic growth.</i>
12	THE IMPACT OF FOREIGN DIRECT INVESTMENT (FDI) ON ECONOMIC GROWTH IN EASTERN AFRICA: EVIDENCE FROM PANEL DATA ANALYSIS	SEIKO MINOTA ZEKARIAS (2016)	<i>This study has analyzed the impact of Foreign Direct Investment (FDI) on Economic growth in 14 Eastern Africa countries by employing 34 years (1980-2013) panel data, using dynamic GMM estimators after checking for autocorrelation and model specification tests. Developing countries have been attracting FDI attempting to reduce resource gaps, technology gap, and unemployment and trade deficits. However, unlike classical growth theories, the empirical studies sought inconclusive effect of FDI on growth. The findings confirm that FDI has positive and marginally significant effect of FDI on economic growth, the rate of economic conditional convergence at 5%, absence of significant crowding out effect moving from FDI to domestic investment, interdependence of domestic investment and trade openness in the sub-region. Thus, I conclude that FDI is a key driver of economic growth and a catalyst to economic conditional convergence in Eastern Africa; so, the sub region need to attract more FDI by improving investment environment, strengthening regional integration, developing human capital and basic infrastructure, and promoting export-oriented investment.</i>
13	THE IMPACT OF FOREIGN DIRECT INVESTMENT ON ECONOMIC GROWTH IN JORDAN	Basem Mohammed Louzi ¹ & Abeer Abadi ² (2011)	<i>This paper focuses on the FDI-led growth hypothesis in the case of Jordan. The study is based on time series data from 1990 to 2009. The econometric framework of co-integration and error correction mechanism was used to capture two way linkages between variables interest. An econometric result shows that FDI inflows do not exert an independent influence on economic growth. And also the impact of DIN and TP on GDP growth rate is found to be positive. Based upon these results the ultimate objective of the Jordan government is to attract FDI for development an appropriate policy mix is necessary to be taken in the future.</i>

14	FOREIGN DIRECT INVESTMENT IN ZIMBABWE: THE ROLE OF INSTITUTIONAL FACTORS	FARAYI GWENHAMO (2009)	<i>The purpose of the paper is to examine the impact of property rights on foreign direct investment (FDI) in Zimbabwe for the period 1964-2005. While the macroeconomic determinants of FDI have been analyzed to a considerable extent in past empirical work, the role of institutional factors such as the protection of property rights and the efficiency of the legal system has been underexplored. Using a multivariate co-integration framework, the paper employs a newly constructed de jure property rights index for Zimbabwe to determine the impact of property rights on FDI. The empirical evidence shows that property rights are consistently an important explanatory variable of FDI in Zimbabwe, even after controlling for periods when there are no significant new foreign capital inflows. Other significant explanatory variables of FDI in Zimbabwe are the real gross domestic product (GDP), capital intensity, the external debt to GDP ratio, political instability as well as the educational levels.</i>
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CHAPTER FOUR: DATA AND METHODOLOGY

In this section, the basic and detailed model that will help to look at the interactions will be discussed and specified.

4.1. Research Design and Approach

The purpose of this study is to examine the impact of foreign direct investment on economic growth factors. In considering the nature of the research the appropriate research design for this research would be explanatory research design. Hence explanatory research design was employed. Quantitative approach to research is convenient for quantitative description, comparisons between groups, areas or variables. Therefore for this research quantitative design is used. The study employed a time series data covering period of 1992 to 2018.

4.1.1. Type and Sources of Data

The thesis makes use of quantitative time series data for answering the research question to register quantifiable change. To complement this approach, qualitative interviews were conducted. The inclusion of multiple sources also allows for what is known as data triangulations; where both quantitative and qualitative data are contrasted in order to strengthen the conclusions.

4.1.2. Primary Data

Primary data was used in the empirical part of this study through interviews, discussing with different government institutions like, Development bank, planning commission, MOFED, National bank, Ethiopia Investment commission and commercial bank officials. A semi-structured interview method has been employed when conducting the interviews with the five Related CEOs. A semi-structured interview include a flexible approach to the interview process, where key concepts are devised and a number of suggested questions that relate to the key concepts are drafted; but may be modified or omitted from the interview, depending on the insights or new knowledge that arise during the actual interview process.

4.1.3. Secondary Data

Initially, the data used in this study is a time series/historical data collected from different sources such as Ethiopian Investment Commission, National Bank, Planning Commission, Ethiopian Development Bank, Central Statistics Agency, United Nations Conference on

Trade and Development, World Bank and International Monetary Fund. Yearly time series data on the different variables under investigation ranges from 1991-2018. The length of sample period is limited by the availability of data for some of the variables. This means the period over which data is available for all of the variables, is taken to be the sample period of analysis in this paper.

4.1.4. Method of data analysis

The Concept of Multivariate Time Series

Time series is broadly defined as a sequence of data points measured typically at successive points in time spaced at uniform time intervals. It can be divided into two major parts univariate and multivariate time series. Univariate time series analysis uses only the past history of the time series being forecast plus current and past random error terms for single data series. Multivariate time series analysis is the study of statistical models and methods of analysis that describe the relationships among several time series. Multivariate time series consists of multiple single series referred to as components. As such, concepts of vector and matrix are important in multivariate time series analysis. Assuming that a time series variables, denoted as $RPGDP_t, FDI_t, \dots, GCons_t$ are of interest, and we let $Y_t = (RPGDP_t, GDS_t, FDI_t, INF_t, TR_t, \dots, GCons_t)$ are the time series vector at time t for $t=0, \pm 1, \pm 2, \dots$. Multivariate processes arise when several related time series are observed simultaneously over time. Multivariate time series processes are of interest in a variety of fields such as engineering, the physical sciences, business and economics and particularly the earth sciences (in meteorology and geophysics). According to (Box et al., 2008) the main purposes for analyzing and modeling vector time series jointly are to gain an understanding of the dynamic relationships over time among the series and to improve accuracy of forecasts for individual series by utilizing the additional information available from the related series in the forecasts for each series.

For the proper investigation of the objective of the study, the method of data analysis employed for this particular study was quantitative data analysis techniques. And the complemented interview and questionnaire were analyzed and summarized. To examine the impact of FDI on economic growth Autoregressive Distributed Lag Model were employed. A time series data ranging from 1992-2018 used to undertake the econometric analysis. In order to analyze the econometric models the researcher used co-integration and vector Autoregressive Model estimation techniques. Further, the estimation was done by using STATA software.

4.1.5. Model specification

The selected method for the purpose of analyzing the data is multivariate time series Auto-Regressive Distributed lag (ARDL) model. ARDL model is selected because it is the most successful, flexible and easy model for the analysis of multivariate time series. ARDL model does not require differentiating the variables as endogenous or exogenous. Moreover, the possibility of combining long-run and short-run information in the data by exploiting the co-integration property made it the most important reason why the ARDL model continues to receive interest.

