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THE CONTRIBUTION OF FOREIGN DIRECT INVESTMENTS FOR REGIONAL ECONOMIC DEVELOPMENT: IN THE CASE OF OROMIA REGIONAL STATE

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CENTER FOR REGIONAL AND LOCAL DEVELOPMENT STUDIES

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BY

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A THESIS SUBMITTED TO THE SCHOOL OF GRADUATE STUDIES OF ADDIS ABABA UNIVERSITY IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE DEGREE OF MASTER OF ARTS IN REGIONAL AND LOCAL DEVELOPMENT

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This is to certify that, this thesis prepared by Tilahun Debele Dabessa entitled "**The Contribution of foreign Direct Investment for Regional Economic Development: In the Case of Oromia Regional State**" prepared and submitted in fulfillment of the requirements for the Degree of Master of Arts in Regional and Local Development Studies. This MA thesis complies with the regulations of the University and meets the accepted standards with respect to originality and quality.

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3. Advisor ______________________ Signature ____________ Date______________

DECLARATION

I, the undersigned, declare that this thesis is my original work and not been presented for a degree in any other university, and that all sources of materials used for the thesis have been duly Acknowledged.

Name: Tilahun Debele Dabessa

Signature: ______________________

Place: Addis Abba University, college of Development studies

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May God bless you all

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Acronyms

BOFED- Bureau of Finance and Economic Development (Oromia)

CSA- Central Statistical Authority

EIC- Ethiopian Investment Commission

FDRE- Federal Democratic Republic of Ethiopia

FDI – Foreign Direct Investment

GDP- Gross Domestic Product

IMF – International Monetary Fund

MNE- Multi National Enterprises

OIB- Oromia Investment Bureau

ONRS- Oromia National Regional State

UNCTAD- United Nations Conference on Trade and Development

UNDP- United Nations Development Program

UNFPA- United Nations Population Fund

UNO- United Nations Organization

WB – World Bank

Abstract

This study assesses the contribution of foreign direct Investment for regional economic development: In the case of Oromia regional state. A sample of 77 foreign companies and 406 respondents from the local community used as a primary source and secondary data obtained from the federal and Oromia bureaus were analyzed in the process of answering the basic questions. After the data has been collected, it was analyzed using linear regression and Descriptive statistical analysis. The result of the study indicates that there is a positive relationship between the regional economic growths Vs foreign direct investment and regional tax revenue Vs inflow of foreign direct investment. However, less positive correlation exhibited among the dependent and independent variables in both contexts. The job opportunities have been creating for the local community. However, in terms of the quality of the job they are very poor which characterized by poor payment and unskilled labor recruitment. The social development practice by the foreign companies in the region indicates that, they are actively participating in the provision of clean water for the local community. Regarding the human capital development, the study found that the foreign companies' participation is minimal to zero. Based on the major findings the study forwarded recommendation for the foreign companies and for the regional government as well.

Key word: FDI Economic contribution in Oromia Region.

CHAPTER ONE

Introduction

1.1. Background of the study

Foreign direct investment is one of the key economic features of the modern globalized world. The United Nations Conference on Trade and Development's (UNCTAD) World Investment Report (2014) predicted that foreign direct investment (FDI) globally could increase to 1.7 trillion USD in 2015 and 1.8 trillion USD in 2016. Beyond the prediction, in 2016 the FDI showed a figure of 1.89 Trillion USD globally. However, it declined by 23% to 1.52 trillion USD in the year 2017 due to a variety of economic and political instabilities around the globe. UNCTAD (2018)

In 2013, 54 percent (778 USD billion) of the total global FDI flow went to developing countries. Africa saw more than 4% increase in FDI inflow every year, although developing Asian countries i.e. India, continued to be the region with the highest recipients of FDI inflow. In East Africa, FDI increased by 15 percent to 6.2 billion USD in 2015 because of rising flows to Ethiopia and Kenya. This is due to the increasing integration of developing countries into international trade and the global market as it is accompanied by a dramatic arrival of foreign capital into developing countries in the form of FDI. UNCTAD (2014)

Ethiopia was Africa's third largest recipient of FDI by the end of 2017. According to UNCTAD's (2005/06) report, prior to 1991, FDI flows were negative or near zero. The FDI inflow to Ethiopia increased from 0.17 Million USD in 1992 to 545.1Million USD in 2004. Since then and to this date, yearly FDI inflow has varied between 545 million USD to 953 million USD dollar in 2014 (UNCTAD, 2008 & Tsegaye, 2014). This is in part because the Ethiopian industrial strategy is attracting Asian capital to develop its manufacturing base Indeed, foreign investment in light manufacturing from China, Turkey, and India is the major cause of the increase in FDI coming into Ethiopia.

The attitude of many developing countries towards the importance of FDI has changed remarkably and they have taken steps to ease restrictions on FDI inflow. These countries supportive policies towards FDI base themselves on the assumption that FDI increases the country's output, productivity, and technology transfer (Damooei et.al, 2006). Recognizing the importance of FDI in the development of its economy, since the early 1990s, Ethiopia taken a significant step towards liberalization of the economy and of private investment in return experienced rapid economic development and today has become one of the world's fastest growing, non-oil producing economies.

Indeed, the country sees FDI as an important source of capital to fill the resource gap between domestic investment and saving which remains wide due to low levels of income and domestic saving. In Ethiopia, it is reported that between 1990 and 1997, gross domestic investment as a proportion of GDP rose from 12 percent to 19 percent whereas gross domestic saving remained the same. (UNCTAD,2002). This implies that the gap needs to be filled either by loan/development assistance or from private foreign investment. Nevertheless, trends in development assistance show its reduction as a source of funds.

The role of FDI has been widely recognized as being a growth factor in the regional economic development of developing countries. More significantly, it is seen as a means of transferring modern technology and innovation from developed to developing countries. FDI enables host (investment receiving) countries to achieve investment levels beyond their own domestic saving. Nevertheless, the development impacts of FDI in developing countries should not be presumed to be a given, much of the desired outcome depends rather on host country characteristics. According to Nunnenkamp et.al. (2004), recipient countries even the regions with a better endowment of human capital, are more likely to benefit from FDI-induced technology transfer, as spillover from foreign affiliate to local enterprise is more likely. In addition to the host country's absorptive capacity, institutional development, the rule of law, level of corruption, protection of property rights, the quality of public management are crucial factors that determine technology and know-how transfer from foreign affiliates to domestic firms.

Reports suggest that FDI plays a significant role for regional economic development. At the regional level, FDI contribute to overall economic growth and regional economic restructuring by increasing competition and by transferring and diffusing new forms of production organization. These changes then should lead to productivity improvements across the regional economy (Florida, 1996). FDI is typically attracted to the existing economic clusters to benefit from external economies of scale such as markets, existing pools of qualified labor, factors of production, suppliers, infrastructure, institutions and innovative capabilities (UNCTAD, 2001).

Oromia is the largest and most populous region in Ethiopia covering more than one-third the area and 55 million people of Ethiopia respectively. (Oromia Investment Commission, 2016) With the very fertile land, over 60% of Ethiopia's top export earner commodity coffee, comes from Oromia region, 36 % of the livestock in Ethiopia contributed by this region. Its implication would be Oromia is a fertile ground for foreign direct investment specially for these MNE`s which wants to invest on primary sectors. Besides Oromia is the leading investment destination in Ethiopia and better positioned in terms of infrastructure development.

1.2 Statement of the problem

Investment in general seen as one of the most important variables in driving economic growth and development. (Selamawit, 2015) Hence, foreign direct investment is believed to serve as a strong mechanism for the encouragement and spread of business opportunities throughout developing and industrialized economies thereby enhancing economic development.

It has been argued in a numerous study (OECD 2014, Andrea, et al. 2012, Healdsburg 2009) that FDI contributes positively to economic development in host economies. In this regard, developing countries, emerging economies and countries in transition have come increasingly to see foreign direct investment as a source of economic development, modernization, income, growth and employment. Countries have liberalized their foreign direct Investment Regimes and pursued other policies to attract Investment.

Even though the inflow of FDI for the year 2017 has declined by 10% to 3.6 Billion USD, then the previous year due to political instability Ethiopia, the 8th largest Economy in Africa in the year 2017, is the third largest recipient of FDI in Africa next to Egypt and south Africa (UNCTAD, 2018). Besides, Ethiopia received nearly half of the inflow of FDI in the Eastern Africa and the nation continued to attract investments in light manufacturing industries. According to Ethiopian Investment Commission (2018) an increase in the inflow of FDI to the country especially in the past ten years, dramatically increased the economic growth, tax Income, the employment opportunity, the production of export items, linkage with the local economy, the technology & knowledge transfer and the social Development by the MNE in Ethiopia.

Despite the fact that, there are many foreign companies operating in Oromia regional state, the poverty level of the communities is still very high. The contribution of those FDI to the local communities and the regional state is not yet clearly known. to the best of my knowledge other than assessing how many FDI are attracted and how much foreign currency earned, previous studies give less importance on the benefits of FDI to the society and the region. Therefore, in this paper I tried to assess the direct benefits that the communities earned from the attraction of foreign investments in the region. Besides, this study assessed whether the foreign direct investment is contributing in a significant manner for the region`s economic development based on the past 23 years [1996 - 2018] time series data.

The main reasons for selecting Oromia regional state for this study is its proximity to the capital city. Since Oromia is the largest recipient of FDI than the rest of regional states, carrying out a research in this region will be sounded and even better to represent the nation`s performance comparatively. Besides, the presence of Oromia Regional government offices in Addis Ababa helped the researcher to have an access for the data whenever it is necessary.

1.3. Objectives of the study

The contribution of this thesis is the combination of empirical study with a theoretical explanation, to investigate the developmental effects of FDI measured through regional economic growth, employment creation, tax income generation, social development and linkage with the local economy. By doing so, the study will capture the role of foreign direct investment for the regional economic development in Oromia regional state.

1.3.1 Specific objective of the research

- Examining the relationship between the inflow FDI and economic growth of the region.
- Assessing the inflow of FDI and its contribution for the tax income of the Oromia region.
- Describing the contribution of FDI for local employment opportunity in Oromia.
- Evaluating the social development roles have been played by the FDIs` in the region.

1.4 Research question

In general, this paper provided an answer for the following basic research questions.

- Does the FDI inflow contributed for the economic growth of the region?
- Does the inflow of FDI increased the tax income of the Oromia region?
- How far the region benefited by an employment opportunity from the inflow of FDI?
- What the social development roles have been played by the FDIs` in the region?

1.5 Significance of the study

This research might use to update the existing knowledge in the given area, it initiates other researchers for similar studies on the impact of FDI on the rest of regional states in Ethiopia, the findings of this study will help the Oromia regional government to use it as an input for development policy formulation. Furthermore, it might serve as a reference for further studies by other researchers in the future.

1.6 Scope of the study

The scope of this study emphasis on the role of foreign direct investment for the regional economic development: in the case of Oromia regional state. So that the study will be mainly focus on the role that have been played by the FDI for the regional economic development in Oromia region in general, and in the Finfinnee surrounding Oromia special zone in particular.

1.7 Limitation of the study

The refusal and absolute lack of willingness to cooperate by the foreign companies in an effort to collect data so that to carry out this research picked as a limitation for this study.

1.8 Organization of the paper

The rest of the chapters are organized as follows: - In the second chapter it consisted related literature review including the theoretical literature, empirical literature and conceptual framework as well. Whereas the final chapter contains conclusion and recommendation of the study. In the third chapter of research methodology the paper consisted description of the study area, research approach, research design, research methods and data analysis technique. Chapter four contains data analysis and interpretation.

CHAPTER TWO

Literature Review

In the following section, the paper aimed to define what foreign direct investment is, its relationship with the economic growth, tax income revenue, employment creation, social development issues and move on to introducing the literature on effects. After reviewing theoretical and empirical literatures, finally the researcher developed a conceptual framework.

2.1. Definition of FDI and conceptual discussion

Foreign direct investment (FDI) is a form of international investment that has been recently breaking through all around the world, especially during the last decade, which has been driven by globalization and the opening of world economies (Chirila-Donciu, 2013).

There is no straightforward and clear-cut definition of FDI, as different organizations use somewhat different definitions. The inevitable part of the definition is that the investment made must be by a resident entity of one country into a resident enterprise in another. For instance, the International Monitory Fund (IMF, 2015) defines foreign direct investment as an investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management (IMF, 2015). Similarly, UNCTAD (2018), define FDI as an investment involving a long-term relationship and reflecting a lasting interest and control of a resident entity in one economy other than that of a foreign direct investor. Furthermore, the investment must result in a significant degree of influence and control of the management of the enterprise. This is most often defined as obtaining a minimum of 10 percent of the voting share.

According to Anna (2015) FDI is defined as a form of international capital movement that differs from other forms in the way and duration of the investment's commitment. capital investment abroad regarded foreign direct investment if the purpose is to establish and maintain permanent equity relations with the foreign company and at the same time to exercise a noticeable influence on the management of that company.

Additionally, FDI can be categorized as Greenfield Project (GP), Merger and Acquisition (M&A). A GP refers to the establishment of new production facilities or expansion of existing production facilities. This involves a direct substantial capital investment, hence, adding directly to capital stock/formation, employment, and productive capacity in the recipient country. M&A, on the other hand, entails the taking over of an existing enterprise or the merging of capital, asset, and liabilities of an already existing business. M&A is merely a matter of ownership transfer, i.e. it will not add or reduce the physical capital of the enterprise at hand at the time of the transaction. M&A can also take place between companies in unrelated activities seeking to diversify risk and to deepen economies of scope. GP is more likely to contribute to economic development due to its direct impact on capital formation (Mwilima, 2003).

There are two types of FDI, vertical FDI and horizontal FDI (some of the time the mixture of the two might exist) when explaining why MNCs engage in FDI. In the case of vertical FDI, a firm "slices" their production chain by allocating different parts of production to countries where production costs are lower. Horizontal FDI is occurs when a company "duplicates" its production chain in order to place its production closer to foreign markets. The decision to invest in foreign market may result from a tradeoff between fixed cost, a cost of establishing a new plant, and variable costs such as transportation costs, tariff which are associated with exporting to that country (Hansen et al. 2011).

