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Investigating Investment Practices in Ethiopia: Success Stories and Challenges Ahead

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Abstract
Ethiopia has pursued its own investment policies aimed at transforming its economic structure. After the incumbent regime assumed to power, it has tried to boost private investment. The general objective of this study is to investigate the distribution and challenges of investment, and explore practices aligning with in the context of development theories in Ethiopia. To this end, secondary data was collected from government offices, unpublished documents, books and reviewed journals to underpin the theories with the existing investment realities of Ethiopia. The distribution of investment portray that most of the investment is concentrated in Addis Ababa, unfairly making it "Metropolis" and other regional states of Ethiopia as "Satellites" that can be accounted for the existence of large market potential and location advantage. The various incentive packages introduced by government are not effective to attract investment to periphery areas. It is possible to underpin various development theories with the practice of Investment in Ethiopia. The surplus labour theory is partially applicable in the context of Ethiopia where most of the family members are disguisedly unemployed. This is aggravated by the high population density and seasonal nature of agriculture. This paper tried to investigate if there is infant industry argument implementation in Ethiopia and it is difficult to generalize thereof. The policy lacks to specify until when is the support, no measure to know whether they pass that stage for lifting the protection and is difficult to state its presence. The theory of Developmental state, the neoclassical counterrevolution market-friendly approach and Keynesian Growth theory recognizes that there are many imperfections in developing countries and governments do have a key role to play in facilitating the operation of markets. This is very aligned with what the current government is practicing. The development orientation of Ethiopia is Agricultural development will lead to industrialization. This implies that gradually there will be a structural change of the economy from agriculturalist to industrial, very aligned with structuralism development theory. It is found that the basic challenges of investment are presence of nominal investors, bad governance, low saving; investors rush to service sector and corruption. Therefore, it is recommended to boost the private sector by going beyond incentive such as infrastructures, finance, good governance, investigating regional states potential investment specializations and creating interregional trade.
Keywords: Investment, Challenges, Ethiopia, Development Theories

1. Introduction

1.1 Background

Though Ethiopia is nonoil-producing country, it is an undeniable fact that it has made a considerable progress in social and economic growth. The Rural Development Policy and Strategy underlines that agriculture-led development conveys rapid economic growth and lay solid foundation for industrial development. The Industrial Development Strategy focuses on export manufacturing with prime concern to textile and garments, leather and leather products, agro-processing and small and micro-enterprises Ethiopian investment Agency (2012). Recently the government has formulated the five year Growth and Transformation Plan (GTP) that runs from 2009/10 to 2015. Infrastructural and human resource investments are expanding with the crowding in effect of private investment. Thinking to make attractive, the investment law has been revised three times for the last twenty years. The privatization program has been continued to enhance the role of the private sector in the economy. However, as stated in (MoFED, 2013), still Ethiopia remains an untapped and unexploited market for investors.

1.2 Problem Statement

Most of the LDCs trade and investment orientation is correlated with advanced nations. There are various development theories which are debatable to the applicability in the LDCs. Recently these nations are trying to adopt their own contextual policies. Ethiopia after the introduction of the current government, through lifting various restrictions, it tries to give support for the domestic private and FDI. Though growing, as compared to the public infrastructure boosting, the expansion of private investment is still at its infancy. For its sustainability, however, needs to identify the basic hindering factors of the investment. These determinants can be identified as economic or other governance aspect. From the governance perspective, the effectiveness of the designed investment incentives is not analyzed. It also needs to investigate the existing investment governance scale of the country. When attempting to align development theories with investment practices, spatial economics underlines as the resource distribution in a country is not only an economic issue, but also political. Development will also be sustainable if there is reduced regional disparity. The question is therefore, how far the issue is considered in Ethiopia. Thus, this paper is therefore initiated to investigate the distribution and challenges of the investment practice with reference to development theories as a case in point of Ethiopia. This research tries to answer the following questions:

- How is the private investment distributed across regions?
- How far is the investment practice of Ethiopia aligned with the development theories?
- What are the hindering factors of the investment?