Auto-Regression Distributed Lag is an econometric model used to capture the linear interdependencies among multiple time series. It generalizes the univariate Auto Regression (AR) models by allowing more than one evolving variable. The ARDL model describes the evolution of a set of k variables (endogenous variables) over the same sample period as a linear combination of their past values.

Following the augmented Solow production function(Mankiw, 1992) and empirical literature(such as Egwaikhide Christian Imoudu, (2012), etc.), let a country's production function can be represented by the function:

$$Y = f(A, L, K) \dots\dots\dots(1)$$

where Y denotes output (or gross domestic product), L denotes labor force, K denotes capital and A denotes total factor productivity, which explains the output growth that is not accounted for by the growth in factors of production specified. Assuming that the capital stock consists of two components: domestic owned capital measured by Gross Domestic Investment (GDS) and foreign owned capital measured by Foreign Direct Investment (FDI).

$$K = GDS + FDI \dots\dots\dots(2)$$

Adopting a production function that make output a function of labor, capital (where capital is specified as domestic and foreign owned capital separately), trade deficit, inflation and government consumption, we can have a function:

$$Y = F(A, L, GDS, FDI, INF, TR, GCons) \dots\dots\dots(3)$$

where TR denotes trade deficit, $GCons$ denotes government consumption, L Labor denotes the Employment and INF denotes inflation. Assuming that the relation follows a simple Cobb-Douglas type production function.

$$RPGDP = A_t GDS_t FDI_t INF_t GCons_t EMP_t TR_t \dots\dots\dots(4)$$

To investigate the impact of foreign direct investment on economic growth we have used various tests and variables. The dependent variable is Real Per capital Gross Domestic Product, and independent variables include Gross domestic saving, Inflation, Foreign direct investment, Government Consumption, Employment and trade.

$$Y=f(GDS, FDI, INF, TR, GCons, Emp) \dots\dots\dots (5)$$

The functional form of the above model is written as by modifying in time series form.

$$RPGDP_t = \beta_0 + \beta_1 GDS_t + \beta_2 FDI_t + \beta_3 INF_t + \beta_4 TR_t + \beta_5 GCons_t + \beta_7 Emp_t + \varepsilon_t \dots\dots\dots (6)$$

Where $\beta_1, \beta_2, \beta_3, \beta_4$ and β_5 are constant elasticity coefficient of output with respect to $GDS_t, FDI_t, INF_t, TR_t$ and $GCons_t$ respectively, β_0 is a constant parameter and t is the white noise error term. The effects of the independent variables on the dependent variable (RPGDP) are expressed via coefficient estimate, their sign and statistical significance. The variables of interest in the given model are $RPGDP_t$ and FDI_t .

RPGDP= Real Per capital Gross Domestic Product

GDS = Gross Domestic Saving

FDI= Foreign direct Investment as Percentage of GDP

INF= Inflation= Annual GDP Deflator at time t

TR= XM= Trade Deficet

Gcons= Government Consupion as % of GDP

DI= Domestic Investment as % of GDP

Emp= Employment as % of GDP

The unit root test is employed to find the order of integration. After this the ARDL bounds co-integration test, causality test and various diagnostic tests are applied.

I. Unit Root Test

To check the order of integration of variables, the unit root test is applied. It is recognized that the strategies to find the unit root is complicated in the literature. We have employed the ADF test. The ADF also called Dickey Pantula test, is supported linear regression. The ADF used in the replacement of correlation because ADF can handle most complex and bigger models. The augmented Dickey Fuller (ADF) statistic is a negative number. The requirement for the ADF test is as follows:

$$\Delta Y_t = \alpha + \beta t + \rho Y_{t-1} + \zeta_i \sum_{i=1}^p \Delta Y_{t-1} + \mu_t$$

The ADF test includes lagged difference as a key component in order to oppose autocorrelation. This study also uses ARDL approach to analyze the co-integration between FDI and economic growth in Ethiopia.

II. ARDL Bounds Testing for Co-Integration Approach

Autoregressive distributed lag is applied because all the variables are stationary at the mixed level, some are stationary at first difference and others are at log level. Due to this we have used ADRL bounds testing co-integration approach which shows the co-integration relationship between the variables. If the error correction term (co-integration equation) is negative it shows the existence of long-run co-integration relationship among the variables.

We have also applied various tests, including serial correlation LM test to check the autocorrelation, Breusch pagan Godfrey test for heteroskedasticity, Ramsey Reset test for model's functional form, and Jarque Berra test to check the normality of variables. To find the direction and causal relationship between variables, we have applied granger causality test.

4.1.6. Variables and definition

Real GDP Growth: It is well known that there is no single way to bring about development. This implies that sources and ways of economic development differ across countries. Governments in different countries take different policy measures in order to accelerate their economic development. Economic development is one of the main objectives of every society in the world and other things being equal, economic growth is fundamental to economic development. There are many variables that contribute to economic development.

Theoretically, FDI in the neoclassical growth model promote economic growth by increasing the volume of investment, in the endogenous growth model, FDI raises economic growth by generating technological diffusion from developed countries to developing countries where lack of appropriate technologies and financial resource is hampering development (Borensztein et.al., 1998).

In this section, we start from the standard production function and extend to include our variable of interest in order to test to what extent FDI explains economic growth in Ethiopia. In order to test this, a standard production function is used given by: $Y = f(K, L)$, where output is a function of capital and labor. In order to capture the impact of FDI on growth, FDI

is explicitly incorporated in the model. The following variables are the variables included in the growth model. The rationale behind the inclusion of these variables is explained below:

Real Gross Domestic Product (RGDP): Real GDP is included to capture the performance of the economy. It is the main outcome variable in this study. Economic growth is conventionally measured as percent rate increase in real GDP. It is measured as a log of nominal Gross Domestic Product (GDP) deflated by GDP deflator.

Foreign Direct Investment (FDI): FDI is measured as a log of FDI stock per GDP in USD, based on theoretical and empirical justification, the relationship between real GDP growth and FDI is expected to be positive although circumstances might influence this relationship otherwise.

Unemployment (Uempl): Total unemployed individuals in the country or the yearly unemployment rate.

Domestic Investment (DI): Domestic investment is measured as the difference between total investment and FDI. Domestic investment is seen as one of the major driving forces of economic growth.

Trade (T): Trade is taken as a proxy for openness, which is defined as the share of exports and imports in GDP. Openness to trade has been used extensively in the economic growth literature as a major determinant of growth performance. This variable is meant to serve as a proxy for a country's degree of trade openness or "outward-orientation".