There are three possible motives for FDI to take place. First, Market seeking FDI that refers to the purpose of serving local and regional markets, host countries characteristics that can attract this kind of FDI are the size of per capita income, GDP growth and the growth potential of the market. Second, resource/asset seeking FDI refers to FDI for acquiring resources that are not available in the home country. Resources might for instance be like natural resources, raw material, and availability of skilled and unskilled labor. Finally, efficiency seeking FDI, this type of FDI occurs when a firm can gain from the common governance of geographically dispersed activities, epically in the presence of economics of scale and scope, and diversification of risk. Dunning (1993).

2.2. Theoretical literatures

The purpose of this section is to review the most relevant and significant literature written in this topic. The section will briefly introduce the main theoretical perspectives that have been used to investigate the impact of FDI in host country's economic development will be reviewed.

2.2.1. Dependency Theory

Dependency theory is rooted in the Marxist thought. Dependency/structuralist scholars argue that developing economies suffer negative consequence from foreign investment as a result of profit repatriation, declining reinvestment and income inequality. Accordingly, FDI inflows to the "periphery" distract local firms, stifle technological innovation and "crowd out" domestic firms (Dixon and Boswell, 1996). Similarly, Dixon and Boswell (1996) argue that foreign investment has an initial positive effect on growth in the beginning but in the long run the reliance on foreign investment exerts a negative impact on growth. The infrastructure and institutions that develop with foreign investment support further foreign investment and negative externalities/spillovers such as unemployment, over-urbanization, and income inequality.

Likewise, according to Moran (1978), foreign investors pervert or subvert host country political processes by co-opting the local elites and/or by using their influence in their home countries. It is argued the benefits of FDI are poorly distributed between the MNC and the host country, and MNC draws off an economic surplus that could have been used to finance international development.

Throughout the 1970's and 1980's, economist predominantly supported the dependency theory of FDI and its impact on economic development in developing countries. In Latin America, many countries promoted FDI as a means to finance development after the debt crisis. Most of these countries followed the "Washington Consensus" and privatized state-run enterprises in hope they would be more efficient. However, in 1970s in Latin America, MNCs were accused for being "imperialist predators" that exploited developing countries and causing the underdevelopment of world's economy "periphery" (Alfaro, 2003).

2.2.2. Neoclassical Theory

The neoclassical growth theory in contrast, which dates back to Solow (1956) and Rostow (1995), assign an important role to FDI as a growth-enhancing factor to developing countries. In the growth model by Rostow (1956), FDI is seen as a way of meeting the capital and technological transfers required for economic transformation. Solow (1956) emphasizes on the increased foreign capital and progress in technology as important variables in output growth, hence development. Moreover, according to this theory, economic growth comes from two sources, factor accumulation, and total factor productivity growth. As a result, FDI plays a twofold function by contributing to capital accumulation and by increasing total factor productivity (Lucas, 1990). Likewise, in the neoclassical growth models FDI promotes economic growth by increasing the volume of investment and/or efficiency but FDI affects growth only in the short run because of diminishing returns to capital in the long-run.

2.2.3. Endogenous growth Model

Endogenous growth literature on the other hand explains how FDI contribute to economic growth through labor training and skill acquisition not merely through capital formation/accumulation and technology transfer. According to this theory, technology transfer, expansion of the level of knowledge arises via labor training and skill acquisition. Similarly, through the introduction of alternative management practices and organizational arrangements, domestic firms can learn or imitate from FDI. Thus, FDI is expected to contribute to output growth by raising total factor productivity due to a perceived diffusion of technology and increased efficiency through better marketing, managerial structure, and superior technology (Blomstrom et al., 1996; Borenztin et al., 1995; de Mello 1997, 1999).

In addition, endogenous growth literature has identified country’s condition that must be present for FDI to have a positive impact on growth such as the complementarities between domestic and foreign investment, adequate level of human capital, open trade regimes, and well-developed financial markets. (George, 2010). This further can be related to growth enhancing effect of FDI through spillovers.

2.2.4. Spillovers

Spillovers take place from non-market transactions when resources, especially knowledge are extended without a contractual relationship, so-called externalities. In the literature, it is common to distinguish between linkages and spillovers. Linkages are a precondition for spillovers to occur. The theoretical literature identifies four means in which spillovers can take place, and thereby, enhance productivity and economic development in recipient countries.

The so-called four channels are; imitation, skill acquisitions, competition and export. The extent, however, depends on the complexity level of products and processes, for instance, simple manufacturing and process, managerial and organizational innovation are said to be easier to imitate than production that is more complex. Any upgrading to local technology occurring from imitation might leads to positive spillover effect. The second spillovers channel is skill acquisitions, it can arise when MNCs invest in training local employees, then local workers who has carried out this knowledge move to domestic firms, thereby generate productivity improvement due to adaptation of new technology/knowledge. The third channel is where spillovers take place through competition, it is argued that FDI enhance competition in the economy it enters and thereby put pressure on domestic firms to use existing technology more efficiently, thus, yielding productivity gain in the host country. Finally, spillovers arise via export, if domestic firms learn to penetrate export market from MNCs through collaboration or imitation (Greenaway et al., 2004).

All in all, modernization theory scholars, on one hand, argue that FDI raises income level and provides employment opportunities to the host country thereby boosting overall economic growth. On the other hand, dependency theory scholars argue that MNCs may prevent economic development by squeezing out local entrepreneurs, by worsening the distribution of income, by reducing consumer welfare and introducing inappropriate consumption pattern in the host countries. Alternatively, favorable effects of FDI is not a given fact, it perhaps depends significantly on host country enabling environment, political and macroeconomics stability, institutional capacity, infrastructure and educational system. (Hansen et.al. 2006; Hansen et.al. 2011).

2.3. Empirical Literature

The empirical macro level literature on FDI and economic development has been occupied on either measuring the effect of FDI on variables such as GDP/productivity growth or measuring the determinants of FDI. Most empirical studies on FDI and economic development measured by economic growth are cross country studies and especially panel-data.

A study by Zhang (2001) on 11 developing countries of Latin America found that a significant benefit of FDI to recipient countries is due to technology transfer and spill over efficiency. They scrutinize the 11 Latin America countries using co-integration and Granger causality test. In their analysis, they found that FDI has a positive impact only in five of the eleven countries. The author indicated that the benefits does not happen automatically instead depends on host country absorptive capacities, liberal trade policy, human capital, and export-oriented FDI policy. Similarly, De Mello (1999) and Borensztein et.al (1998) found that there is a relationship between foreign direct investment and economic growth, though this tends to be so because of the host country characteristics such as human capital.

De Mello (1999), on a time series and panel data studies on impact of FDI, a positive effect of FDI in promoting long run economic growth, through technological upgrading and knowledge spillovers was found. The study was focused on 32 countries both from OECD and non-OECD countries over the period of 1970-90. He concluded that the long run growth in host countries is determined by the spillovers from knowledge and technology from foreign investment to host countries. However, in the non-OECD samples he found negative short run impact of FDI to GDP and no causation from FDI to growth. This perhaps relate to the claim, by some scholars, the growth promoting effect of FDI is related to the income level of host countries. Likewise, studies by Blomstrom, Libsey and Zejan (1994) found that foreign direct investment promotes growth only in higher income developing countries. The study was a cross- country analysis of 78 developing countries and they found no positive effect for lower income developing countries.

Balasubramanyam et.al. (1996) investigated how foreign direct investment impacted economic growth in developing countries using cross-sectional data and the Ordinary Least Square (OLS) regression method. They found that FDI has a positive impact on economic growth only in countries that have export promoting strategy. This supports the “Bhagwati hypothesis” that the growth impact of FDI is positive for export promoting countries than import substituting countries, emphasizing on the role of trade regime on FDI impact.

Kokko et al. (2001) investigated the possibility of spillovers to local firms using a cross sectional data of 1,243 manufacturing firms in Uruguay in 1998. The study distinguishes the difference in spillovers effect in different trading regimes. This was defined in terms of the number of years in which the country was under import substitution and export promoting trade policies. They found that exporting tendency of locally owned firms appeared to be positively related to the presence of outward-oriented MNCs; however, the case was not the same for MNCs established during the import substituting regimes.

The study conducted by IMF (2011) on Eastern Central and South Eastern Europe countries indicate that the impact of FDI on trade depends on whether the sectors are tradable and non-tradable. The paper defined manufacturing, agriculture, mining, retail, hotels, and restaurants as tradable sectors and electricity, transport, communication, real estate and financial intermediation as non-tradable sectors. They study was conducted by applying both a cross sectional and time series econometrics method. This study found a high positive correlation between export performance of host countries and stock of FDI going to the tradable sectors, in contrast, FDI stock in the non-tradable sectors is positively associated with import.

The sector impact FDI on economic growth has not been studied extensively; the earliest research to consider this matter was Alfaro (2003). The study was based on 47 countries in the primary, secondary and service sectors for the period from 1981-1999 in cross country regression. In his finding, positive growth effect of FDI was found on manufacturing sector, negative in the primary sector and the service sector was found to be vague.

Jacques (2010), examine the long run relationship and causality of FDI and growth for ten Sub Saharan African (SSA) countries by applying a co-integration and non-causality test approach in the periods from 1970-2007. They find a long run relationship between FDI and economic growth in Angola, Cote divorce, Kenya, Liberia, Senegal and South Africa. However, FDI was statistically significant and positive only in Angola and Ivory Coast, insignificant in Kenya. In Senegal and South Africa, the direction of causality run from GDP to FDI, GDP affects FDI significantly and positively.

Empirically, according to many studies conducted on the determinants of FDI in Africa argue that FDI inflow is attracted largely by natural resource endowments. Ina Africa almost 40 percent of FDI has been in the primary sector, particularly oil and mineral extraction business. Countries like Angola, Botswana, Namibia and Nigeria who are endowed with oil and mineral resources have received foreign investment targeted at the oil and minerals sectors of their economy (Basu and Srinivasan, 2002). Morisset (2000) indicate in his study that, on a survey conducted on 29 African countries, there is a high correlation between FDI inflows and total value of natural resources in each country. (Getinet A. Hirut A., 2006)

A few scholars have also emphasized on the way in which the growth effects of FDI depends on the financial market conditions of the recipient country. Alfaro et al. (2004) and Durham (2004), emphasize that growth effect of FDI depends on sound financial markets of the host country. Alfaro et al. (2004) used cross-country data for the period of 1975-1995 and found that FDI alone plays a vague role in promoting economic growth, however, when several financial development measures are included positive effects are found. Durham (2004) used data for 80 countries from 1979-1998 and found that it is also necessary for a country to have a strong institutional capacity and investor friendly legal framework for FDI to have a positive effect on growth.

Overall, foreign direct investment may have profound effects, that their effect is of various kind such as growth, export, technology, know-how transfer etc. Yet, these effects are found to vary across countries and depends on several circumstances/factors such as institutional development, human capital development, government policies, sector, MNCs investment motives etc.

2.4. FDI and its contribution for economic development

2.4.1. Foreign Direct Investments and Economic growth

Many policy makers and academics contend that foreign direct investment (FDI) can have important positive effects on a host country's development effort. In addition to the direct capital financing it supplies, FDI can be a source of valuable technology and know-how while fostering linkages with local firms, which can help jumpstart an economy. Based on these arguments, industrialized and developing countries have offered incentives to encourage foreign direct investments in their economies (Laura Alfaro, 2013).

There are a number of controversial outcomes among a number of researches about the impact of foreign direct investment in the economic growth of the host country. While some of the researches came out with a positive relation between the foreign direct investments, others figured out that there is little or no significant relation among foreign investment and economic growth. Lipsey (2002) takes a more favorable view from reviewing the micro literature and argues that there is evidence of positive effects. Surveying the macro empirical research led Lipsey to conclude, however, that there is no consistent relation between the size of inward FDI stocks or flows relative to GDP and growth. On the other hand, Hanson (2001) argues that evidence that FDI generates positive spillovers for host countries is weak. In a review of micro data on spillovers from foreign-owned to domestically owned firms. Even there are some findings which came out with a negative relationship. Grog and Greenwood (2002) conclude that the effects of foreign companies for the economic growth of the host country are mostly negative.

Foreign investment may influence economic growth in direct and indirect ways. Its direct effect is that foreign investment increases production, employment, added value and export. These factors directly increase GDP; for instance, employment increases the individual's income and this income increment is directly calculated in GDP. Likewise, is for added value and export. But, foreign investment increases GDP indirectly as well; for instance, transition of technology, knowledge and know-how through license, imitation and job training. Besides, externalities, technology spillover, human capital formation, efficiency and productivity are the factors which indirectly increase GDP in economic growth. Chakrabarti (2001)

Carkovic and Levine (2005) also showed that foreign direct investment (FDI) leads to the increase of economic performance. But, Grog and Greenaway (2004) proved that foreign direct investment (FDI) does not have any influence on economic growth.

2.4.2. Foreign Direct Investments and Tax income revenue

The debate around the effects of tax incentives on FDI is a relatively old one, but nevertheless unsettled. Opponents argue that tax incentives negatively affect economic growth and development by depriving developing countries from tax resources that are much needed to finance investments in infrastructure, education or health, in addition to the fact such incentives are not effective in attracting FDI (IMF, 2014; World Bank, 2005). In contrast, proponents of tax incentives suggest that tax incentives lead to a more effective use of public resources and limits rent-seeking activities (e.g., Tiebout, 1956). These incentives to investors are also needed given the poor investment climate in developing countries (e.g., political instability, inadequate public infrastructure, or corruption). Moreover, revenue losses from tax incentives may be justified by the positive effects of FDI on economic growth, which will ultimately increase the income tax base (OECD,2008).

The literature on tax competition has long been suggesting that increasing international integration might impose a growing pressure on tax policies, as increasing taxes on a mobile base (such as capital) in one country creates an incentive for tax payers to relocate abroad. Amadou et al. (2019) Therefore, the equation of tax regarding to foreign direct investment is by applying a wide range of tax incentive it is possible to attract more foreign investments in return it rewards the host country with an increase on the tax revenue.