1.3 Objective of the Study

The general objective of the study is to investigate the distribution of investment and explore the practice aligning with in the context of development theories in Ethiopia. Specifically it purports to:

- Examine the regional investment share in Ethiopia
- Investigate the practice of investment in the context of development theories
- Identify the challenges of investment
- Put the way forward

1.4 Scope of the Study

The regional distribution analysis of the study covers aggregate investment of the last 22 years. It considers operational investments, which is used to compare across all regional states of Ethiopia.

1.5 Significance of the study

Identifying the challenges of investment can be springboard information for decision-making stakeholders such as the Investment Agency. Apart from this, it will fill the gap of the existing literature as integrated studies of investment and development theories are minimal and even absent in the context of Ethiopia.

1.6 Data Source and Analysis

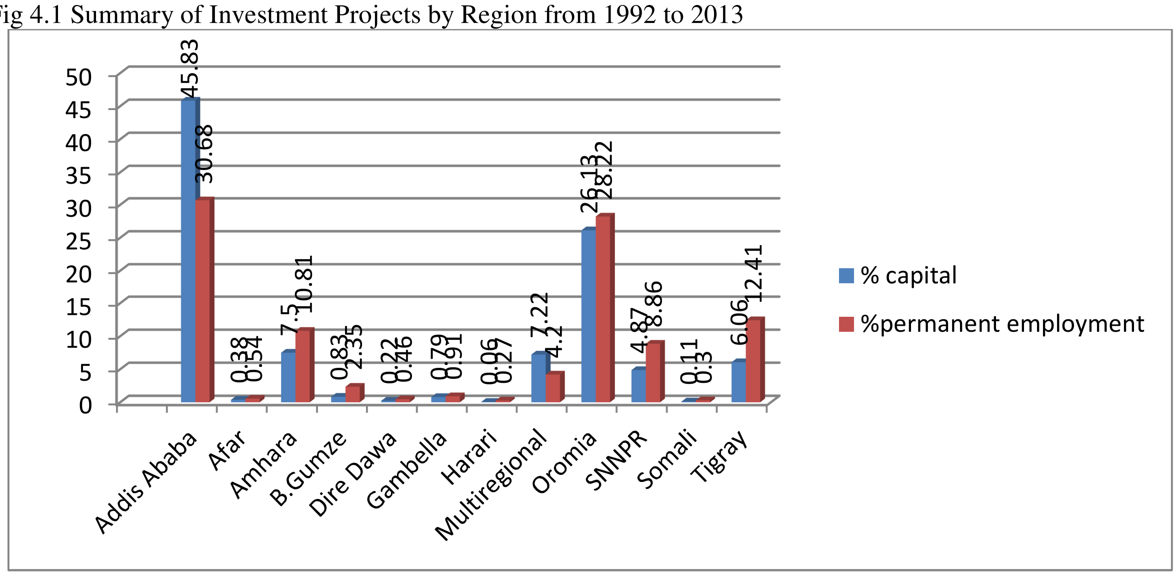
Secondary sources such as books, reviewed journals, conference and report papers were the main sources of the research. Government unpublished documents were collected from Ethiopian Investment Agency, Central Statistics Agency and Ministry of Finance and Economic Development. The data is analyzed qualitatively and quantitatively. The quantitative is supported with tabulations and narrations.

2 Discussion and Analysis

2.1 Regional Share of Private Investment in Ethiopia

This section presents the summary of regional share of investment by region during the last 22 years period of incumbent government, Ethiopian People Revolutionary Democratic Front (EPRDF). Nearly half of the capital investment is in Addis Ababa (45.8%) followed by Oromiya (26.1%), Amhara (7.5%), Multiregional (7.2%), Tigray (6%) and SNNPR (4.87%). This distribution portrays that around 70% of the investment is concentrated in Addis Ababa and Oromiya region.