CHAPTER FIVE: RESULT AND DISCUSSION

5.1. Trend analysis of all variables

5.1.1. Trends of Rea GDP

The data below show a trend of real gross domestic product from the year 1992 to 2018, accordingly, the trend shows for the first ten year the trend didn't show much significant difference or increment; since 2007/08 the trend shows some increasing trends. However, after the year 2015 the trend analysis indicates the gross domestic product of the country increases significant up to the ends of the trend graph. Overall the trend shows the country's GDP is increasing time to time.

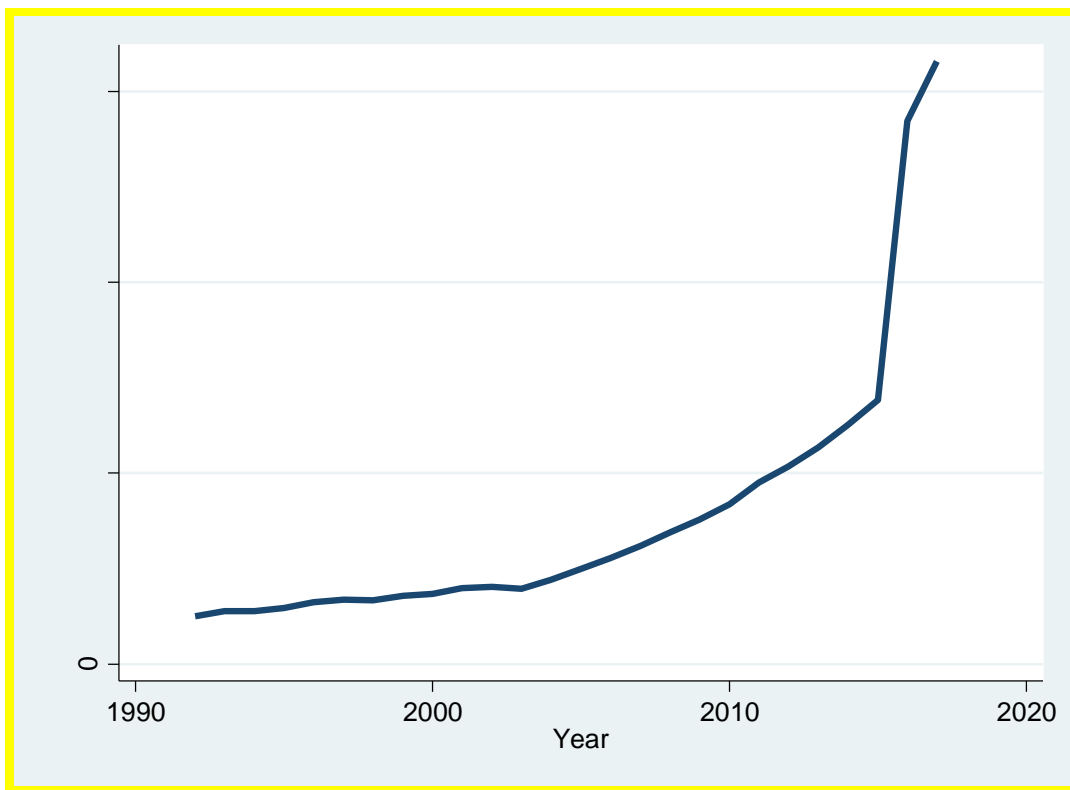


Figure 4.1: trends of real GDP in “000,000” Birr

Source; own computation

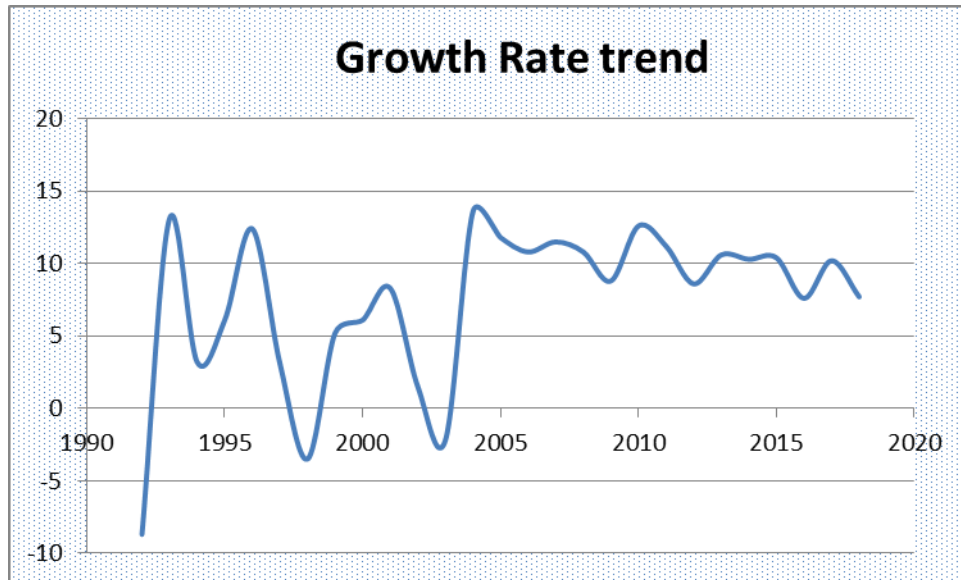


Figure 4.2: Trends of Growth rate

Source; own computation

As it can be observed from Fig. 4.2, the growth rate trend shows an average of 11/4 from 2004 to 2011. The second trend is from 2012 to 2018 which is 9.3 in average that shows the growth rate of the country is increasing at a decreasing rate. The growth rate at 2018 is 7.7 which shows a decrease from double digit.

5.1.2. Consumption Trend

The trends of the consumption graph shows the country's consumption expenditure is increasing from time to time; as shown in the trend graph below the trends of the consumption is moderately increasing up to the year 2005/2006. However, it significantly starts to increase since the years 2010; as well as its increasing rate are also very high.