Some researchers suggest that FDI could increase general welfare in the host country through increase in the tax revenue. The welfare decreases when a country offers relaxation in the tax for foreign investment or if there had been a transfer pricing from foreign firms to their mother countries. Amadou et al. (2019) claimed that welfare effect of FDI was uncertain. Foreign investment increased welfare through an increase in competition and tax on their profits and reduced welfare through transfer of profits earned by local enterprises to the foreign enterprises.

Bond and Samuelson (2015) suggested that host countries could lose some tax revenue in short run if tax holidays were given to attract FDI in early period. Tax revenue could increase in the long run because foreign investment would not pull out after that tax holiday period.

2.4.3. Foreign Direct Investments and the employment opportunity

Employment creation is one of the many aspects which are related to inward foreign investment, although it is passionately debated. FDI may have direct and indirect as well as quantitative and qualitative effects on employment, each of which may be positive or negative. (Anna 2015)

Since they are suffering from the severe type of unemployment level, developing countries are working firmly to attract foreign investments so that to create an employment opportunity emanates from the foreign investments. (McLaren, 2013) have shown that FDI's social and distributional impact on the host country has been generally favorable in developing countries of various regions. Apart from bringing in a package of highly productive resources into the host economy there have been a visible positive impact on the creation of jobs not only in those sectors attracting FDI inflows but also in the supportive domestic industries.

FDI often generates new employment (direct employment is higher in green filed investments) and creates jobs (indirectly) through forward and backward linkages with domestic firms. Estimates for a number of developing countries indicate that FDI has a multiplier effect on domestic employment. Aaron (2012) estimated that FDI in developing countries created about 26 million direct jobs and 41.6 million indirect jobs in 2007. Iyanda (2015) obtained a higher estimate for Namibia: about 2 to 4 jobs were created for each worker (directly) employed by foreign affiliates.

The quantitative effects of FDI on the volume of employment include (ILO, 2014): jobs created directly by setting up new foreign affiliates or expanding existing affiliates, and indirectly by stimulating additional employment in suppliers and distributors. Indirect effects are on the whole positive and substantial. They can generate the same or more jobs than transnational corporations (TNC) create directly. the cases of Thailand and Philippines can be raised as an example. A number of studies (Barnie,2017) which estimated indirect employment effects for individual MNC subsidiaries in some developing countries showed that the number of jobs generated indirectly depended on the industry. Strong effects were found for the automobile and food processing industries, while textile and clothing, electronics and mechanical engineering showed weaker effects.

The qualitative impact of foreign capital on employment means changes in: wages, job security, skills and labor productivity.(ILO,2014) Foreign affiliates generally pay higher wages than domestic firms in similar activities, (Schneider, 2014) especially in industries that demand higher levels of skills and technology or in export-oriented activities where high quality and timely delivery are needed. However, there are also some export-oriented activities such as simply assembly operations where a foreign investor takes advantage of low-wage labor.

An increase of intra and inter-industry wage gap tend to offer greater job security than domestic firms. (Schneider, 2014). This results from their size, competitive position and need for a stable workforce. However, investors, who are motivated by low wages offer insecure employment, since they can move to other countries as wages rises tend to upgrade employee skills by investing in training Firms, including foreign companies, always undertake some forms of training, at the minimum to ensure that technologies in use are deployed efficiently. However, the decision to invest in more advanced forms of training depends on the returns they expect, their time horizon, and the extent of competition they are exposed to. FDIs can contribute to skill up grading by investing directly in training in their affiliates. They can also induce or support their local suppliers to train workers to meet their quality standards.

According to (Jeremy, 2017) Foreign investors can induce the government or industry association to set up training facilities. The role of foreign companies in skill building differs by sector, industry and among host countries. For instance, some companies may start with training employees in low-skill categories and invest in further training over time as their wages rise and more complex technologies are used. In others, rising labor costs and technological upgrading may not converge. In the case of FDI in export-oriented activities where their advantage depends primarily on low wages and simple technologies, foreign companies can just move on to other locations as wages rise. Or, in more complex activities may not find it economical to use more advanced technologies because the cost of training is higher than that of relocating to countries with better skill endowments.

2.4.4. Foreign Direct Investments and Social development

The concept of social development has been used variably in the development discourse to cover a wide range of issues. The UN Social Summit in Copenhagen 1995 established "a new consensus to place people at the center of our concerns for sustainable development and pledged to eradicate poverty, promote full and productive employment, and foster social integration to achieve stable, safe and just societies for all". The follow-up Special Session of the UN General Assembly in 2000 reiterated these commitments, and added a full paragraph of issues to be addressed under the concept of social development (UN 2000).

Multinational corporations care primarily about profit, and social development is important only if it affects "the bottom line". The above review of factors affecting investment decisions indicate that social development issues are of marginal interest. However, in recent years multinational companies have been under increasing pressure from consumer groups, politicians and activists internationally as well as from the UN and international bodies to act socially responsibly. Ursula (2018) on the other hand Dunning (2009) states, this may imply avoiding investment in countries that disregards human rights, where conditions for workers or child labor are unacceptable, or companies may feel obliged to improve education and health conditions where they invest. Failing to act socially responsibly may negatively affect a company's reputation and sales, and thus its long-term profits.

Corporate social responsibility (CSR) is generally defined as a principle that an organization should behave in a way responsible for the society and environment. The concept of corporate social responsibility has been adopted in various perspectives. For example, Kitzmueller and Shimshack (2012) synthesize the CSR literature from the economic perspective. Schmitz and Schrader (2015) provide a comprehensive review of the theoretical and empirical studies on CSR. Kitzmueller and Shimshack (2012) synthesize the CSR literature from the economic perspective. Schmitz and Schrader (2015) provide a comprehensive review of the theoretical and empirical studies on CSR. From a narrow economic perspective, it can be defined as obligations of firms to increase profits and maximize shareholder value. Nevertheless, some argue that firms have responsibilities to take care of social problems beyond their economic obligations By taking into account the multi-dimensional nature of CSR, it has been acknowledged in more recent literature that CSR covers a large range of issues relating to the impact of firms on their social environment and can be roughly summarized to consist of economic, legal, ethical, and philanthropic components.

In the general development debate, economic development as measured by growth in GDP per capita is viewed as an important, but not sufficient, means of achieving improvements in human well-being, reduction in absolute poverty, wider choices and greater opportunities to realize human capabilities, and other development goals.(Schmidt, 2016) There is also broad agreement that a higher level of investment in a country is conducive to a higher rate of economic growth (other things being equal), though the exact relationship depends on a number of institutional and other factors. A standard development argument therefore runs as follows: Higher investment enables higher economic growth, which in turn may enable the realization of social development and other development objectives. (Kolstad and Line, 2002)

2.5. Conceptual framework

There are two dominant rival attitudes which stand against each other about the contribution of foreign direct investment for the economic growth and development of the nations. This group in favor of it argues that FDI plays an important role as a growth-enhancing factor to developing countries. It is seen as a way of meeting the capital and technological transfers required for economic transformation, labor training and skill acquisition. In contrary, those against it criticizes FDI for exposing the developing economies to suffer negative consequence such as profit repatriation, declining reinvestment, income inequality, distract local firms, stifle technological innovation and “crowd out” domestic firms, foreign investors pervert or subvert host country political processes by co-opting the local elites and/or by using their influence in their home countries.

The researcher`s take on this argument, if the foreign direct investment is whether helpful for Economic Development or not every foreign direct investment might not put a positive influence on regional economic development. However, there are a pre conditions necessary to fulfill so that to make it to play a positive impact in the economic development process of the nation. These pre conditions partially includes: -

- Strong institutional development of the host country.
- host country`s liberal trade policy legislation
- better human capital endowment
- export-oriented FDI policy have to be formulated
- the host country needs to develop sound financial markets
- the lower the level of corruption and bureaucracy

Once the above pre conditions are genuinely addressed, the inflow of foreign direct investments will contribute to the host country or the recipient region in terms of: -

- Economic growth
- An increase in tax income revenue
- Employment opportunity and job creation for the local community
- Active participation of Foreign companies in social development practices

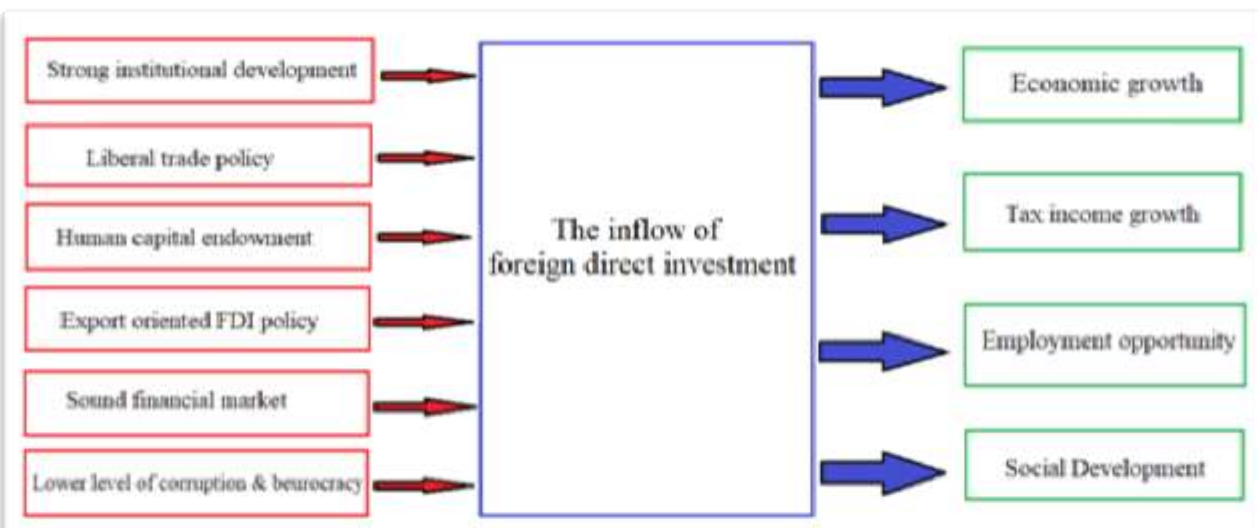


Figure 2.1 Conceptual framework

CHAPTER THREE

Research Methodology

This section outlines and justifies the methods chosen to answer the research questions. Methodology refers the process used to collect information, data for the purpose of making a research. It informs the reader of the approaches utilized to collect and analyze the data, including what types of data were collected and why this was considered appropriate. The aim is to explain the motivation and suitability of the chosen methods to the reader.

3.1. Description of the Study Area

The study was carried out to see the role of foreign direct investment for the regional Economic development in Oromia regional state. In particular in the Finfinnee surrounding Oromia Special zone. Oromia is the largest region covering an area of 363.346 square kilometers, more than the size of Germany. Oromia borders all national regional states of Ethiopia except Tigray. It also shares international boundaries with Kenya in the South and South Sudan in the West. The recent estimations reported that, the Oromia Region`s population is 55 Million (Oromia Social and Labor affairs Bureau, 2016). However, the (Central Statistics Agency, 2015) estimation lowers the size of population to 35 million, still making it the most populous state in Ethiopia.

fig 3.1 Oromia Regional state map

fig 3.2 Oromia Regional state flag

The region occupies vast and fertile areas in the East, South East, Central and Western parts of Ethiopia. Administratively, it is divided into 20 zones, 309 districts and 39 urbans administrative. Afaan Oromo is the working language in the region. The national capital Addis Ababa, known as Finfinnee in Afaan Oromo, is also the capital city of the region. The recently opened Adama & Jimma Industrial parks expected to attract more FDI so as to enhance the economic growth of the region. (Oromia Investment Commission, 2016)

3.2. Research Approach

The approach used in this research is a mixed research approach which makes the use of both qualitative and quantitative approach. According to Kothari (2004:5) the quantitative approach involves the generation of data in quantitative form which can be subjected to rigorous quantitative analysis in a formal and rigid fashion. However, qualitative approach to research is concerned with subjective assessment of attitudes, opinions and behavior.

3.3. Research design

Research design is a master plan specifying the method and procedures for collecting and analyzing the need of information. Research design is needed because it facilitates the smooth sailing of the various research operations, thereby making research as efficient as possible yielding maximal information with minimal expenditure of effort, time and money (Kothari, 2004). It helps the study to be relevant to the problem and it uses economical procedures. It specifies which approach will be used for gathering and analyzing the data.

The types of research employed under this study were descriptive and explanatory research. The major purpose of descriptive research is description of the state of affairs as it exists at present. Then this study describes and critically assesses the significant role played by the FDI for the regional economic development in Oromia region. Second, the study employs explanatory in that the relationship between variables is correlated with an aim of estimating the influence of FDI on the economic growth of the region.

3.3.1. Sources and data collection techniques

To undertake this study, both the primary and secondary sources of data's were used.

3.3.1.1. Primary data

Primary data used in this study through questionnaire. Currently there are 327 foreign companies that are actively operating in Oromia. Based on the Yamane (1967) provides a simplified formula to calculate sample sizes. This formula was used to calculate the sample sizes to sample the foreign companies located in Oromia region with 90% confidence level.

$$n = \frac{N}{1+N(e)^2}$$

Where:

n - Is the sample size

N - Is the population size

e - Is the level of precision with 90 % confidence Interval

When this formula is applied to the above population size, summarized as follows:

$$n = \frac{N}{1+N(e)^2}$$

$$\frac{325}{1+325(0.1)^2}$$

n= 77 Foreign companies

Five members each from the local community where the sampled 77 foreign companies located are sampled randomly for the questionnaire, the minimum sample size of 385 local community members were targeted as a respondent by means of questionnaire.

During the data collection process, the total number of 450 questionnaires were distributed for the respondents with a consideration of a contingency for the failure to respond fully and totally not responded back respondents. However, fortunately 406 of the questionnaires were responded successfully, 19 were not responded for the questionnaire fully and 25 of them failed to respond me back with the distributed questionnaires. Therefore, by rejecting 44 potential respondents but failed to show up, I carried out the study with 406 respondents for some of my research questions. the questionnaire process carried out with Afaan Oromoo, Amharic, and English languages accordingly with the help of a field assistant.