Fig 4.1 Summary of Investment Projects by Region from 1992 to 2013



Source: Computed from Ethiopian Investment agency (2013)

Spatial economics have various justifications why such agglomeration happens. *Firstly*, though, there is cheap rent land in regions, investors prefer Addis Ababa to minimize the transportation cost. The outermost ring investment would consist of either land-intensive or cheaply transported items (Von Thünen cited in Paul Krugman, 1998). The import-export in Djibouti route, cargo airport and domestic market is very favourable in

Addis Ababa and Oromiya special zones, which is very applicable in the context of *location theory. Secondly*, most of the wealthier persons are concentrated in Addis Ababa, which create high nearby demand. The 1995/96 to 2004/05 consumption and expenditure survey of Ethiopia portrays that only Addis Ababa, Harar and Diredawa persistently show high levels of income at all times (MoFED 2005). *Thirdly*, there happens small cost of production in the presence of educated and uneducated labour market pooling that can favour technology spillover. Alferd Marshal sets this as one of the external economies that agglomerated firms create. Studies also show that agglomerations are minimal or nonexistent in small towns.

2.2 The Spread and Backwash Effects of Investment in Ethiopia

Franks thesis on development of underdevelopment articulates that it is possible to put a *microstructure* of a particular underdeveloped country, with its centre regarded as "*metropolitan*" and its peripheries like different rural areas and regions as "*satellites*". This concern is further explained by Gunnar Myrdal theory of cumulative causation of geographic dualism pertinent to nations and regions within nations. It has two effects: the backwash effect and spread effects. Backwash effects are unfavourable to other regions and are created though capital, trade and migration (Ghosh 2001). In this research context, it is possible to outline Addis Ababa as "*Metropolis*" and other regional states of Ethiopia as "*Satellites*". Capital is shifting from regional states to Addis Ababa which further widens inequalities in the share of investment. The demand for capital is higher in Addis Ababa because of the better existing opportunities for investment. Trade is attracts the investment, producing positive effect for Addis Ababa as it has a better competitive advantage and markets that have increasing returns and external economies, which relatively other areas have less to enjoy. The regional states lack basic infrastructure and be considered as inferior by the investors. However, trickle-down effect for regions also happens from the expansion of investments in Addis Ababa that Myrdal calls spread effect. These *trickledown effects* consist of an increased demand for region's products and the diffusion of technology and knowledge. The areas around Addis Ababa experience some spreads effects as regards demand, technology, information Medias (FM radios with limited coverage) etc, particularly for Oromiya. The nearby Oromiya region farmers can easily supply agricultural outputs and thereby can extend their market. However, as presented by Myrdal the spread effects are generally weak in LDCs, which there is limited link between the rural agriculture and the urban industry (Gosh 2012). Oromiya region has also backwash effect from Addis Ababa. For instance, the outflow of waste from the industries pollutes the lower catchment farmers affecting their health, animals and agricultural land. Moreover, there is a dislocation of farmers associated with the multipurpose need of land for the Addis Ababa city administration.

2.3 Policy Responses for Reducing Polarization Effects

The neoclassical theory and the cumulative causation approach are the two arguments related to regional disparity. Neoclassical economists argue that government should not intervene to uplift the lagging region. Doing so distorts the market; and accelerated growth occurs if invested to exceedingly productive regions. On the other hand, the cumulative causation principle envisages divergence and supports policy intervention. Hirschman recognizes policies must be designed to reduce what he calls the *polarization effects* of interregional differences and reinforce the trickle down effects (Gohsh 2001). In order to breakup such agglomerations, the government has set various incentive packages such as *tax exemptions* that can encourage investments in emerging regions as compared to developed regions of the country. Any investor who invests to establish a new enterprise in the states of Benshangul Gumuz, Gambela, Afar (except in areas within 15 km right and left of the Awash river), Somali, Borena and Guji Zones of the State of Oromiya and some specific Zones of SNNP shall be entitled to an income tax deduction of 30% for three consecutive years after the expiry of the income tax exemption period (Federal Negarit Gazette, 2012). However, the distribution of investment shows that this intervention has not yet achieved the desired target as most investors are congested in and around Addis Ababa.

One of the other reasons for clustering of industries in Addis Ababa is the relative difference of the *factor costs* mainly land, labor and capital. The capital cost i.e. interest rate does not have impact on distribution as far as the banks do not have charge difference across regions. The other measure of the government is related with land rent. Even though these interventions, the share of the regional investment and growth rate is still uneven.