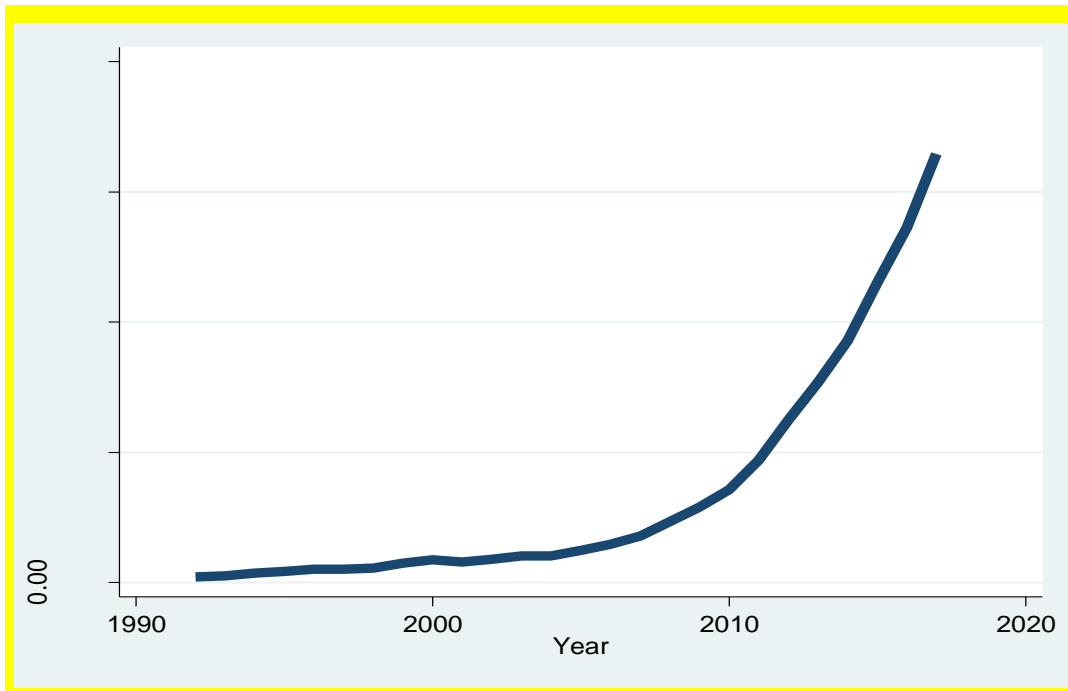


Figure 4.3 trends of Consumption in “000,000” Birr.

5.1.3. Trends FDI

Foreign direct investment is the amount of money that is invested in the country coming from abroad; meaning that the amount of capital inflow in terms of investment. As shown in the trend graph below although it shows some fluctuations however, it was increasing with a minimum increasing rate. After the year 2000 the flow of FDI towards the country was at its increasing. Still the trend was increasing after 2010 however the fluctuating rate is highly responsive, meaning the change in FDI was very large amount. Although, the country’s FDI flow shows an increasing trend, however after the year 2010/11 it starts to decline at a significant rate and continues decreasing almost to insignificant by 2017 and 2018. The decrease of FDI in the consecutive years is due to the political instability of the country.

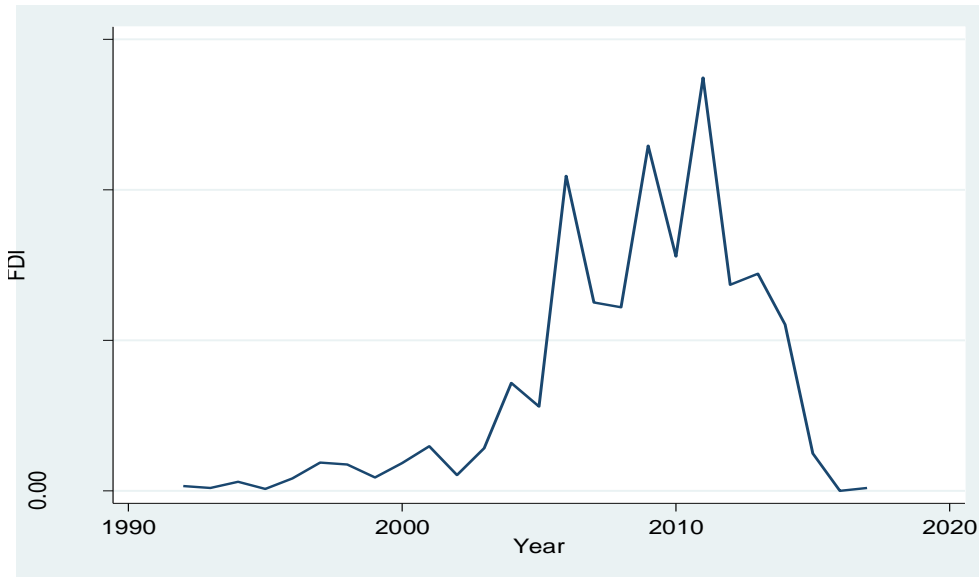


Figure 4.4 Trends of FDI Inflow in “000,000” Birr

5.1.4. Trends of Gross domestic Saving/GDS/

Saving is a critical macroeconomic variable which can measure the performance of any economy, as shown in the graph below the trends of the country’s saving; it seems not good at first couple of ten years. Between the year 1992 and 2010 the country’s saving amount didn’t show as such responsive changes; however after the year 2010 the saving amount begins to show a significant changes and continuous up to the end of the trend graph.

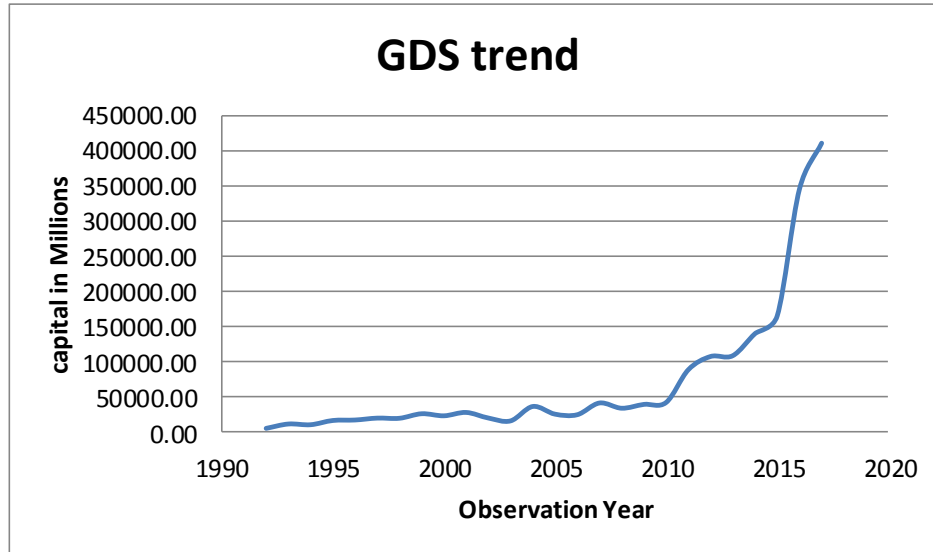


Figure 4.5 Trends of gross domestic saving

5.1.5. Trends of Employment

Comparatively, as shown in the trend map below there was two pick points where the employment was at its highest level; in the year 1995 the employment rate in Ethiopia was high as shown in the trend analysis below; however, the employment rate decreases up to the year 2002/2003. The maximum employment was registered in the year 2008 where the trend also shows a vertical increasing slope; this was because of the construction of mega Projects like Sugar factory, fertilizer factory, Great renaissance dam project and other projects which immersed significant amount of employment. After reaching the pick point, conversely the trend graph bounce back to go down wards and reaches to the minimum rate. During this period, it can be observed that there is a slowdown of economic growth which could not absorb the available unemployment which shows the decline of employment too.