3.4.1.2. Secondary data

Since it is difficult to capture the direct impact of FDI on the region`s community some years back, unlike the primary data I employed the quantitative analysis which generated from the time series secondary data collected. By coupling them, it would help to highlight the holistic impact of foreign direct investment in the region and the community for the past 23 years.

The secondary data used in this study is a time series/historical data collected from different sources by physically visiting both federal and regional government institutions such as Ethiopian Investment Commission, Oromia Investment Commission, Oromia Revenue Authority, Oromia Trade and Industry Bureau, Central Statistics Agency, Ministry of Finance, Oromia Social and Labor Affairs Bureau, Oromia Micro, Small and Employment Creation Agency and National Bank of Ethiopia. The time series data on the different variables used under this investigation ranges from 1996 - 2018. Furthermore, for the sake of most appropriate and reliable data, the researcher also reviewed different Annual Reports, Journals, Publishing's and profiles regarding FDI and Development from UNCTAD, World Bank and International Monetary Fund (IMF) and other relevant sources.

3.4.2. Data Analysis Techniques

3.4.2.1. Descriptive Statistics

The quantitative data collected were analyzed through the use of statistical techniques such as percentages, arithmetic means, standard deviations, table and charts. Descriptive analysis helps describe, show, or summarize data in a meaningful way.

3.4.2.2. Linear Regression Analysis

The study employed simple linear regression analysis in order to establish relationship between the dependent variable and an independent variable by using the following regression formula:

$$\mathbf{Y = \beta_0 + \beta_1 X_1 + \epsilon}$$

Where:

Y = Output Produced in the region (Regional GDP) (Dependent Variable)

X_1 = The Net Inflow of Foreign Direct Investment in the region

β_0 = Coefficient of the model

β_1= Marginal Change in X1

ϵ = Stochastic Error Term

Another Simple linear regression analysis also carried out to establish a relationship between a Dependent Variable (Regional Tax Income Growth) and An Independent Variable (Net Inflow of foreign Direct Investment to the region).

$$\mathbf{Y = \beta_0 + \beta_1 X_1 + \epsilon}$$

Where:

Y = Tax Revenue of the region (Dependent Variable)

X_1 = The Net Inflow of Foreign Direct Investment in the region

β_0 = Coefficient of the model

β_1= Marginal Change in X1

ϵ = Stochastic Error Term

CHAPTER FOUR

Data analysis, interpretation and presentation

4.1 Introduction

In assessing the contribution of foreign direct investments for the Oromia region economic development, research findings based on Questionnaires and secondary data analysis are presented in this chapter. The presentation is organized in line with research objectives and questions. To address this objective, I have presented my interpretation and reflections of the issue along with the research participants' own direct interpretation and understandings. The chapter is organized into three sections. Section one covered the general characteristic of the respondents. Section two dealt with linear regression analysis. It used to answer two of my research questions which they are the contribution of foreign investment for the growth of regional economy and the growth of tax income. Section three presents, the descriptive analysis which used to answer the employment opportunity generated by the FDI in the region, Participation of foreign companies in social development and their adverse effects.

4.2. General Characteristics of the respondents

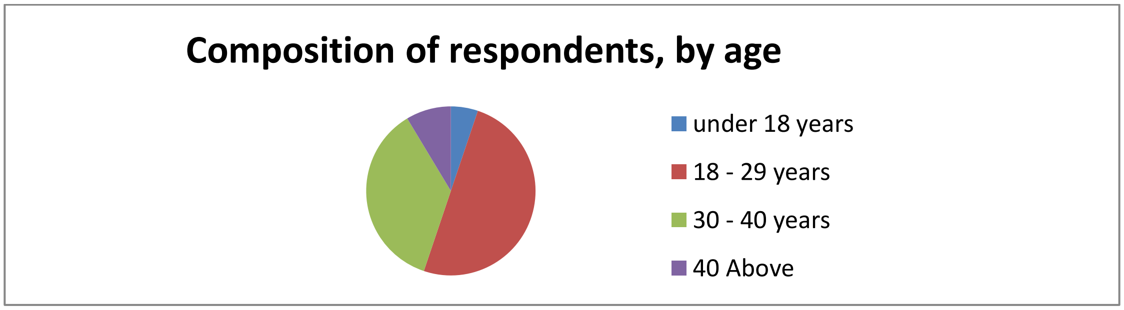
When we review the general profile of the respondents the majority 259 out of the 406 respondents are male. They cover the 64% portion of the over whole respondents. Female respondents represented by 36% respondents which numbered as 147 of the sampled population.

Table 1: composition of the respondents, by Gender

Gender composition of the respondents		
Gender	Number of the respondents	Percentage
Male	259	64%
female	147	36%
total	406	100%

Source: Survey Data, 2019

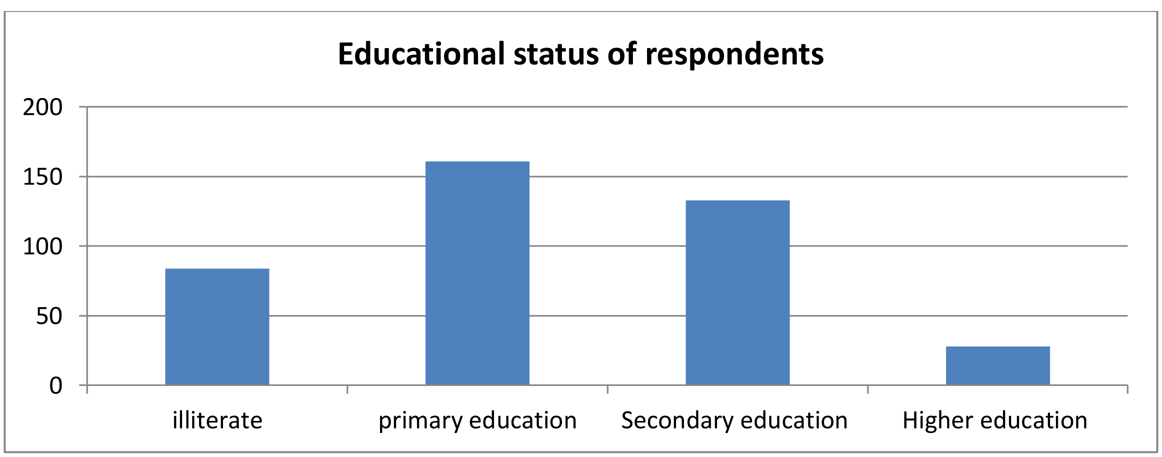
The age compositions of the respondents are summarized as follows: those sampled respondents under the age of eighteen but in the mid teenager are 21 in number or 5% of the entire sampled population. The majority respondents lied in the age group between 18 – 29 years with 203 respondents and 30 – 40 years composed 147 respondents. Those sampled population above the age of 40 years numbered 35 or 8.6% of the population.



Source: Survey data, 2019

Figure 4.1 Composition of respondents, by age

The other factor summarized as a statistic of the sampled population in this study is their Academic status. 84 respondents are illiterate. 161 of them attended primary Education. Secondary education attendants are 133 in number. Both groups cover 39.7% and 32.8% of the total respondents respectively. 28 respondents entered in to the Higher education and graduated by Diploma and above.



Source: survey data, 2019

Figure 4.2 Educational status of respondents

4.3 Linear Regression Analysis

The study employed a multiple regression analysis in order to establish relationship between the independent variables and the dependent variable. In this study the Linear Regression Analysis is being applied to assess the causal relationships between Oromia region economic growth and the inflow of foreign direct investment. On the other hand, the study will also assess the relationship between regional tax income and the inflow of foreign investments.

4.2.1 The FDI contribution for the economic growth of the region.

Recently most of developing countries paid a great attention for attracting the foreign investments so as to contribute for their economic growth, employment creation, hard currency generation, knowledge and technology transfer and so on. In the Ethiopian context besides the federal government, the regional governments also considering foreign investments as a means of regional economic growth and employment opportunity. (Ethiopian Investment Commission, 2018)

As a largest recipient of the foreign investments in Ethiopia, the Oromia regional state have been facilitating a conducive environment to attract a foreign company so as to promote inclusive regional development. Since 1996/97 to 2017/18 more than 385 foreign companies have shown an interest to invest in Oromia. 330 were invested and still actively operating in the region. 21 of them were invested and engaged in the operation however they abandoned the projects due to a variety of reasons. Despite the fact that 34 foreign companies were agreed to invest in the region and acquired the land, but still they didn’t implement the project which they aimed to plant. (Oromia Investment Commission, 2018)

Based on the secondary data obtained from the Oromia regional offices, I assessed the relationship between Oromia region economic growth and Foreign direct investment inflow based on the past 23 years’ time series of data starting form 1996/97 up to 2017/18.

4.2.1.1 Regression: variables

Table 2: Summary of the variables

```
summarize OroGdp OroFdi
```

Variable	Obs	Mean	Std. Dev.	Min	Max
OroGdp	23	1636.159	1840.211	181.6773	5765.44
OroFdi	23	20.89151	32.73818	.002	145.0916

As we can see on the above table 2.0, there are 23 observed values in both dependent and independent variables side which implicates the 23 years of data (1995/96 – 2017/18) were used as an input in both sides for this regression.

Y = B1 + B1X1 + u

Where: Y= Regional GDP (Independent Variable)

B1= Slope of the regression

B2= the effect of a one unit increases on independent variable against a dependent variable.

X1= FDI inflow to the region (Independent Variable)

U= error terms

Y (Regional GDP) = B1 + B2 (FDI Inflow to Oromia) + u (Error Terms)

4.2.1.2 Regression: ANOVA table and interpretation

Table 3: ANOVA table and presentation

reg OroGdp OroFdi

Source	SS	df	MS
Model	8614934.82	1	8614934.82
Residual	65885343	21	3137397.29
Total	74500277.9	22	3386376.27

Number of obs	=	23
F(1, 21)	=	2.75
Prob > F	=	0.1124
R-squared	=	0.1156
Adj R-squared	=	0.0735
Root MSE	=	1771.3

OroGdp	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
OroFdi	19.11437	11.53503	1.66	0.112	-4.87404	43.10279
_cons	1236.831	441.0011	2.80	0.011	319.7186	2153.943

We will use the robust standard errors to control for the problem of heteroskedasticity.

Table 4: Regression output with robust standard errors

. reg OroGdp OroFdi, robust

Linear regression

Number of obs	=	23
F(1, 21)	=	12.33
Prob > F	=	0.0021
R-squared	=	0.1156
Root MSE	=	1771.3

OroGdp	Coef.	Robust Std. Err.	t	P>|t|	[95% Conf.	Interval]
OroFdi	19.11437	5.444067	3.51	0.002	7.792818	30.43593
_cons	1236.831	451.752	2.74	0.012	297.3609	2176.3

Where;

prob > **F** = This is the p-value of the model. It tests whether R2 is different from 0. Usually we need a p-value lower than 0.05 to show a statistically significant relationship between FDI and

GDP. Therefore, with the value of 0.021 there is a statistically significant relationship between FDI and Regional GDP.

R-square shows the amount of variance of GDP explained by FDI. In this case FDI explains 11.6% of the variance in Regional GDP.

P>|t| - Two-tail p-values test the hypothesis that each coefficient is different from 0. To reject this, the p-value has to be lower than 0.05 (you could choose also an alpha of 0.10). In this case, FDI is statistically significant in explaining regional GDP.

t - The t-values test the hypothesis that the coefficient is different from 0. To reject this, the t-value need to be greater than 1.96 (for 95% confidence). It is possible to get the t-values by dividing the coefficient by its standard error. The t values also show the importance of a variable in the model. In this case the t- value equates 3.51

Regional GDP = 1236.8 + 19* FDI for each one-unit increase in FDI, increases the regional GDP by 19 units. This means there is a positive relationship between the inflow of FDI and the Regional GDP.

4.2.1.3 Regression: correlation matrix

Below is a correlation matrix for all variables in the model. Numbers are Pearson correlation coefficients; go from -1 to 1. Closer to 1 means strong correlation. A negative value indicates an inverse relationship roughly, when one goes up the other goes down. On the other hand, the positive value indicates that when the independent variable goes up the dependent variable follows the same way.

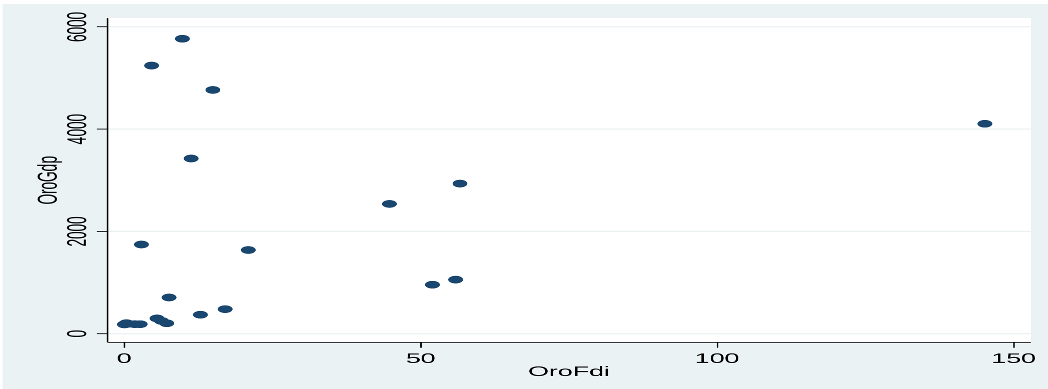
```
. corr OroGdp OroFdi
(obs=23)

             |   OroGdp   OroFdi
-------------+------------------
      OroGdp |   1.0000
      OroFdi |   0.3401   1.0000
```

Source: OLS regression output, 2019

Figure 4.3 Correlation Matrix

In this case with the value is 0.34, which indicates that there is less positive correlation between the regional economic growth and the foreign direct investment inflow to the region.