The following table illustrates the most expensive lease scenario in the industrial sector investment. Citrus paribus, it is assumed that investors flow to the input cheap areas. Relatively, the land lease price is high in Addis Ababa and Amhara region and small in other regions. Even though, relatively the lease price is low in Gambela and Somali, their share of investment is minimal implying that *investors are less elastic to land lease* in the region in comparison to other regions. This implies that the incentive package is not as effective as planned to attract investors to periphery areas; which the concentration of industries in the center is caused by *other factors*. This calls the need of other strong actions other than the reduction in land price and taxation incentive. Therefore, the Oromiya being close to Addis Ababa coupled with the small land lease price get the advantage of attracting more investors.

Table 1 Urban Land Lease Base Price for Industrial Investment

S.NO	Region	Urban industrial investment lease price	Duration of urban- land lease holdings	Years of payment	Towns
1	Addis Ababa expanision zone	22.13 Birr/M2/Year or 265.5 Birr/M2	Up to 60	Within 30 years	
2	Tigray	0.42 Birr/M2/Year	Up to 80	15 to 99 years depending on the sector of development	Axum, Meklle, Adigrat, Endeslassie, Adwa
3	Oromiya	6.65 Birr/m2 / year	Up to70 to 95 based on grade of towns	It differs	Adama, Burayu, Sebeta, Menagesha, Holeta, Sululta, Sendafa-Bekke, Legetafo-Leg-Dadi, Gelan, Dukam, Bishoftu, Modjo, Shasehemene, Dalle (Langano, Abiyata and shala lakes area
4	Amhara	34.282 Birr/M2/year	Up to 80	Within 40 years	*Bahir Dar, Gonder,Dessie*
5	SNNP	1.33 Birr/M2/year	Up to 80		Awassa
6	Diredawa	9.78 Birr/M2/year	Up to 80		Highest grade
7	Gambela	0.07 Birr/M2/year			Highest grade
8	Somali	0.23 Birr/M2/year	95		Highest grade

Source: (Ethiopian Investment Agency, 2010)

2.4 Investment and Employment Generation: Existence of Duality

Free market permits the move together of labor, capital and entrepreneurship to superior return areas. The *Lewis Surplus labor theory* states the dual existence of traditional labor and the modern labor. Surplus Labor means the existence of such a large population in the rural sector so that the marginal productivity of labor has fallen to zero. This condition is also called disguised unemployment. Thus for development, there could be transfer of labor from the agricultural sector to the modern surplus generating industrial sector and is pursed for capital accumulation (Todaro and Smith 2012). Though Lewis is criticized multidimensionality, it is possible to underpin this theory in the context of Ethiopia. The average land holding per household in Ethiopia is ***not more than one hectare***. Because of this, most of the family members are disguisedly unemployed which is also aggravated by the *seasonality* of agriculture in the country. In non-irrigated areas, the usual active farming period in the country ranges from May to December and in the remaining months, farmers are idle, usually in the north. From December to April these rural labor migrate for work to the nearby towns. For example, most of the physical manual works in Addis Ababa road, train and housing works are accomplished by these migrants. According to EIA (2013), during the last 21 years out of the total temporary employment created, the share of Addis Ababa is 38.3%. However, to find the actual figure needs further research that whether this temporary employment is made by the migrants or those original habitants of the town. In the same period, the share of Amhara, Oromiya, Tigray and Dire Dawa was respectively 12.7%, 24.7%, 4%, 2%.

2.5 The Infant Industry Investments: Does it exist in the Context of Ethiopia?

Governments may enact exchange rate controls, import duties, quotas and tariffs to prevent infant industry from international competitors. When the Infant-industry gets strong enough to compete internationally, protective measures are intended to be removed. Practically it is not always the case for the reason that the various shields that were introduced may be intricate to remove. The Ethiopian government has defined rules for which the investment is reserved for Ethiopian national's, foreigners, joint venture and government. The concern of this section is therefore to evaluate if the government has infant industry argument practice. As articulated in the Federal Negarit Gazette (2012), the following areas are exclusively reserved for Ethiopian nationals; which prohibits foreign industries:

- Banking, insurance, micro-credit and saving services;
- Broadcasting and mass media services;
- Attorney and legal consultancy services;
- Preparation of indigenous traditional medicines;
- Advertisement, promotion and translation works;
- Domestic air transport services using aircraft with a seating capacity of up to 50 passengers;
- Packaging, forwarding and shipping agency services

However, it is difficult to consider these as infant industry investments. The policy lacks to specify until when is the support, no measure to know whether they pass that stage for lifting the protection. Some investors even abuse the protection.

