



**ADDIS ABABA UNIVERSITY
SCHOOL OF GRADUATE STUDIES**

**ASSESSMENT OF FOREIGN DIRECT INVESTMENT
EFFECTIVENESS IN DEVELOPMENT AND ITS CHALLENGES
AND PROSPECTS: THE CASE OF SPECIAL ZONE OF OROMIA**

BY: SHIFERAW NEGASH

**JUNE, 2014
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BY: SHIFERAW NEGASH

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A Thesis Submitted to the School of Graduate Studies, Addis Ababa University, Faculty of Business and Economics, Department of Public Administration and Development Management in Partial Fulfillment of the Requirements for the Degree of Master's of Arts in Public Administration

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ADDIS ABABA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF PUBLIC ADMINISTRATION AND
DEVELOPMENT MANAGEMENT

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Lists of Acronyms

BRICS	Brazil Russia India China South Africa
EIA	Ethiopian Investment Agency
FDRE	Federal Democratic Republic of Ethiopia
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IMF	International Monitoring Fund
LDCs	Less Developed Countries
LICs	Low Income Countries
MNC	Multinational Corporations
MOFED	Ministry of Finance and Economic Development
OECD	Organization for Economic Co operation and Development
PLC	Private Limited Company
SZO	Special Zone of Oromia
SPSS	Stastical Package for Social Studies
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
USD	United States Dollar
WB	World Bank
WIR	World Investment Report

Abstract

Foreign Direct Investment (FDI) plays an important role as an engine of employment, technological development, productivity enhancement, economic intensification, and more importantly, as an instrument of technology transfer, specially from developed to developing countries. The Government of Ethiopia having realized the inadequacy of the domestic capital and low national saving, opened several economic sectors to foreign investors. The government has also issued several investment incentives, including tax holidays, duty free import of capital goods and export tax exemption to encourage foreign investment.

The very essence of this research is assessing the contributions of FDI to the development of SZO in terms of local employment creation, generation of revenue, transfer of technology, linkage with domestic firms in boosting local productivity. It assessed the effectiveness of FDI in the development of SZO and at the same time challenges that hinder the effectiveness of FDI were also identified. SZO is one of the investment potential zone found at the very vicinity of Addis Ababa.

This study employed mixed research method where both qualitative and quantitative data were used in the assessment. Questionnaires and interview were the main instruments used to gather first hand information from experts, FDI owners and key officials of zonal investment offices and regional investment Commission. The sampling methods used were both probability and non probability sampling. Purposive sampling was used to select experts with better knowledge and information from different sectoral offices. FDI owners were selected randomly from 53 FDIs operating in different sectors. The study sample includes 60 experts from different offices, 18 FDI owners and two officials. Totaly 80 respondents were involved in this study.

The result of this study indicated that the contribution of FDI to the development of SZO has been constrained by various challenges of infrastructure, institutional bureaucracy, and other organizational and human elements. Therefore it requires an effective mitigation of those challenges and impediments enhancing basic infrastructure provision, training and developing skilled manpower, institutional reforms, enforcement of technology transfer and timely implementation of projects, regular environmental auditing as well as a continuous follow up or monitoring for effective implementation of FDI projects to exploit all the benefits of FDI.

Chapter One: Introduction

1.1 Background of the Study

Investment in general and foreign direct investment in particular is, without doubt, one of the primary engines of growth and development in all economies. Foreign Direct Investment (FDI) plays an important role as an engine of employment, technological development, productivity enhancement, economic intensification, and more importantly, as an instrument of technology transfer, especially from developed to developing countries (Jensen, 2003). However, its effectiveness rests on strong complementarities with other elements in the growth process, most notably technological progress, skill acquisition and the development of innovative capacity. These elements make investment a natural departure for Governments seeking to formulate a robust development strategy. The link between investment and the other determinants of growth however is not an automatic process. It requires among other things a favorable macro policy environment and specific policies and institutions aimed at encouraging saving and attracting and directing investment to key sectors in the economy thereby enhancing the contributions of investment to skills formation, technological change, competitiveness and economic growth. A clear understanding of how such a synergy between investment policies on the one hand and technological progress on the other can be taken as an essential prerequisite for designing an effective national investment policy and investment promotion strategy.