4.2.1.4 Regression: exploring relationships



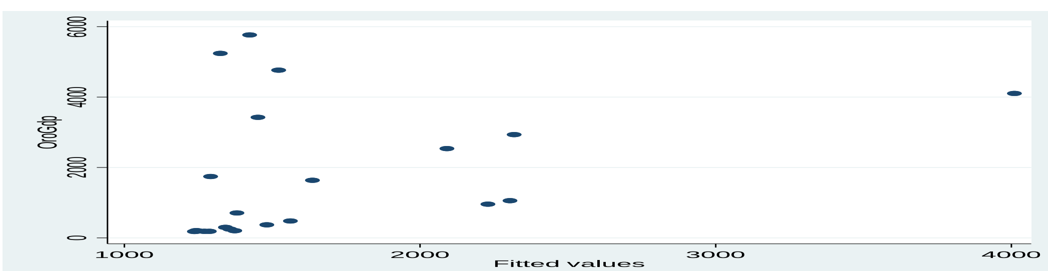
Source: OLS regression output, 2019

Figure 4.4 relationship among variables

There seem to be a slightly linear relationship between regional economic growth and FDI.

Regression: getting predicted values

How good the model is will depend on how well it predicts Y, the linearity of the model and the behavior of the residuals.



Source: OLS regression output, 2019

Figure 4.5 Predicted values

On the figure 4.0 in order to say the model is fit enough to predict the dependent variable, a 45-degree pattern in the data required. In this case the model seems to be doing less good job in predicting Oro-GDP (Dependent Variable).

4.2.1.4 Regression: testing for homoskedasticity

A non-graphical way to detect heteroskedasticity is the Breusch-Pagan test. The null hypothesis is that residuals are homoscedastic. An important assumption is that the variance in the residuals has to be homoscedastic or constant. Residuals cannot vary for lower of higher values of X (i.e. fitted values of Y since Y=Xbox). A definition: "The error term [e] is homoscedastic if the variance of the conditional distribution of [e] given Xi [var (ei|Xi)], is constant for i=1…n, and in particular does not depend on x; otherwise, the error term is heteroskedastic" (Stock and Watson, 2003) In the example below we fail to reject the null at 95% and 90% concluded that residuals are homogeneous.

```
. hettest

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity
         Ho: Constant variance
         Variables: fitted values of OroGdp

         chi2(1)      =     1.09
         Prob > chi2  =   0.2971
```

Source: OLS regression output, 2019

Figure 4.6 Heteroskedasticity test

The Breusch-Pagan test suggests the possible presence of heteroskedasticity in our model. The problem with this is that we may have the wrong estimates of the standard errors for the coefficients and therefore their t-values.

There are two ways to deal with this problem, one is using heteroskedasticity-robust standard errors, and the other one is using weighted least squares (Stock and Watson, 2003). WLS requires knowledge of the conditional variance on which the weights are based, if this is known (rarely the case) then use WLS. In practice it is recommended to use heteroskedasticity-robust standard errors to deal with heteroskedasticity.

4.2.1.5 Regression: omitted-variable test

Testing for omitted variable bias is important for our model since it is related to the assumption that the error term and the independent variables in the model are not correlated (E (e|X) = 0) If we are missing variables in our model and is correlated with the included regressor and, the omitted variable is a determinant of the dependent variable" (Stock and Watson, 2003,), …then our regression coefficients are inconsistent. In State we test for omitted-variable bias using the ovtest command:

```
. ovtest

Ramsey RESET test using powers of the fitted values of OroGdp
       Ho:  model has no omitted variables
                 F(3, 18) =      1.09
                 Prob > F =      0.3772
```

Source: OLS regression output, 2019

Figure 4.7 Omitted Variables test

The null hypothesis is that the model does not have omitted-variables bias, the p-value is higher than the usual threshold of 0.05 (95% significance), so we fail to reject the null and conclude that we do not need more variables.

4.2.1.6 Regression: specification error

Table 5: Link test of variables

```
. linktest

      Source |       SS           df       MS      Number of obs   =        23
-------------+----------------------------------   F(2, 20)        =      1.32
       Model |  8667785.32         2  4333892.66   Prob > F        =    0.2903
    Residual |  65832492.5        20  3291624.63   R-squared       =    0.1163
-------------+----------------------------------   Adj R-squared   =    0.0280
       Total |  74500277.9        22  3386376.27   Root MSE        =    1814.3

------------------------------------------------------------------------------
      OroGdp |      Coef.   Std. Err.      t    P>|t|     [95% Conf. Interval]
-------------+----------------------------------------------------------------
        _hat |   1.416865   3.347422     0.42   0.677    -5.565735    8.399465
      _hatsq |  -.0000855   .0006751    -0.13   0.900    -.0014938    .0013227
       _cons |  -421.0114   3493.635    -0.12   0.905    -7708.607    6866.584
------------------------------------------------------------------------------
```

Source: OLS regression output, 2019

The thing to look for here is the significance of _hatsq. The null hypothesis is that there is no specification error. If the p-value of _hatsq is not significant then we fail to reject the null and conclude that our model is correctly specified. In this case we fail to reject the null hypothesis both in the 95% and 90% confidence interval. Therefore, the model is correctly specified.

4.2.1.6 Regression: multicollinearity

An important assumption for the multiple regression models is that independent variables are not perfectly multicollinear. One regressor should not be a linear function of another.

```
. vif

    Variable |       VIF       1/VIF
-------------+----------------------
      orofdi |      1.00    1.000000
-------------+----------------------
    Mean VIF |      1.00
```

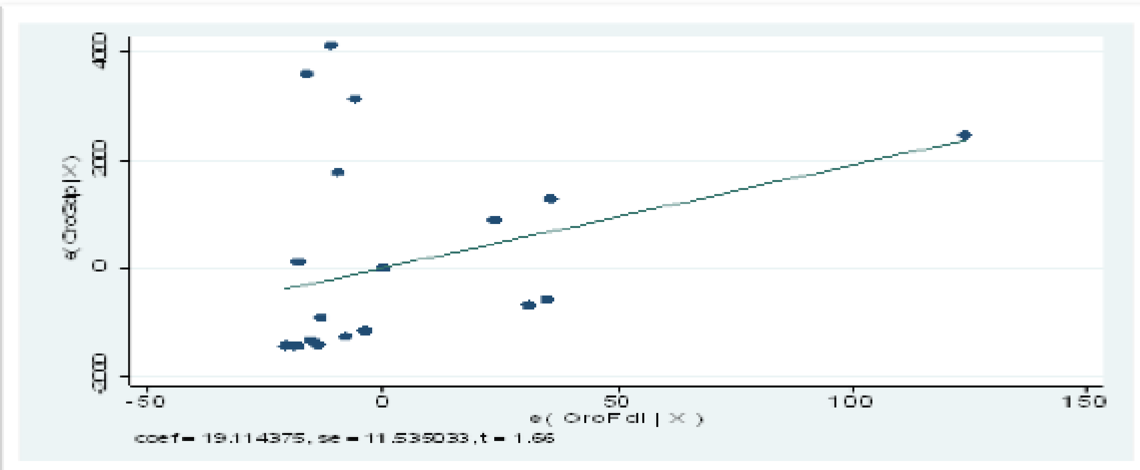
Source: OLS regression output, 2019

Figure 4.8: Testing Multicollinearity

A vif> 10 or a 1/vif < 0.10 indicates trouble. In this case, since we have a single independent variable, the problem of multicollinearity is nonexistent.

1.4.1.7 Regression: outliers

Outliers are data points with extreme values that could have a negative effect on our estimators. After running the regression type:



Source: OLS regression output, 2019

Figure 4.9: Testing for outliers

- These plots regress each variable against all others, notice the coefficients on each. All data points seem to be in range, no outliers observed.

Based on the above regression of the past 23 years' time series data, we can summarize that there is a positive relationship between the economic growth and the inflow of foreign direct investment in Oromia region. A one-unit additional investment by foreign investments rewards the regional economy with almost 25-unit increase. However, the relationships between those two variables are less strong positive correlation with a value of 0.34.

4.2.2. The contribution of FDI on the tax income of the Oromia region.

According to the FDRE ministry of revenues (2019) There are several sources which used to finance the tax income itself. In the Ethiopia context it includes corporate income taxes, turns over tax; value added tax, excise taxes and so on. Some researchers argue the growth of the foreign direct investment is contributing by increasing the tax income of the host country on the other side other researchers discredit the above point by referring the tax income generations from the foreign investments are an insignificant and those Foreign companies are frequently committing the tax fraud crime against the host nation.

Table 6. Types of Tax sources in Ethiopia

No.	Types of Taxes	Rate
1	Corporate Income Tax	30%
2	Turn Over Tax	2% and 10%
3	Excise Tax	10% up to 100%
4	Custom Duties	0% up to 35%
5	Income Tax from Employment	0% up to 35%
6	Withholding Tax	2%
7	Value Added Tax (VAT)	15%
8	Export Tax	0 % (with exception of hide& skin 150%)
9	Royalty Tax	5%
10	Dividend Tax	10%

Source: FDRE Ministry of Revenues, 2019

Ethiopia has implemented economic reform program (ERP) and has been modernizing tax and custom administration by overhauling the legislations and improving administration since 1992/93 with the aim of encouraging trade, investment and hence development. Given the important role of FDI in the development process of developing countries.

Ethiopian tax policy is geared towards promoting investment, supporting industrial development and broadening the tax base and decreasing the tax rate in the view of financing the need of government expenditure. With the view of creating investment friendly environment and attract foreign direct investment, Ethiopian government have been providing a wide range of fiscal incentives. However, Ethiopia has been providing tax incentives to encourage private investment and to promote the inflows of foreign capital since 1992. Ethiopian Government has been providing extensive tax incentives to attract FDI. These include tax holidays, exemption of raw material and machinery import duties and exemptions of export duties on most export goods, etc. However, the evidence that is available suggests that these initiatives led to revenue losses than the positive economic effect (IMF, 2006).

The Oromia regional state tax incentive proclamation for the foreign investments is as same as the federal investment proclamation. There is no exceptional incentive by Oromia for the foreign investments (Oromia Investment Commission, 2016). Even though Oromia is the biggest recipient of the foreign investment among the regions, the contribution of foreign investment for the tax income growth is not yet studied. Besides it was not organized in an orderly manner so that was difficult to measure the significance of foreign investment for the tax income growth of the region. As one of my research objectives I assessed about a significance relationship between the regional tax income and the inflow of foreign investment in the region with a linear regression analysis.

4.2.2.1 Regression: variables

Table: 7 Summary of variables

summarize OroRevenue OroFdi

Variable	Obs	Mean	Std. Dev.	Min	Max
OroRevenue	23	39.53941	49.65205	2.861498	161.8593
OroFdi	23	20.89151	32.73818	.002	145.0916

Source: OLS regression output, 2019

- Y = Regional Tax Income
- B0 = Constant value (slope)
- B1 = Marginal change in X1
- X1 = Investment Inflow in to the region

Where; Y= B0 + B1X1 = U

Regional Tax Income (Y) = B0 + B1 (Investment Inflow to the region) X1 + u

4.2.2.2 Regression: ANOVA table and interpretation.

Table 8. ANOVA table and interpretation

avplot OroFdi

reg OroRevenue OroFdi

Source	SS	df	MS		
				Number of obs	= 23
				F(1, 21)	= 2.71
Model	6205.80368	1	6205.80368	Prob > F	= 0.1144
Residual	48031.3594	21	2287.20759	R-squared	= 0.1144
				Adj R-squared	= 0.0722
Total	54237.1631	22	2465.32559	Root MSE	= 47.825

OroRevenue	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
OroFdi	.5130186	.311449	1.65	0.114	-.134675	1.160712
_cons	28.82168	11.90715	2.42	0.025	4.059408	53.58395

Source: OLS regression output, 2019

Robust standard errors will carry out to control for the problem of heteroskedasticity

Table 9: Robust standard errors

. reg OroRevenue OroFdi, robust

Linear regression

Number of obs	= 23
F(1, 21)	= 10.95
Prob > F	= 0.0033
R-squared	= 0.1144
Root MSE	= 47.825

OroRevenue	Coef.	Robust Std. Err.	t	P>|t|	[95% Conf.	Interval]
OroFdi	.5130186	.1550089	3.31	0.003	.1906599	.8353773
_cons	28.82168	12.15871	2.37	0.027	3.536245	54.10711

Source: OLS regression output, 2019

Where;

Prob > F = this is the p-value of the model. It tests whether R2 is different from 0. Usually we need a p-value lower than 0.05 to show a statistically significant relationship between FDI and GDP. Therefore, with the value of 0.0033 there is a statistically significant relationship between Regional Tax Income and foreign direct investment.

R-square shows the amount of variance of GDP explained by FDI. In this case FDI explains 11.4 % of the variance in Regional Tax Income.

P>|t| Two-tail p-values test the hypothesis that each coefficient is different from 0. To reject this, the p-value has to be lower than 0.05 (you could choose also an alpha of 0.10). In this case, foreign direct investment inflow is statistically significant in explaining regional Tax income with a value of 0.003.

t - The t-values test the hypothesis that the coefficient is different from 0. To reject this, we need a t-value greater than 1.96 (for 95% confidence). we can get the t-values by dividing the coefficient by its standard error. The t values also show the importance of a variable in the model. In this case the t-Value is 3.31, which implicates that the importance of the independent variable (FDI inflow) is significant enough.

Regional Tax Income = 28.82 + 0.51* FDI for each one-unit increase in FDI, the regional tax income increases by 0.51 unit. Its implication is, there is a positive relationship between the inflow of FDI and the Regional GDP.

4.2.2.3 Regression: correlation matrix

Below is a correlation matrix for all variables in the model. Numbers are Pearson correlation coefficients; go from -1 to 1. Closer to 1 means strong correlation. A negative value indicates an inverse relationship (roughly, when one goes up the other goes down). A positive value on the other hand, implicates both variables have the same movements.