2.6 Privatization and Investment

Privatization program offers colossal opportunities to investors. The *theory of Developmental state* states strategical involvement of government. As a reflection, sectors such as electrical energy supply and transmission through the National Grid System; Postal services except courier services, and air transport services with a capacity of more than 50 passengers are exclusively reserved for the government (EIA, 2013). According to Todaro and Smith (2011), the neoclassical counterrevolution can be divided into three approaches: the free-market, the public-choice (new political economy), and the market-friendly. The *market-friendly approach* recognizes that the developing-country's factor and product markets imperfections require systematic market friendly government intervention; for instance, expansions of social and physical infrastructures (health, educational, road) and provision of conducive environment for private sector. This approach also entertains the notion that market failures of LDCs in areas such as environmental outcomes and investment coordination. Aligned with this theory, it is indicated in the Growth and Transformation Plan of the country (GTP) that feasible investment projects in areas where the private sector is unable or unwilling to commence will be promoted by the government so as to rectify market failure and there by foster rapid economic development. *Keynes Growth Theory* also supports government investment in infrastructure as it boosts and injects income into the economy. To this end, various public investments such as Sugar Industry, Metal and Engineering Industry and Coal Phosphate Complex Fertilizer Project are on progress which are planned to be undertaken during the GTP period. There is a ***gradual privatization*** held in the country among which in 2010/11, 21 public enterprises were transferred to private sectors through sale and joint venture. Moreover, 2011/12 budget year, 10 enterprises sale has been approved (MoFED, 2013). Usually, government spending *exceeds* income that pushes to fiscal deficit. As a result, sometimes citrus paribus donations and debts, Government finances this expenditure by borrowing funds from the economy through the issue of bonds... This theory is reflected in the government actions such as *Great Renaissance Dam* bonds that it has also a dual sense of creating ownership and nationality.

2.7 Structuralism Development Theory and Investment Orientation in Ethiopia

One of the principles of structural change theories is that there can be a transformation of agrarian society (subsistence) to modern industrial community (urbanized manufacturing and service economy). The Policy directions of structuralists stand for government intervention for enhancing the industrial sector by *Import Substitution Industrialization.* The development orientation of Ethiopia is Agricultural development will lead to industrialization; gradually to achieve a structural change of the economy from agriculturalist to industrialist nation. It is also expected to strengthen the forward and backward linkages of sectors. Ranging from Micro and small scale enterprises to large-scale investments are given important role in the realization of export promotion and import substitution strategies. Particularly, the export sub sector plays a key role in the economic growth and raising foreign exchange. *Devaluation* of the domestic exchange rate can also be of its reflection. Promotion of FDI in selected areas and encouraging domestic investment are efforts of the country for achieving the desired target.

2.8 Challenges of the Investment

Investment is increasing across period in the country. However, there are basic hindering challenges which some of them are presented in this paper. *Firstly,* Some of the investors are nominal and do not invest trust-worthily. Some others start building and stop after a certain period; and others fence and rent the land: other than the intended purpose, which the case is getting worse as the concerned authority did not took immediate measure for such occurrences. As presented on Reporter Magazine Amharic Version Wednesday Yekatit 5, 2006 E.C, based on the assessment made by Urban Renewal and Land Bank Office, long period fenced 109 investment plot of lands were found in *Arada, Bole, Yeka, Nifas Silk Lafto, Gulele and Lideta* sub-city administrations. However, its macroeconomic level detail cause and effect analysis needs further research. *Secondly*, one of the basic factors for development is the favourability of investment environment. The Federal Anticorruption Commission conducted a study through "*Selam Development*" research organization. The study was on Foreign Direct Investors to Ethiopia about their corruption experience in government services. The survey finds out that, most of the investors do not have trust on government for the reason that offices are corrupted. Except Latin America and Antarctica, the sample contains 350 companies representing 42 countries. The finding from the 350 companies shows that:

- 20% of them stated government procurement contracts are made non-transparently
- 71% of them believe it is difficult to run business in the country because of corruption and very complex and procedural procurement
- 67.4% of them stated in order to break the bureaucratic problems, they give corruption for government top officials and workers thinking as there is no other alternative solution.