In Ethiopia numerous macroeconomic reforms have been implemented with the objective of achieving macroeconomic stabilization and growth since 1991. The macroeconomic reforms include privatization of state owned enterprises, liberalization of trade policy, reduction of import tariff rates, elimination of non-tariff barriers, devaluation and deregulation of price & exchange rate controls (UNCTAD, 2002). These reforms have also been implemented with the aim of attracting foreign direct investment to the ultimate goal of poverty reduction thereby enhancing a better standard of life.

According to World Bank report (2012), in 2010/11 the Ethiopia's private sector share of gross capital formation in GDP was only 6.9%, which can be explained by both external

and internal factors. The former include lack of access to finance and foreign exchange, the difficulty in securing land, and frequent change of government policies and regulations. The expansion in informal economic activities is also a constraint to the growth of formal enterprises. Among the internal constraints is lack of technical and managerial skills and weak entrepreneurial capacity.

The World Bank's 2012 *Doing Business* rankings show deterioration in some indicators compared with 2011, notably access to finance, investor protection, registration of property and cross-border trade. Ethiopia was relatively better in paying taxes, dealing with construction permits, opening businesses and enforcing contracts. Ethiopia ranks 40th in paying tax, 56th in dealing with construction permits and 57th in enforcing contracts. Ethiopia's overall ranking in *Doing Business* slipped from 104 in (2011) to 111 in (2012) out of 183 countries. While this slippage might be due to the relatively better performance of other countries, it under scores the need for Ethiopia to intensify policy efforts in this area. Clearly, if Ethiopia is to sustain high and inclusive growth and development, continued efforts to improve the business climate are required

Foreign investors in Ethiopia can invest in all economic sectors other than some sectors exclusively reserved for national investors and the government. Investment in telecommunication services and manufacturing of weapon & ammunition is allowed only in joint venture with the government. To encourage indigenous entrepreneurship and the domestic private sector, the financial sector, import trade, small air transport with a seating capacity of upto 50 passengers. Commercial water & road transport and several small businesses are reserved for national investors. While investments in sectors like Manufacturing, Agriculture, Information Communication Technology, Generation, Transmission and supply of Electrical Energy, Hotel and Tourism (Star designated hotel and resort motel), Health services by constructing own Hospitals, Real Estate development, Secondary and Higher education by constructing own buildings, whole sale trade (Ethiopian Investment Agency, 2013).

In line with the national investment policy, both domestic and foreign investments are being undertaken in Special Zone of Oromia which is found around Addis

Ababa. Although domestic investments are dominant with the largest number there are foreign direct investments in different sectors. This particular research tries to assess the effectiveness of FDI and its challenges.

1.2 Statement of the Problem

The world has increasingly recognized that private capital has a vital role to play in development. The UN's Millennium Declaration explicitly calls for greater foreign direct investment (FDI) to Africa. Over the course of the 1990s, African countries significantly liberalized the environment for foreign investment. Nearly all countries revised their national laws governing FDI and the vast majority lifted controls on capital (UNCTAD, 1998).

According to the proclamation No 280/2002 of the investment policy of the Federal Democratic Republic of Ethiopia investments are designed to improve the living standards of the peoples of Ethiopia through the realization of sustainable economic and social development, create wide employment opportunities for Ethiopians and to foster the transfer of technical know-how, of managerial skills, and of technology required for the progress of the country.