Figure 4.10 : correlation Matrix

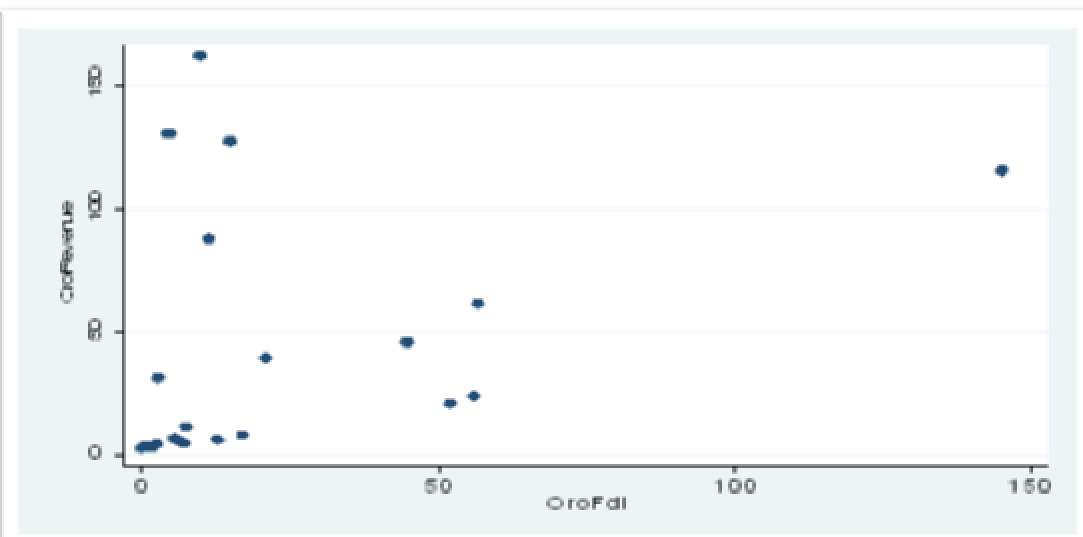
```
. corr OroRevenue OroFdi
(obs=23)

             | OroRev~e   OroFdi
-------------+------------------
  OroRevenue |   1.0000
      OroFdi |   0.3383   1.0000
```

Source: OLS regression output, 2019

In this case with the value of **0.33,** there is a less strong, positive correlation estimated between the tax income and the FDI inflow in to the region.

4.2.2.4 Regression: exploring relationships

Figure 4.11 Regression: exploring relationships



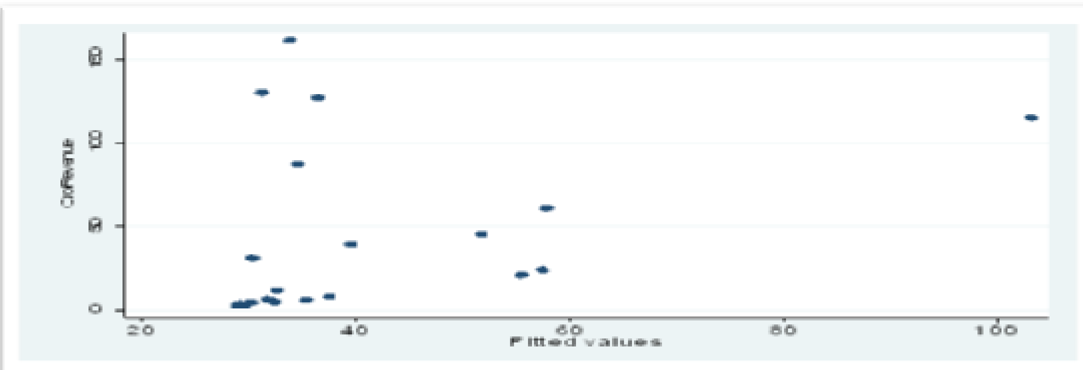
Source: OLS regression output, 2019

Based on the figure 10 output, there seems to be a slightly linear relationship between Regional Tax income and Foreign Direct Investments.

4.2.2.5 Regression: observed vs. predicted values

How good the model will depend on, how well it predicts Y, the linearity of the model and the

Figure 4.12: observed vs. predicted values



Traditionally, a 45-degree looking pattern in the data indicates the model is good enough in predicting the Dependent variable (Oro-tax). In this case the model seems to be weak in predicting the tax income of the region.

4.2.2.6 Regression: testing for homoskedasticity

A non-graphical way to detect heteroskedasticity is the Breusch-Pagan test. The null hypothesis is that residuals are homoscedastic.

Figure 4.13 testing for heteroskedasticity

```
. hettest

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity
         Ho: Constant variance
         Variables: fitted values of OroRevenue

         chi2(1)      =     0.98
         Prob > chi2  =   0.3219
```

Source: OLS regression output, 2019

The Breusch-Pagan test suggests the possible presence of heteroskedasticity in our model. The problem with this is that we may have the wrong estimates of the standard errors for the coefficients and therefore their t-values. In order to deal with this problem, the researcher used to heteroskedasticity-robust standard errors.

4.2.2.7 Regression: omitted-variable test

Testing for omitted variable bias is important for our model since it is related to the assumption that the error term and the independent variables in the model are not correlated ($E(e|X) = 0$). In Stata we test for omitted-variable bias using the ovtest command:

Figure: 4.14 Test for omitted-variable test

```
. ovtest

Ramsey RESET test using powers of the fitted values of OroRevenue
       Ho:  model has no omitted variables
                  F(3, 18) =       1.36
                  Prob > F =       0.2862
```

The null hypothesis is that the model does not have omitted-variables bias, the p-value is higher than the usual threshold of 0.05 (95% significance), so we fail to reject the null and conclude that we do not need more variables.

4.2.2.8 Regression: specification error

Another command to test model specification is link test. It basically checks whether we need more variables in our model by running a new regression with the observed Y (Oro-tax) against Yhat (Oro-tacx predicted or Xβ) and Yhat-squared as independent variables.

Table:11 Link test

linktest

Source	SS	df	MS
Model	6324.88102	2	3162.44051
Residual	47912.2821	20	2395.6141
Total	54237.1631	22	2465.32559

Number of obs	=	23
F(2, 20)	=	1.32
Prob > F	=	0.2894
R-squared	=	0.1166
Adj R-squared	=	0.0283
Root MSE	=	48.945

OroRevenue	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
_hat	.3120646	3.147542	0.10	0.922	-6.253593	6.877723
_hatsq	.0056369	.0252832	0.22	0.826	-.0471029	.0583766
_cons	16.86716	80.19525	0.21	0.836	-150.4172	184.1515

The thing to look for here is the significance of _hatsq. The null hypothesis is that there is no specification error. Since the p-value of _hatsq is not significant with a value of 0.83 then we fail to reject the null hypothesis and conclude that our model is correctly specified.

4.2.2.9 Regression: multicollinearity

An important assumption for the multiple regression models is that independent variables are not perfectly multicollinear. One regressor should not be a linear function of another. When multicollinearity is present standard errors may be inflated. Stata will drop one of the variables to avoid a division by zero in the OLS procedure (see Stock and Watson, 2003, chapter 5).

Figure 4.15: Test for multicollinearity

. vif

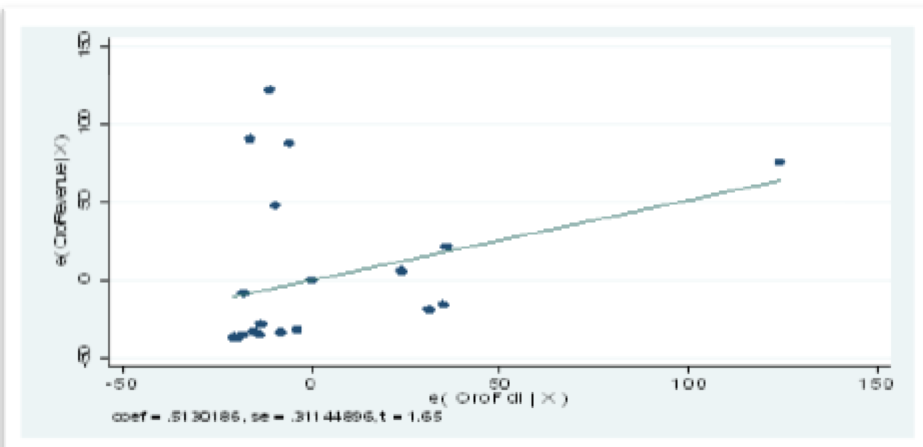
Variable	VIF	1/VIF
OroFdi	1.00	1.000000
Mean VIF	1.00	

Source: OLS regression output, 2019

A vif> 10 or a 1/vif< 0.10 indicates trouble that there is a collinearity among independent variables. However, in this case with a single independent variable, the problem of multicollinearity is cannot exist.

4.2.2.10 Regression: outliers

To check for outliers, we use the avplots command (added-variable plots). Outliers are data points with extreme values that could have a negative effect on our estimators.



Source: OLS regression output, 2019

Figure 4.16 Test for outliers

- These plots regress each variable against all others, notice the coefficients on each. All data points seem to be in range, no outliers observed.

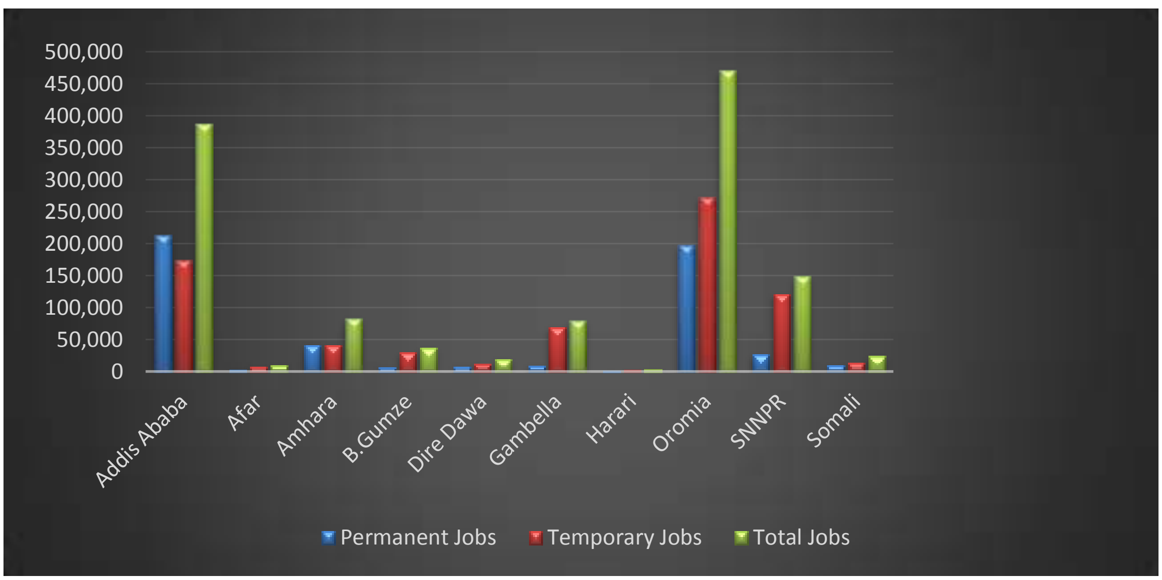
As like as the contribution of foreign direct investment for the regional economic growth, the outcome of the contribution of foreign direct investment for the regional tax income growth indicates the same positive relationship but not strong enough correlation estimated. The correlation among the foreign Investment and regional tax income is 0.34, less strong positive correlation. Besides, the marginal increase on dependent variable (regional tax income) is 0.51 units due to a marginal one unit increase on independent variable (foreign direct investment).

4.2 Descriptive Statistics

The primary data collected were analyzed through the use of statistical techniques such as percentages, arithmetic means, standard deviations, table and charts. Descriptive analysis helps describe, show, or summarize data in a meaningful way.

4.2.1 Employment opportunity by foreign companies

According to the Ethiopian Investment Commission (2018) Starting from 1999/2000 as a nation Ethiopia could create the job opportunity for 660,959 people in the permanent manner and for 1,013,382 in a temporary basis. out of them, 198,125 jobs permanently and 272,997 temporarily were created in the Oromia regional state. from the overall job created in Ethiopia by the inflow of a foreign investments, Oromia shared around 30% of permanent jobs and 27% of the Temporary job from the nationwide job creation. Totally speaking 471,122 out of 1,674,341 total job opportunities or 28 % of the overall job opportunities from the foreign companies were created in Oromia regional state



Source: Ethiopian Investment commission, 2018

Figure 4.17: Employment opportunity by foreign companies in Ethiopia

As we can see in the above chart Oromia positioned as the second most permanent job recipient from foreign investments preceded by Addis Ababa which received 213,194 permanent jobs.

Regarding to the temporary jobs from foreign investments, Oromia stayed in the very first position succeeded by Addis Ababa with a margin of 99,075 temporary jobs.

According to the number of total job manner as we can see in the above graph Oromia seats in the front line by the provision of total employment opportunity succeeded by Addis Ababa and SNNPR with 387,116 and 148,645 job opportunities respectively. Standing from this point we can conclude that Oromia is the largest recipient of employment opportunity from foreign investments in Ethiopia.

The major reasons for being the biggest recipient of Job Opportunity than the rest of regional state is directly related to the Region`s biggest recipient position of the inflow of foreign investment to the country. Since the Oromia regional state located to the nearer proximity of the capital city Addis Ababa and the region better positioned in terms of infrastructural development in contrast to other regional states, Thus, it provided Oromia with a comparative advantage to attract the more foreign investments and the more job Opportunities from the in flowed foreign investments.