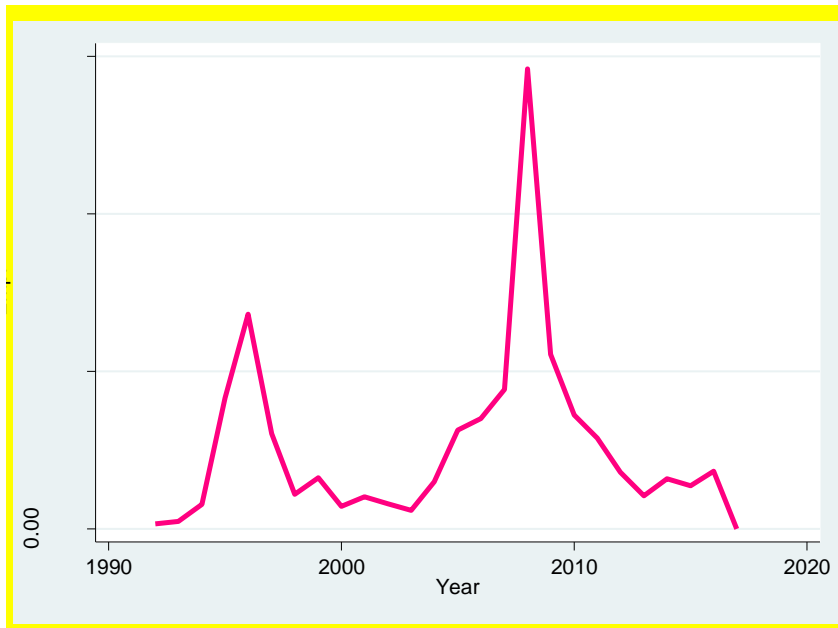


Figure 4.6 Trends of employment

5.1.6. Domestic Investment

The domestic investment trend in the graph shown that in the first two to three years it had an increasing rate; however, it shows a decreasing rate on the next two years. Between the year 2000 and 2010 it shows a little fluctuations and after the year 2011 it had an increasing rate.

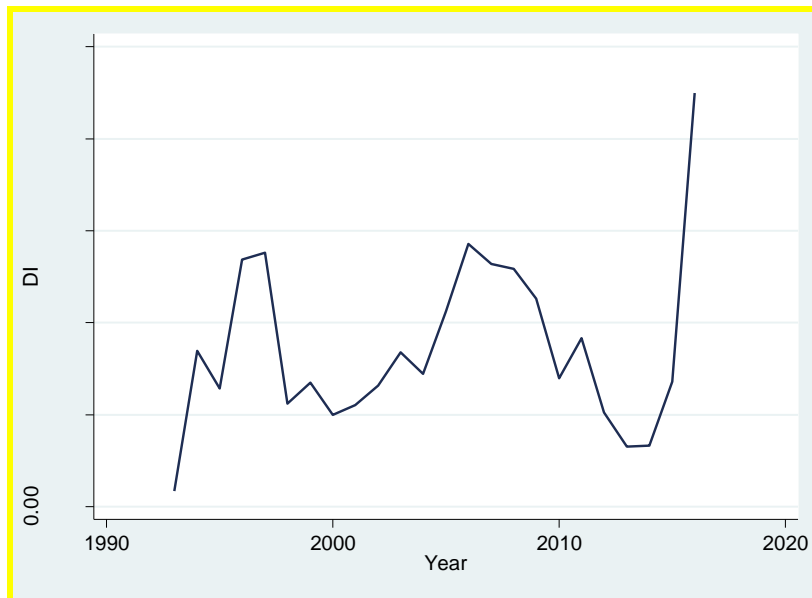


Figure 4.7 Trends of Domestic Investment in “000,000” Birr

5.1.7. Trade balance

The countries trade balance is continuously decreasing as shown in the trend graph below, as shown in the trend graph below at the first couple of years the decreasing trend was a bit minimum after the year 2000 the decreasing trend is increases; basically, after the year 2010 the trade balance decreased with a significant slope due to high demand of import materials for the started mega projects during these time series..

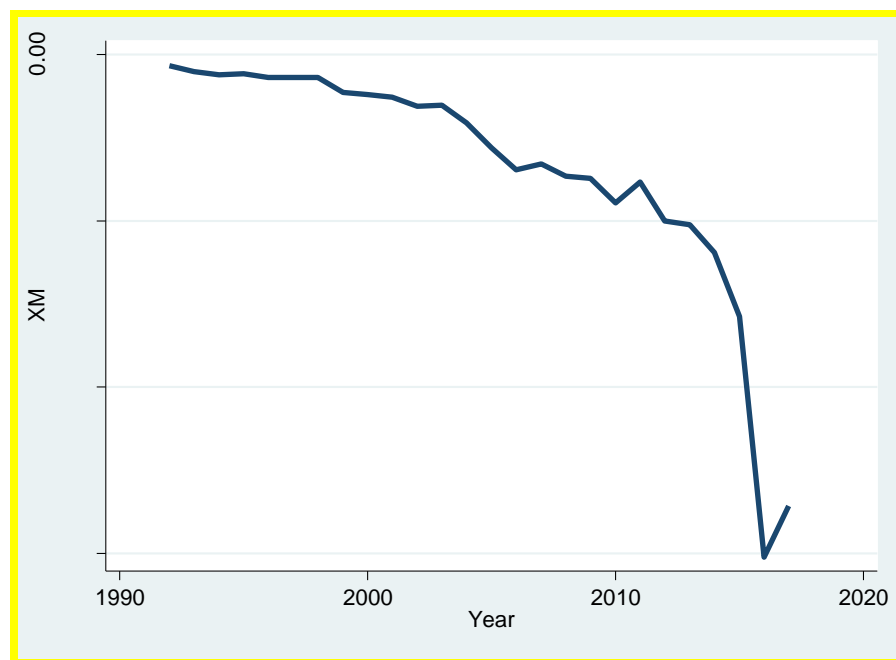


Figure 4.8 Trends of Trade balance in “000,000” Birr

5.1.8. Trends of Inflation

Under this sub-topic the trends of inflation rate is described; accordingly, as shown in the trend graph below the inflation rate is increases at increasing rate, however, its increasing rate is slow; after the year 2005 the increasing rate is show a moderate change. Furthermore, the trend graph shows after the year 2010 the inflation increases in high extent; after the year 2014 the inflation rate decreases with some extent.