These investors were asked to rank the top corrupted government offices and it was found that

- 18.9% put Ethiopian Revenue and Customs Agency
- 8.3% Transport Authority
- 7.4 % Land Administration
- 6.5% Ethiopian Electric Power Corporation (Reporter Magazine Amharic Version Wednesday Tir 14, 2006 E.C.).

This is a big homework for the country, which is an obstacle for attracting FDI. Of course, as compared to previous periods, there is a good start from the government in capturing corruption particularly in the Ethiopian

Revenue and Customs Agency officials. *Thirdly*, for sustainable development domestic mobilization of saving for investment is critical. In this regard, MoFED (2005) reported that though the government has increased capital expenditure to public investment, the growth rate of private investment is relatively small which it is not stimulated as expected. Moreover, the investment is surrounded with problems such as:

- The private sector investment is favouring the service sector investment, rather than agriculture and industry and fails to make sector-wise link in the economy
- The percapita saving is very small as compared to the percapita income growth. However, still it is very challenging because the economy is dominated by the hand to mouth subsistence agriculture. As a result, there is large gap between domestic saving and investment which it makes to need foreign finance
- The high inflation rate is discouraging the amount of income (interest) that can be obtained through saving
- The private investment is largely dominated by the FDI, but not the domestic

4. Conclusions and the Ways Forward

4.1 Conclusions

Ethiopia has developed its own contextual development policies. However, most of the developing nations' policies have links with their former colonizers. This paper has investigated challenges, distributions and examines the investment practices of Ethiopia from the perspective of some development theories. The distribution articulates unfair in that most of the investment is concentrated in Addis Ababa due to location advantage. The incentive package is not effective as planned in attracting investors to periphery areas of the country. Underpinning with the Franks thesis on development of underdevelopment, it is possible to regard Addis Ababa as "Metropolis" and other regional states of Ethiopia as "Satellites". It is possible to link the surplus labor theory in the context of Ethiopia where most of the family members are disguisedly unemployed. It is difficult to clearly outline the practice of infant industry argument in Ethiopia for the reason that the policy lacks to specify until when is the support, no measure to know whether they pass that stage for lifting the protection and is difficult to state its presence. The theory of Developmental state, the neoclassical counterrevolution market-friendly approach and the Keynesian Growth theories recognized that governments do have a key role in the economy. This is very aligned with what the current government is practicing. The development orientation of Ethiopia is Agricultural development will lead to industrialization that associated with structuralism development theory. It is found that the basic challenges of investment are presence of nominal investors, bad governance, low saving; rushing to service sector and corruption. The presence of development theories in-favor of government intervention does not necessarily mean that this intervention is correct. There are occurrences of crowding out private investment arising from government competition over the use of resources such as credit, land...that could have been utilized by the private sector.

The Ways Forward

The existing investment incentive package is not capable enough to minimize the regional disparity of investment in the country in that the lion's share of investment proceeds to cluster in and around Addis Ababa. Therefore, beyond the incentive, the government should examine other factors; and strengthen infrastructures, finance and good governance. Investment potentials of the country should also be properly investigated so that the private sector will be informed and motivated to invest particularly in the periphery areas. In this regard, the growth corridor identification can be a good entry point. Regions should also identify their investment specialization areas so that it can be possible to create inter regional interaction. Regional states should also try to attract investors by creating the above favorable conditions and aware their local investors to invest at their locality, in order that getting rich at regions and flying to Addis with the capital will be minimized. Moreover, there should be a detail further research in the area.

The market is failing to invest in the agriculture and manufacturing sector. Therefore, there should be more impressive incentive package and good governance for attracting the investor and confirm how beneficial is investing the stated sectors. Moreover, the Investment Agency with the support of stakeholders should strictly follow whether the bank credit taken by investors is utilized for the permitted investment. In addition, the land should not be given and left; there should be regular monitoring to check if the land is developed for the intended purpose. After investigating why investors are failing to invest, the administration should not be nominal and have to take serious administrative measures. This needs to have a committed civil servant.

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