4.2.1.1 Response of the local community on employment opportunity

Before firmly concluding about whether the region is benefited by employment opportunity, we need to figure out whether genuinely the local community earned those jobs, the quality of the jobs, the payment system, and the job security provided by the FDIs` need to take in to consideration so that to capture a holistic image. Based on the primary data collected by means of questionnaire from the local community, out of 406 respondents 252 of them or 62.1 % of the respondents agree with the idea of *"the local community can get an access for the job opportunity"* 154 out of 406 respondents or 37.9 % them claimed that *"there is no access for local community in order to engage in the job opportunity and the job were stolen by the people came from other areas who they have a better human capital and or relative relationship with those who manages the companies on behalf of the foreign investors."*

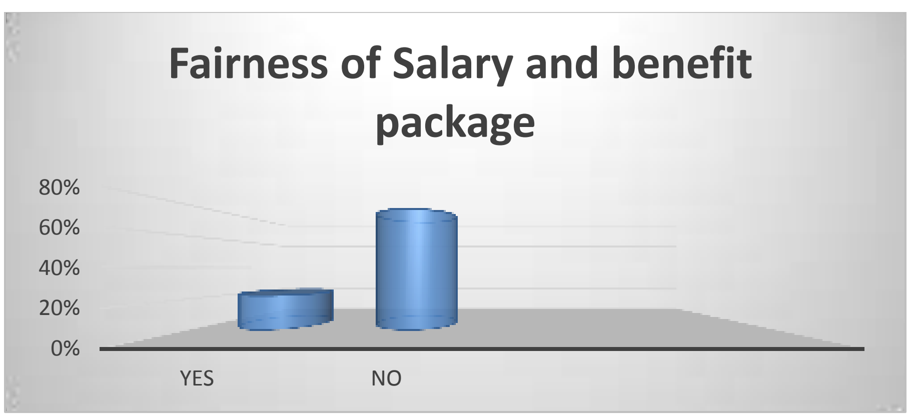
Table 12: Job Opportunity for Local Community

Job Opportunity for Local Community		
Response	Number	Percentage
Yes	252	62.1%
No	154	37.9%
I Don`t Know	Nil	Nil
Total	406	100%

Source: Survey Data, 2019

4.2.1.2 Payment and benefits for employees

According to Lipsey (2002) survey, He has shown that MNEs pay higher wages than domestic firms even after controlling for firm and worker characteristics. Furthermore, the presence of multinationals sometimes generates wage spillovers: wages tended to be higher in industries and in provinces that have a higher foreign presence Sjoholm (2001). However, this situation is quietly different in Oromia. Among those 252 respondents agreed with the presence of job opportunities for the local community only 56 or 22.2% of them agrees with the fairness of amount paid for labor by those foreign companies. However, 168 or 77.8 % of respondents who previously agreed with the presence of job opportunity for local community in this regard, they strongly criticize the amount of payment and benefit package for labor who engaged in employment by the foreign companies.



Source: Survey Data, 2019

Figure 4.18: response on fairness of salary and benefit package

According to the response from the employees of the foreign companies, with more than 10 years of work experience 21 of them earns below 1,500 birr as a monthly salary before taxes, 7 employees with an experience of 8 years earns a monthly salary of 2500 birr before taxes, 14 employees with more than 3 years of experience earns 3000 birr before taxes in a monthly basis. When we see the job, security provided for those employees, since it is a mandatory with the state proclamation all of them are members of the pension contribution. The health insurance provided only for 7 out of 42. The rest 35 of them can get the health treatment in the public health institutions if and only if they faced an accident related to the work place.

Since a satisfaction of income is a function of the recipient's attitude, out of 42 employees in the foreign companies 28(67%) of them are *"strongly dissatisfied with the payment they receive as a salary"*. despite the fact that they have a work experience more than 5 years, 7 of the total respondents believe *"the payment for their work is fair enough and they are satisfied"*. 7 of the respondents out of 42 sampled employees are indifferent about the payment for their job whether satisfactory or not.

As it is observed from the findings, Despite the fact that the income level is a function of academic status, work experience, employment type, type of the business that the firm engaged in and so on, with such a work experience the amount of payment offered for the employees are very low. The job security provision is only subjected to the best interest of the foreign companies and it is symbolic which committed only to fulfill the obligatory proclamations of the government.

Table 13: Employee satisfaction with the level of their income

Employee satisfaction with the level of their income		
	Number	Percentage
Satisfied with their Income	7	17%
Dissatisfied with their income	28	67%
Neutral	7	16%
Total	42	100%

Source: Survey data, 2019

To summarize, It’s undeniable that Oromia seats in the front line with the provision of total employment opportunity. The majority of the respondents agree the local community have got a chance to be recruited by the foreign investments planted in their locality. However, the slide majority of employees from the local community members were engaged in unskilled labor which rewards with poor payment. Due to that most of the employees strongly criticizes the payment for labor. It indicates the presence of the very poor payment practices by the foreign companies.

4.3 Participation of foreign companies on social development

4.3.1 Social development practices by foreign companies

The majority of foreign investments attracted into Africa characterized by a production of consumer goods. So, they need the local natural resource as an input in order to produce their final good. Local natural resource is a communal property of the given locality. Therefore, in addition to the employment opportunity, the local community needs to repay back with an alternative option for the utilization of their natural resources by the foreign investments. One of the mechanisms for creating a win-win scenario among the local community and the foreign companies is participating in the social development.

Concerning the social development practices by the foreign companies in the Oromia regional state, according to the primary data gathered from the local community 308 out of 406 (76%) respondents are responded that *“they directly benefited by getting an access for clean water which contributed by the foreign companies to the local communities.”* 56 out of 406 (14%) respondents responded with *“there is no kind of direct benefit to the local community in their locality”* and the rest 42 respondents (10%) from the local community responded that *“they have no idea whether there is the Social development practice carried out by the foreign companies or not"*. Among 77 randomly selected foreign investments 67 of them (87%) committed to provide clean water for the local community. In this regard it is possible to conclude, the majority of the foreign companies provides a clean water for the local dwellers, in return it have an interrelated benefit of minimizing girls school dropout, improving the holistic health of the local community by preventing water borne diseases and saving the precious time of mothers by eliminating a wastage of time to bring a water from remote area.

Table 14: Direct benefit the community earned from the presence of FDI

Direct benefit the community earned from the presence of FDI				
	Number of companies	Percentage	Respondents	Percentage
Clean water provision	67	87%	308	76%
Health care facility	2	2.6%	14	3.4%
Academic institution	1	1.3%	7	1.7%
No kind of Participation	7	9.1%	56	14%
I Don`t` know	-	-	42	10%
Total	**77**	**100%**	**406**	**100%**

Source: Survey Data, 2019

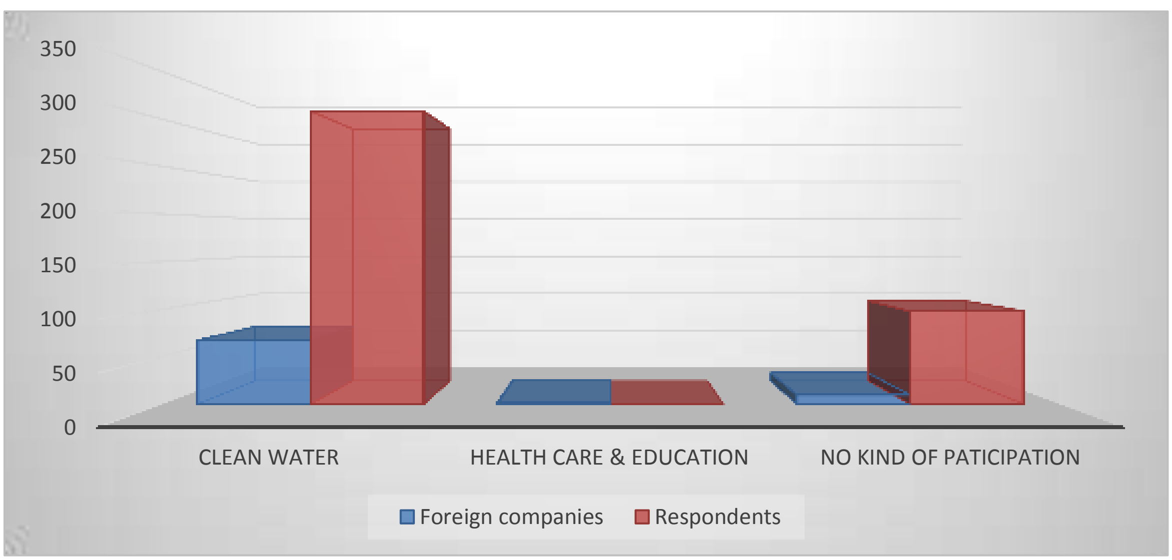


Figure 4.19: FDI participation and local community response on social responsibility

4.3.2 Foreign companies' effort in building human capital

Social development is a multi-dimensional issue. It can be expressed through a various way. according to World Bank, (2011) the most beneficiary type of social development is developing the human capital of the given community. When we are talking about the human capital it is a composition of enhancing the educational status and improving the health of the community by the provision of Academic institutions and health care facilities. Developing the human capital has a multiplier effect on the community. Besides creating well educated and healthy society it is helpful to supply a sufficient level of productive and skilled labor force for the demand of companies in the local community. In spite of this accepted general truth the participation of the foreign companies in the enhancement of the human capital in their locality is very low.

World Bank (2011), and more recent papers from the Social Development Department of the World Bank view social development as a combination of "empowerment" (giving people voice, capability and choice), "inclusion" (making institutions and policies more inclusive of poor people's needs and aspiration and more effective in delivering them), and "security"(enhancing social stability and human security)

Out of the 77 randomly observed foreign investments only two of them provided the health care facility for the local community. Which means an engagement of foreign companies in Health care practices are only 2.6 %. And there is only one foreign company involved in the construction of primary education institution which is 1.3% of the foreign companies. according to the respondents only 14 of the 406 (3.4% of respondents) witnessed for the provision of health care facility, while seven of (1.7 %) the total respondents observed the presence of the construction for the educational institution in their locality by the foreign companies. The foreign companies almost totally failed to participate in the human capital development in the Oromia region.

4.3.3 Environment conservation Practices

One of the aspects of controlling environment damage is involving in the Environment protection practices by those foreign companies. As UNCTAD (1999) notes, these views, in part, reflected the fact that multinationals many times were involved in the exploitation of natural resources and reflected the reaction against the "extractive nature" of FDI.

According to the response from the directly affected local community respondents only 14 out of 406 respondents (3.4%) testified that there is some kind of environmental protection practices carried out by the foreign companies. However, the vast majority respondents 402 respondents (96.6%) are responded that there are no environmental protection practices in any forms by the foreign companies in their locality. Besides the vast majority of respondents, according to the direct observation of the researcher (since the researcher authorized to observe the situations and to conclude about the events in the qualitative researches) there is no environmental protection activities are not carried out by the foreign companies.

4.3.4 The foreign companies' provision of assistance for the local farmers

The other way of participating in between the foreign companies and the community is providing the necessary support like technology, knowledge, capital and alternative techniques for the local farmers or productive parts of the community in order to empower them for the production of standardized output which used as an input for the firms operating in the given locality. Relating this issue with the Oromia situation out of 406 respondents all of them (100%) described that there is no support in any forms for the local community or farmers in an effort to enhance their productivity both in quality and quantity so as to create a linkage. Other than operating in their major business objectives, the foreign companies are not involving to enhance the production and productivity of the local community. They are not committed to create a linkage so as to boost the local economic development.

4.3.5 Land compensation for displaced farmers

Stepping aside the social development efforts by the foreign companies, almost all of the foreign companies I observed which is 75 out of 77 or 97% foreign companies were planted in the land which have been under the ownership of the local farmers. The government compensation system according to the local community can be considered as "strongly unfair" the majority of 336 out of 406 respondents (83%) agree with this idea, 21 of local community members thinks the compensation system is fair. While 49 of them have no clue about whether it is fair or not, according to those local community members who believes the compensation system for land is strongly unfair, before some ten years ago most of the farmers where displaced with the compensation of 0.90 cents per meter square of land. Some five years ago the farmers were displaced by a compensation of 3 birr/ meter care of land. These days Most of the farmers were engaged in unskilled labor practices such as Guard, their wives and daughters work as a janitor in the foreign companies who took their land for the investment activity. However, when it comes clear that the government compensation for displacing farmers are very unfair that foreign investment planned to plant its firm in some specific locality by displacing the local farmers expected to compensate the local community subjected to displacement for the given investment. Compensating the farmers in substitution for their land also can be considered as a social responsibility since it helps to avoid the uncertainty and unexpected shocks that the farmers and their house hold might experience after the displacement. In this regard based on the data gathered from the local community none of the foreign companies were committed to compensate the displaced households for the sake of their investment.

4.3.6 Adverse Effect on environment by the operation of foreign companies

Despite the fact that the attraction and operation by the foreign companies to some extent used to contribute for the economic growth of the Oromia region, it also comes out with an adverse effect on the environment and people of the local community.

Table: 15 Respondents response on Type of Pollution they are experiencing

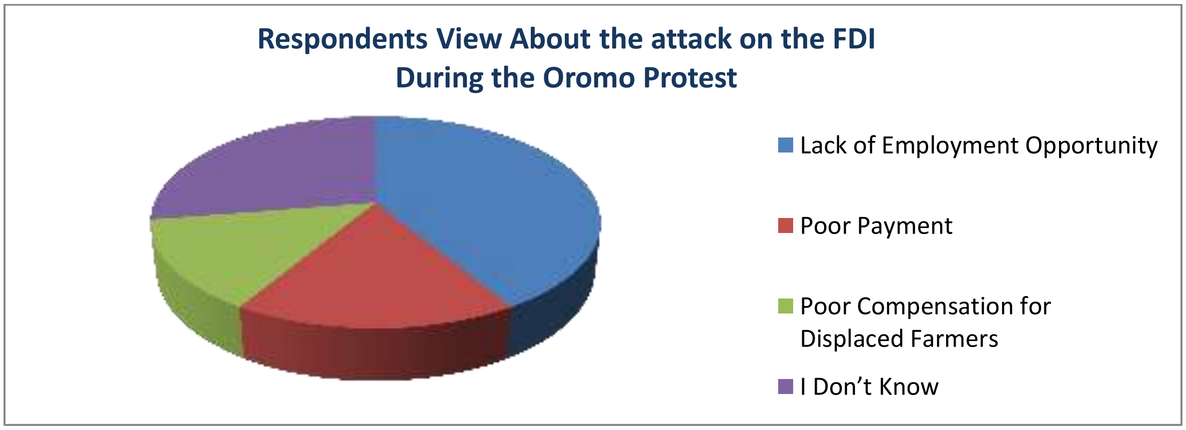
Respondents response on Type of Pollution they are experiencing		
Type of Pollution	Number of Respondents	Percentage
Air pollution	140	34%
Water pollution	142	35%
Air & water pollution	106	26%
No pollution experienced	18	4.4%

Source: Survey Data, 2019

Per the researcher observation and the information gathered from the local community 140 (34% respondents) experienced the air pollution from the smokes of the industries during their production process. Other 40 % or 162 respondents complained for the water pollution on the local rivers which used for drinking of their cattle and washing their cloths. For instance, the pollution by the foreign company (Ayka-addis) against the river named “Kersa” around sebeta led to the death of many cattle and livestock of the local communities which led to a massive protest around the region against the above-mentioned foreign company. One of the respondents reported for the Noise pollution around his locality. While 18 of the respondents testified for no environmental pollution in their locality from the foreign companies' operation, the air and water pollutions are frequently experienced pollution problems in the Oromia region.