Figure 4.9 Trends of inflation

5.2. Regression analysis: Impacts of FDI on Economic Growth

Under this sub-topic the impacts of foreign direct investment will be assessed; the sub-topic incorporate the unit root test, co-integration test, lag selection test, and the estimation result.

5.2.1. Unit Root Test

A unit root test should be considered if one wants to perform a regression using a time series data; accordingly, in order to check whether the data is free from unit root problem dickey-fuller unit-root test was employed. Accordingly, all of the variables was converted to log form in order to keep the consistency of the variables in terms of stationary; and hence, all of the variables had got a unit root problem at log level, therefore in order to avoid the problem first difference of the log variables were taken, and all of the variables become stationary at first difference.

Table 4.1 unit root test of each variable

	At log level	1st difference
logRGDP	0.9989	0.000
logGcons	0.9935	0.000
logFDI	0.2705	0.000
logGDS	0.9442	0.000
logEMPL	0.7334	0.000
logInflation	0.7983	0.000
logBOP	0.6555	0.000

5.2.2. Long Run Test for Co-Integration

Johansen co-integration Test technique is employed to test the presence of co-integration between the series of the same order of integration through forming a co-integration equation (Onyekachi and Vincent, 2017). Under this Test, there are two co-integrating equations; we compare the trace statistics and critical values. These two values tell us whether co-integrated variables exist. For the purpose of decision we are going to compare the 5% critical value and trace statistics. Furthermore, the Eigen values of the entire are significantly greater than zero. However, since the result shows the existence of seven equations the alternative hypothesis there is co-integration among the variables is accepted. This implies that there is long run relationship among the one dependent variable and six independent variables.

Table 4.2 Johansen Tests for Co-integration

Johansen tests for co-integration					
Trend: constant Sample: 1995 -2017					Number of obs =23 Lags = 2
maximum rank	parms	LL	eigenvalue	trace statistic	5% critical value
0	90	-1877.7549		3370.9390	192.89
1	107	-1489.1428	1.00000	2593.7147	156.00
2	122	-1107.5561	1.00000	1830.5413	124.24
3	135	-744.99196	1.00000	1105.4131	94.15
4	146	-432.98107	1.00000	481.3913	68.52
5	155	-240.56779	1.00000	96.5647	47.21
6	162	-210.55313	0.92646	36.5354	29.68
7	167	-199.40847	0.62058	14.2461*	15.41
8	170	-193.6832	0.39216	2.7955	3.76
9	171	-192.28542	0.11445		

5.2.3. Lag Selection Test

The lag selection test was also performed; as we have seen in the table below the appropriate lag to use is lag 2.

Table 4.3. Lag selection test

Selection-order criteria								
Sample: 1999 - 2018 Number of obs = 20								
lag	LL	LR	df	p	FPE	AIC	HQIC	SBIC
0	-1857.95				1.3e+66	177.805	177.902	178.252
1	-1685.39	345.12	81	0.000	4.7e+62	169.085	170.056	173.561
2	988.539	5347.9	81	0.000	5.4e-41*	-77.8606	-76.0149	-69.3554
3	4238.11	6499.1	81	0.000	.	-385.63	-383.59	-376.229
4	4426.95	377.68*	81	0.000	.	-295.55*	-401.574*	-394.214*

5.2.4. Test for Autocorrelation

Autocorrelation is happen when the error terms make some pattern; for the purpose of testing the existence of autocorrelation Durbin's Alternative Test For Autocorrelation were used; accordingly the interpretation is made through observing the p-value; if the p-value is significant it implies that there is autocorrelation problem; however, if the p-value is insignificant or less than five percent it means that there is no the problem of autocorrelation. Accordingly, as observed in the table below the p values is greater than five percent and hence the data is free from autocorrelation problem.

Table 4.4 Durbin's Alternative Test for Autocorrelation

Breusch-Godfrey test for autocorrelation				
lags(p)		chi2	df	Prob > chi2
1		2.833	1	0.0923
	H0: no serial correlation			

5.2.5. Normality test

Table 4 contains the results of residual and stability diagnostics. We have applied the autocorrelation test to check the serial correlation of residual, the results express that there is no serial correlation in the residual. The Breusch Pagan Godfrey test is applied to check the heteroskedasticity, the null hypothesis of 'no hetero' is accepted as the probability is greater than 0.10. To find the distribution of the error term, the Jarque Berra (JB) test is used, the null hypothesis is 'residual are normally distributed'. The p-value of JB is greater than 0.10 which is failed to reject the null hypothesis. It means the error term is normally distributed. Another

test is applied to check the functional form of our model. The Ramsey reset test exposed that the functional form of the used model is good.

Table Results of Residual and Stability Diagnostics

Tests	F-stat	P-value
Serial correlation LM test	3.9164	(0.3365)
Breusch Pagan Godfrey (Heteroskedasticity) test	2.2326	(0.2793)
Ramsey Reset test	1.0102	(0.4207)
Jarque-Berra test	0.4829	(0.7854)

5.3. Estimation Result: ARDL Model

Table 4.5. contains the results of the long and the short run ARDL co-integration. The value of R-square is favorable for our model. The short run results of ARDL are significant for GDS, Empl, INF. The variable FDI and DI have negative value and all other variables have positive value. The negative and significant error correction term shows the long run relationship among the variables.

In the long run, except, FDI, all other variables have a positive impact on economic growth. The coefficient of capital shows that a 1% increase in GCos causes a 0.58% increase in economic growth at 5% at the level of significance. Similarly, the coefficient of GDS expresses that a 1% change in GDS causes 2.53% change in economic growth. The coefficient of FDI indicates that a 1% change in FDI causes 17.56% change in economic growth at 5% level of significance. The coefficient of DI that a 1 percent change in DI causes a 0.76% change in economic growth at 10% level of significance. The Empl has a negative effect on economic growth, which is insignificant, but mostly InF have a positive impact on economic growth.