4.3.7 The Oromo Protest and its adverse effect on the foreign Companies

The past three to five years Ethiopia experienced a continuous political turmoil and turbulences. The turmoil was in particular intense in Oromia regional state. Beginning from the 2014 integrated master plan of Addis Ababa and Oromia, the Oromia Region went through a continuous instability. Even though the integrated master plan was suspended the group of young Oromo Protesters named 'Qerroo" refused to cease their protest and advanced to the next stage. Despite the fact that the immediate reason of the protest was the "Master Plan" the refusal of those young men "Qerroo" to avoid their protest insights that the socio- political problem faced by the region were multidimensional. One of the major incidents happened during the protest was an attack on the foreign investments in the Oromia region in particular in the Addis Ababa surroundings.



Source: Survey Data, 2019

Figure 4.20 : Respondents view about the attack on the FDI during the Oromo protest

Based on the data gathered from the members of the local community about what is the reason behind for attacking the foreign investments in the region out of the 406 total respondents 168 (

41%) of them responded that *"even though the protest was politically motivated the failure to provide an employment opportunity for the local dwellers make the youngsters angry so that to attack the foreign investments."* 70 (17%) out of the 406 respondents believe *"those who employed in the foreign investments earn very poor payment. They made a frequent strike even during peaceful times. Therefore, the instability time exposed the foreign companies to be attacked by their own employees."* 56 (14%) of the respondents expressed their feeling that *"the attack on foreign companies carried out by the children of the displaced farmers as revenge for their land grabbed by those companies."* 112 (28%) respondents responded that *"they don't know why such a thing happened in their locality."*

From the above responses we can understand that unemployment, poor payment for those employed, farmer's displacement with very unfair compensations, little or no social development, and lack of friendly relationship with the local community were the major reasons for a massive attack against the foreign companies in Oromia region.

CHAPTER FIVE

Summary and conclusion

5.1 Conclusions

The OLS regression used to examine the relationship between Oromia Regional Economic Growth and the inflow of foreign direct investment indicates that, there is a positive relationship between those two variables. A one-unit additional investment by foreign investments rewards the regional economy with almost 25-unit increase. However, the relationships between those two variables are less positively strong with a correlation of 0.34. therefore, the region needs to pursue the effort for attracting more and more foreign direct investments in a strong and comprehensive manner.

As like as the contribution of foreign direct investment for the regional economic growth, the outcome of the contribution of foreign direct investment for the regional tax income growth indicates the same positive relationship but not strong enough correlation. The correlation among the foreign Investment and regional tax income is 0.33, less strong positive correlation. Besides, the marginal increase on dependent variable (regional tax income) is 0.51 units due to a marginal one unit increase on independent variable (foreign direct investment). Which is far more deviated from the same case happened between the regional economic growth and foreign direct investment inflow. In general, the inflow of foreign investments contributed for the growth of regional tax income.

According to the number of total jobs, Oromia seats in the front line by the provision of total employment opportunity succeeded by Addis Ababa and SNNPR with 387,116 and 148,645 job opportunities respectively. Oromia also seats in the front line with the provision of total employment opportunity. In the past 19 years more than 470,000 jobs were created by the foreign investments in the region. The inflow of foreign companies contributed its own part in an effort for reducing unemployment.

Despite the fact that the local community have got a chance to be recruited for the job opportunity by the foreign investments planted in their locality. However, the slide majority of the local community members are engaged in unskilled labor which rewards them with poor payment. Due to that most of the employees strongly criticizes the payment for labor. Besides their criticism with more than 10 years of work experience 21 of my respondents who work in the foreign companies earns below 1,500 birr as a monthly salary before taxes. It indicates the presence of the very poor payment practices by the foreign companies. The job security and benefit package provision are only subjected to the best interest of the foreign companies and it is symbolic which committed only to fulfill the obligatory proclamations of the government.

Regarding to social responsibility, the majority of the foreign companies provides clean water for the local community, in return it have an interrelated benefit of minimizing girls school dropout, improving the holistic health care of the local community by preventing water borne diseases and saving the precious time of mothers by eliminating a wastage of time to bring a water from remote area. Nevertheless, The Foreign companies almost totally failed to provide assistance for the Oromia regional governments` effort of building the human capital of the community in the region. When we are talking about the human capital, the health and education provision covers the large portion of it. Out of the 77 randomly observed foreign investments only two of them provided the health care facility for the local community. Which means an engagement of foreign companies in Health care practices are only 2.5 %. And there is only one foreign company involved in the construction of primary education institution which is 1.3% of the foreign companies. Not only that, the foreign companies' involvement to support the local farmers so that to enhance their production and productivity is null. Other than the provision of clean water, the foreign companies' involvement in the social development is very insignificant.

The increasing of foreign investment in the region also comes out with an adverse effect on the environment and people of the local community. The local community experienced the air pollution from the smokes of the industries during their production process. the water pollution on the local rivers which used for drinking of their cattle and washing their cloths. Led to the death of many cattle and livestock of the local communities such a problem coupling with other factors triggered a massive protest in the region against foreign company. Noise pollution also observed in some areas however it is not that significant. While the air and water pollutions are frequently experienced in the Oromia region. There are no environmental protection activities are carried out by the foreign companies. If there is no initiation to improvise the situation, the strained relationship between the foreign companies and the local community might goes to the worst condition.

According to the response from the local community, *"lack of employment opportunity, poor payment for those employed, farmer's displacement from their land for the sake of foreign investment with very unfair compensations, little or no social development practices by the foreign companies, adverse effect on the environment and lack of friendly relationship with the local community were the major reasons for a massive attack against the foreign companies in Oromia region during the Oromo Protest."* the foreign companies, regional government and local community need to work together to improve the relationship among the foreign companies and the local community in order to tackle further hostile relationship and to avoid unprecedented attacks in the future as well.

5.2 Recommendation and policy implications

5.2.1 Recommendations for the regional government

The results of foreign direct investment (FDI) effect on growth show that foreign direct investment (FDI) has a positive effect on economic growth in Oromia region. The regional government of Oromia needs to give more emphasis on the attraction of more foreign companies which they engaged in all productive kind of activities This might help in creating more relationship among the regional economy and foreign investments.

In addition to the federal investment proclamations it is my recommendation that, if the Oromia region develops its own investment proclamation based on the region unique natures and specific characteristics. In return it serves as a mechanism to attract more investments. by providing comparatively attractive tax and other incentives, In the long run it helps to increase the tax base and the tax revenue of the region. However, the provisions of tax incentives need to be carefully assessed and monitored. The costs and benefits related to incentives have to be taken in to consideration. Monitoring and evaluation system should be developed and implemented properly so as to reduce negative impacts. The provision of tax holiday should be reduced or replaced by reduced tax rate. Tax incentives should be provided based on critically studied approach; a casual provision of such incentive can affect the country tax revenue.

The region needs to control whether the allocation of the job opportunity by the foreign companies properly addressed to the local community where the foreign firms planted. A commitment to build the human capital of the regions` residents can be helpful to provide the skilled man power for the foreign firms. Besides, the minimum wage law might need to be considered to avoid a very poor payment for employees,

The provision of clean water for the local community is admirable. In addition to that the regional government has to work closely in partnership with the foreign investments for the continuous construction of Health care and academic institutions in the region.

The land compensation practices for the displaced farmers have to be reconsidered. With poor payment for their holdings the poverty is aggravating against the local community and it is triggering a frequent conflict. In order to solve the problem in addition to the government, the foreign companies also need to take a part in land compensation activities.

The Oromia region environment protection authority have an obligation to make a tight control on the pollution that the environment is experiencing in its air and water parts by the foreign investment operations. It has to impose the mandatory obligation for the protection of the environment by the foreign investments

Both the federal and regional government have to provide sufficient security for the foreign investments. Frequent meeting and Discussions must be an alternative course of action in order to address the local community's problem which they are facing from the foreign investment's operation. Solving such a problem also needs to take as a responsibility of the government.

5.2.2 Recommendations for the foreign companies

Regarding to the FDI, they have to improve their record by facilitating the employment opportunity, improving their salary system, supporting the farmers who displaced from their land for the given investment, actively participating in the social development efforts, by refraining or reducing environment damaging activities and actively participating in the environment protection practices and by working closely with the local community they might avoid unprecedented attacks on the future.

The foreign companies have to consider the social responsibility as a multidimensional thing and they need to act accordingly. They have to involve heavily on the enhancing the human capital of the local community than in any other else activities. The bottom-line is the foreign companies in the Oromia region needs to give more weight for the construction of Health care facilities and academic institution which in the long run might be helpful for them too.

The local economic development is something a base for an aggregate economic development for the host country. Among the contributions, that the hosting countries expecting from the foreign investment is the stimulation of the local economic development by creating a linkage between the local economy and the foreign investments in a given locality. However, in this case the Oromia region enjoyed a very weak type of linkage among the local economy and the foreign investments. To solve such a problem besides the transport proximity to the capital city the foreign investments have to take the proximity for raw materials and the accessibility of local market for their firms before planting. By doing so, they can create a linkage with other closely related firms in particular and with the local economy in general. Moreover, it enables them to fill the local demand shortfall by supplying for the local market.

It is possible to make the local youngsters as suppliers of raw material especially for the firms where they located in the resource proximity areas and the local natural resource is a direct input for the production process of the given foreign company. For instance, the Cement factories built in the place where the raw material is sufficiently available and at this point Oromia is a home for more than five giant Cement factories. Not only that, the final output of the foreign companies needs to be available for the local community with a fair price tag on it. By doing so the foreign companies able to fill the demand shortfall, participates in the local economic development and that helps them to create a healthy relationship with the local community.

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Appendix 1 Questionnaire

Addis Ababa University College of Development Studies

Regional & Local Development Studies

Note: -

This questionnaire is proposed for **employees of the selected foreign companies** in Oromia Region.
This questionnaire used as an input for the academic research purpose only.
The respondent name is not necessary to be filled in this form.

I would like to say Thanks in advance for your cooperation and Hospitality to take this survey.

1. General Profile of the Employment Opportunity

- Gender
  - A. Female B. Male
- Age
  - A. Below 18 Years C. 30 - 40 years
  - B. 18 – 29 years D. 40 Years and Above
- Educational Status
  - A. Illiterate C. Secondary Education
  - B. Primary Education D. University/ College
- Are you a member of local community?
  - A. Yes B. No
- How long have you been worked here?
  - A. Below 3 years C. 6 – 10 years
  - B. 3 – 5 Years D. Above 10 Years
- Type of your recruitment?
  - A. Permanent B. Temporary
- How much do you earn monthly?
  - A. Below 1000 Birr C. 3001 Birr – 6000 Birr
  - B. 1000 Birr – 3000 Birr D. 6001 Birr and Above

- What was your career before joining this company?
    - A. Similar Activity
    - B. Private
    - C. Unemployed
    - D. Other
- What a benefit and Job Security package do you have?
    - A. Provident fund/ Pension contribution
    - B. Health Insurance
    - C. Transport and Housing Allowances
    - D. All
    - E. Others

2. Open Ended Questions on Knowledge and Technology transfer

- What a position are you working on?

  ____

  ____

- Are you friendly with production technologies?

  ____

  ____

- What a knowledge transfer programs are you participated in?

  ____

  ____

- Are you capable enough to work in somewhere else with a similar technology?

  ____

  ____

Appendix 2| Questionnaire

Addis Ababa University College of Development Studies

Regional & Local Development Studies

Note: -

This questionnaire is proposed for **the selected members of local community** in Oromia Region.
This questionnaire used as an input for the academic research purpose only.
The respondent name is not necessary to be filled in this form.

I would like to say Thanks in advance for your cooperation and Hospitality to take this survey.

3. General Profile (Member of the local community)

- Gender
  - B. Female B. Male
- Age
  - C. Below 18 Years C. 30 - 40 years
  - D. 18 – 29 years D. 40 Years and Above
- Educational Status
  - C. Illiterate C. Secondary Education
  - D. Primary Education D. University/ College
- Are you from a local community?
  - A. Yes B. No
- Are the local dwellers getting a chance of employment opportunity?
  - A. Yes B. No
- If the answer is yes, are they satisfied enough with the amount paid for labor?
  - A. Yes B. No

4. Social development

- What a direct benefit that the community earned from these investments?

____

____

- Does those FDI participate in environment conservation practices?

  A. Yes B. No

- Are the FDI Support the farmers to enhance their productivity?

  A. Yes B. No

- What a harmful situation they experienced from foreign investment

____

____

- What the land compensation practices looks like?

____

____

- Why the people attacked the foreign investments during the Oromo Protests?

____

____

5. Linkage with local economy

- Are the FDI using the local natural resources for production Purpose?

    A. Yes B. No

- Are the FDI using the locally produced items as an input for production purposes?

    A. Yes B. No

- If the answer is yes for the previous Question, are they satisfied enough with the price offered by the foreign investments for your products?

    A. Yes B. No

- The output of the firms is available for the local market?

    A. Yes B. No

Null Hypothesis: ORO_GDP has a unit root

Exogenous: Constant

Lag Length: 2 (Automatic - based on SIC, maxlag=4)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-3.112957	0.0417
Test critical values:	1% level	-3.808546	
	5% level	-3.020686	
	10% level	-2.650413	

*MacKinnon (1996) one-sided p-values.

Null Hypothesis: ORO_FDI has a unit root

Exogenous: Constant

Lag Length: 0 (Automatic - based on SIC, maxlag=4)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-4.266776	0.0033
Test critical values:	1% level	-3.769597	
	5% level	-3.004861	
	10% level	-2.642242	

*MacKinnon (1996) one-sided p-values.

Null Hypothesis: TAX_REVENUE has a unit root

Exogenous: Constant

Lag Length: 4 (Automatic - based on SIC, maxlag=4)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-3.668375	0.0146
Test critical values:	1% level	-3.857386	
	5% level	-3.040391	
	10% level	-2.660551	

*MacKinnon (1996) one-sided p-values.