Table 4.5 VAR estimation result

Variables	Sort run Results		Long run Results	
	Coeff.	Prob.	Coeff.	Prob.
RPGDP(-2)	-0.8937	(0.0003)		
GCons	-0.5763	(0.0136)	0.5877	(0.0206)
Gcons(-2)	0.4874	(0.0000)		
Empl	0.0223	(0.0050)	-0.0617	(0.1951)
Empl(-2)	-0.0170	(0.0004)		
GDS	-0.0111	(0.1938)	0.0253	(0.0879)
GDS(-2)	0.0488	(0.0002)		
FDI	0.1258	(0.0309)	0.1756	(0.0426)
FDI(-2)	0.2569	(0.0001)		
DI	-0.0006	(0.3344)	0.0076	(0.0815)
DI(-2)	-0.0015	(0.0096)		
INF	0.2269	(0.0011)		
INF(-2)	0.1358	(0.0319)	0.1656	(0.0436)
Coint-Eq.(-1)	-0.1301	(0.0001)		
Constant	5.5794	(0.0255)	-4.9359	(0.0470)
R2	0.9999			

5.4. Interview Analysis

The thesis used mainly quantitative time series data for answering the research question. To complement this approach, qualitative interviews were conducted. The inclusion of multiple sources also allows for what is known as data triangulations where both quantitative and qualitative data are contrasted in order to strengthen the conclusions.

5.4.1. Primary Data

Primary data was used in the empirical part of this study through interviews, discussing with different government institutions like, Development bank, planning commission, MOFED, National bank, Ethiopia Investment commission and commercial bank officials. A semi-structured interview method has been employed when conducting the interviews with the five Related CEOs. A semi-structured interview include a flexible approach to the interview process, where key concepts are devised and a number of suggested questions that relate to the key concepts are drafted, but may be modified or omitted from the interview, depending on the insights or new knowledge that arise during the actual interview process.

Most interview responses were presented and are depicted here under.

1. Do you think FDI in Ethiopia is going good? Means does the country gets the maximum out of FDI as the purpose stated?

There are only few FDS which are doing their best as the purpose they come to the host country, with the required export and some with import substitution but most of them are not going good reason the intention registered in EIC for the amount of required equity they should to put first, is failed to most of the FDI. They started to setup with the principal loan given from mainly DBE, CBE and some private banks for service sector not only this after they commerce operation the actual employment is near to 10% to 15% from their proposal submitted during the process to getting their license.

Another problem is their export performance is not as required rather they request frequently hard currency for the purpose of importation of input for their investment or factory.

So in general as the interviewee concluded the country is not getting the maximum out of FDI as the purpose stated rather they contributed to the negative trade balance of the host country.

2. What are the challenges encountered by foreign investors and local government in the management of foreign direct investment in Ethiopia?

They are some challenges as the operation of interviewee the first challenge is there is no institution at least to support follow up and control frequently after the FFI Commence Operation the second challenge is the intention of the FDI not to disclose honestly their actual import export data on time even they are asked by the regulatory bank NBE violation to respond to the request letter sent to them from responsible body. The third challenge is there poor performance to return their loans which are taken from local banks specially from DBE most of the FDI are on NPH (None performing loan) condition this is a big challenge to the government and the banks to manage the FDI even some they disappear after they took the loan from the bank immediately some disappear after they start operation and becomes the headache of the banks practically there are significant number of FDI acquired by the bank which is out of its mission due to the poor performance or other reason of the FDI

3. What are the major reasons the Investors do not pay their loan on time?

As per the opinion of the interview the reason for the investors that do not pay their loan on time is **first** there is no responsible institution who control them even sometimes nobody knows what they are doing. Only for report purpose and political consumption some related ministries asked the FDI once a year otherwise forgotten.

The second reason is the political interference from the government to the Bank (DBE) not to practice the authority it has properly sometimes there are long armed FDI beyond the control of the bank. The third reason is the commitment of the FDI is poor because they understand better the business environment has porosity to practice the same.

4. Is there any Responsible body that follow up the Investors after operation?

Actually no, but there are some Institutions assumed to be following up for example banks follow up due to the loan purpose trade & industry for the import export purpose EIC for checking any problem happed during implementation for checking any problem happed during implementation for feedback. All these are executed in unorganized way.

5. Is really FDI brings foreign capital in Ethiopia in practice based on Net Import-Export?

There are reports every year these FDI Companies export for report and media consumption. But in matters of net-import-export practically they are negative which no body has never reported this. This contributes a lot to the negative trade balance of the country.

6. What should be the solution?

As per the interviewee opinions the general solutions they propose are

- Instead of political intervention the government should setup intuition dedicated to follow up and to manage FDI after commencing operation
- Revision on the special incentives given to the FDI is required.
- The autonomy power of banks should be practiced without intervention of government body and banks should check whether the FDI paid required equity before they permit the loan.
- The same privilege should be given to FDI should be given to the domestic investors to balance the development and minimize Crowding-out effect.

7. Any comment or improvements needed to FDI management in Ethiopia.

Improvements needed to FDI management as per the interviewee opinion:

The FDI should focus on the import substitution rather than export oriented to reduce the high importation of the country. There must be additional refining criteria before and after commencing operation whether the FDI is serious or gambler.

- There are also technology spill over hindrance due to the willingness of FDI they run the overall business without giving the critical position of local employees.
- The Carding-out effect of FDI to domestic investors should be taken in to consideration.
- There must be some mechanism to award for the best performer FDI at national level to encourage the FDI to head the right way.
- The inflow of FDI also should be controlled and examined with the level of development of the country.

5.4.2. Secondary Data

The secondary data was collected hardly from DBE to complement the Descriptive Analysis.

Table 4.6 Loan Performance and Status of FDI

Status of Foreign Investors Financed by Development Bank Of Ethiopia								
Sr No	Borrower Sector	Approved amount	Required Equity	Loan position as at 30-Apr-2018				Overdue Status
				Undue		Due		
				Principal	Interest	Principal	Interest	
1	Manufacturing	585,095,370.00	250,755,159.00	450,220,360.04	148,017.65	117,259,337.67	127,837,277.64	Doubtful
2	Manufacturing	223,674,474	97,538,089	198,474,917.90	51,657.86	8,963,661.61	6,906,892.92	Pass
3	Manufacturing	1,259,556,728.00	665,750,948.00	257,261,891.79	63,434.44	52,481,538.00	6,946,656.70	Pass
4	Manufacturing	221,209,494.00	221,209,493.00	15,326,813.19	5,038.95	23,701,019.00	2,119,348.29	Special mention
5	Manufacturing	441,476,225.00	441,476,225.00	104,632,885.27	34,399.85	58,877,901.91	4,860,009.36	Special mention
6	Manufacturing	346,228,901.00	346,228,901.00	151,776,452.12	49,899.11	32,974,174.00	14,950,156.04	Special mention
7	Manufacturing	432,602,344.00	259,745,813.00	459,704,838.07	12,568,415.14	-	33,903,787.11	Special mention
8	Manufacturing	1,425,077,983.00	427,523,394.90	-	-	4,257,716.22	42,868.79	Special mention
9	Manufacturing	367,647,449.00	94,276,371.00	109,891,656.30	2,077,203.46	17,507,029.00	4,785,962.71	Special mention
10	Manufacturing	213,906,280.00	733,278,897.00	134,260,513.11	2,736,707.44	44,425,049.73	12,689,955.00	Sub-standard
11	Manufacturing	435,878,614.00	435,878,614.00	-	489,617.08	-	-	Pass
12	Manufacturing	565,740,257.00	565,740,257.00	-	4,917,989.06	-	-	Pass
13	Mining & Energy	360,858,165.00	169,965,255.00	-	163,127.67	-	-	Pass
14	Manufacturing	263,032,768.00	263,032,768.00	-	2,584,795.61	-	-	Pass
15	Manufacturing	336,096,425.00	336,096,425.00	-	4,088,402.40	-	-	Pass
16	Agriculture	117,824,622	50,496,267	18,047,470.62	162,763.48	17,796,146.33	1,464,769.63	Pass
17	Agriculture	82,315,339.00	35,278,001	48,752,373.74	12,021.13	19,207,086.22	532,898.40	Sub-standard
18	Manufacturing	11,775,251.00	35,398,219	6,052,492.45	46,481.05	-	-	Pass
19	Agriculture	98,916,065.00	65,949,031	60,929,248.45	491,571.57	-	-	Pass
20	Manufacturing	50,101,360.00	42,072,598	27,773,040.20	9,130.86	2,783,410.10	1,206,429.81	Pass
Total		7,839,014,114.00	5,537,690,725.90	2,043,104,953.25	30,700,673.81	400,234,069.79	218,247,012.40	

Table 4.7 Lost FDI and acquired by the Bank

FDI Lost and Acquired by the Bank/DBE/					
Sr.No	Sector	Equity	Total Outstanding		
			Principal	Interest	Total
1	Agriculture	30%	87,987,986.92	30,971,800.66	118,959,787.58
2	Manufacturing	30%	-	-	979,372,331.25
3	Agriculture	30%	67,478,713.72	27,377,422.07	94,856,135.79
4	Manufacturing	30%	1,710,461,359.02	575,076,774.55	2,285,538,133.57
5	Manufacturing	30%	510,823,089.54	1,343,547.84	512,166,637.38
6	Manufacturing	30%	-	-	417,359,211.51
7	Agriculture	30%	-	-	209,083,283.83
8	Agriculture	30%	-	-	166,272,294.37
Total			3,857,091,574.94	992,718,342.12	4,849,809,917.06

Table 4.8 FDI Overdue Status

Overdue Status Summary and Analysis				
Stages	Overdue Status	No of FDI	% ge	Discription of NPL Status
1st	Pass	11	39%	1% NPL ??
2nd	Special mention	6	21%	3% NPL ???
3rd	Sub-standard	2	7%	20% NPL
4th	Doubtful	1	4%	65% NPL
5th	Loss	8	29%	100% NPL
Total		28	100%	Over All 40% NPL

Table 4.8 FDI Loan Performance and amount of Loan

FDI Loan Performance and Amount Of Loan	
Pass, Special Mission and NPL	7,839,014,114
Loss	4,849,809,917
Total Loan	12,688,824,031

5.4.3. FDI status and loan performance

As shown on table 4.6, table 4.7 and as summarized on table 4.8 the researcher can deduct and conclude the following findings.

The questionnaire and interview was mode on all FDI financed by DBE as it can be observed almost all are not in a position to return the loan rather the due date is passed and translated to the high level of NPL (non-performing loan) the loan is about **7.9** billion Birr that is no NPL and about 5 billion Birr is loss stage that means the bank acquired the investment project because they disappear from the country.

From the 28 FDI eleven are on pass overdue status which accounts 1% of the NPL and six FDI are on special mention which of accounts 3% of NPL. Both pass and special mention status FDI are about 60% of the total FDI financed by DBE.

The other category of FDI status is the sub-standard which accounts 20% of NPL are Two in number and accounts 20%NPL. On the other hand doubtful overdue status FDI is one which accounts 65% NPL. And finally the loss status which accounts 100% NPL are eight in number and weighed a total capital of 5 billion birr.

The total amount of loan given to FDI is huge about **12.6** billion birr so when we analyzed impact of FDI an economic growth it is not only about the contribution to PGRP but also should be considered the overall performance of the FDI hence whatever the contribution they have the above mentioned amount of money is questionable at the expense of social cost which should not be compromised.

The overall NPL overdue status is about 40% the total number of FDI. This is a considerable concern and gap that the researcher forced to study & recommends some policy implication.

CHAPTER SIX: SUMMARY, CONCLUSION AND POLICY RECOMMENDATIONS

6.1. Conclusion

This study investigates the impact of foreign direct investment on economic growth in Ethiopia using Vector Autoregressive methodology. Six other variables namely: gross domestic saving, domestic investment, employment, inflation, government consumption and balance of payment have been included in as a control variable in concurrence. All of the variables were converted to log form in order to avoid the common problem of time series data. The results of the unit root tests (using both ADF) showed that all variables are stationary at first difference. The Johansen co-integration test showed that a long-run relationship between the variables d exist. Therefore, both a short-run and long run association exists between the independent and dependent variables.

The short-run analysis of ARDL model suggested that, in all range FDI has a significant contribution to economic growth. Therefore, the researcher assumes that any policy in favor of foreign direct attraction should be encouraged because foreign direct investment accelerates economic growth.

Results further show that the positive impact of domestic investment on economic growth becomes less when FDI assumes positive significant impact, implying the crowding out effect of FDI on domestic investment.

In addition to this the findings of the study shows that domestic saving, investment and balance of payment had a positive effect on GDP however; the variable employment had a negative relationship with GDP.

6.2. Recommendations and policy implications

A country to draw a sizable FDI should attain a certain minimum level of development. The policy implication is street forward. The initial impetus for growth should come from Ethiopian themselves. The government therefore should focus on factors that impede domestic investments and support the infant industries and corporations until they get maturity level for competence. Foreign investors are encouraged to invest in a country where the domestic investors are doing successfully. In other words, the success of domestic

investors can influence the location decision of foreign investors. However, how can the domestic investment fuel growth in a country like Ethiopia where the gross domestic savings are very low? In this regard, mobilizing resources from Ethiopians in diaspora is an alternative. Experiences from different countries (e.g. China and India) suggest that the diaspora can support the country's development effort.

The government also has to set up professional institutions to manage and control FDI after commencing operation which is not available at this moment. Due to this, there is no import export data for FDI which measures the real performance of FDI.

And also the government political intervention to banks should be stopped so that the banks can follow up and practice their autonomous power. On top that the banks should check whether the FDI paid required equity before they permit the loan which is up to 70% and take measures for those FDI who entered to non-performing loan/NPL/. Finally the same privilege should be given to FDI should be given to the domestic investors to balance the development and minimize Crowding-out effect.

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