Although Ethiopia is one of the countries with the fast growing economy, still there is a persisting poverty and unemployment both in rural and urban areas (MOFED, 2012). Currently the country is undertaking the growth and transformation plan which is a robust plan requiring significant capital investment and technology transfer. However, due to the low saving of the country there is financial inadequacy constraining in achieving development goals. The government recognizes the role of private investment in particular foreign direct investment to fill the gap of the capital constraint and revised the investment proclamations several times

The Government of Ethiopia revised the investment proclamations several times and opened economic sectors to foreign investors with few restrictions. The government has also issued several investment incentives, including tax holidays, duty free import of capital goods and export tax exemption to encourage foreign investment. Furthermore,

Ethiopia Investment Authority (EIA) the present Ethiopia Investment Agency has been established to service investors and streamline the investment procedures .Nevertheless, Ethiopia's performance in attracting FDI is very poor compared to many African countries. For instance, Ethiopia accounted for only 4.5% of the total FDI flows coming to Africa in 2009-2010 while representing 9% of the population of Africa. From this, the inflow to Ethiopia was only 7.5 dollar per capita while the inflow to Africa was 59.34 dollar per capita. Ethiopia's private sector investment in general and foreign direct investment in particular is not growing as fast as it should, even by the standards of Sub-Saharan Africa. There are far fewer private businesses in Ethiopia than the country's size and potential can accommodate. Businesses in Ethiopia are smaller in scale by international standards and have not managed to enter international markets or attract foreign capital (2011, WIR).

According to the EIA (2014) report, the total number of foreign direct investments in Ethiopia that took the licence until November 2013 is 6466 with their proposed capital of 412,255,522,000 birr. The employment opportunity proposed was 1,874,714 including both permanent and temporary employment. However, there are only 1612 FDI projects which started the operations with a capital of 55,154,750,000 birr. The total employments created by those projects are 368,021.

These facts reveal that FDI in Ethiopia is not only constrained by smaller numbers but also with the failure to commence the operation. The emerging economic diversification and private sector development (PSD) strategy should, therefore, start by asking two basic but crucial questions: What particular obstacles are impeding the growth of private enterprises in modern industry in Ethiopia and their participation in the global market for labor- intensive manufactures? And what should be done to induce the development of a more dynamic private sector? (WB, 2004).

A study conducted by Adam (2007) in Addis Ababa City Administration revealed that FDI in Addis Ababa faced constraints and challenge related to market, cultural shocks and language barriers and it also assessed the opportunity to foreign investors. Most of the researches conducted so far focus on the role of FDI at macrolevel or at the national level

and with greater emphasis to challenges imposed on FDI and opportunities available to them.

This particular research is of special interest to assess the effectiveness of FDI at micro level in Special Zone of Oromia as most of the researches conducted so far focus on the role, challenges and opportunities of FDI at macro level or at the national level. This research assessed the contributions made by Foreign Direct Investment to the development of the Special zone by investigating the revenue generation, job opportunity and the management of local human resources, the linkage with local economic activity through infrastructure and efficiency of production and environmental protection. It also attempted to find the challenges and prospects of FDI in the zone. In line with the above statement of the problems, this research also tried to answer the following questions.

1.3. Research Questions

1. What are the contributions of foreign direct investment in the development of the Special Zone of Oromia?
2. Do linkages exist between foreign direct investments and domestic investments in Special Zone Oromia?
3. Do the incentives provided to foreign investors promote the effectiveness of FDI in Special Zone of Oromia?
4. What are the challenges encountered by investors and local government in the management of foreign direct investment in Special Zone of Oromia?

1.4 Objective of the Study

1.4.1 General Objective

This research paper tries to assess the contributions of foreign direct investment to development, the problems encountered in the process and the future it has in the Special Zone of Oromia .

1.4.2 Specific Objectives

1. To identify the contributions of FDI in local employment opportunity and revenue generation.
2. To investigate the spillover effect of FDI on domestic investment.
3. To identify the gaps and challenges in the course of foreign direct investment.
4. To suggest some policy recommendations.

1.5 Significance of the Study

Foreign direct investment is an engine in the transformation of developing countries like Ethiopia towards a better standard of life for several reasons. One of the reasons is the country lacks capital for investment in infrastructures and in other sectors. There is an increasing trend in population and unemployment and hence investments that absorb labor intensively to reduce the growth of unemployment rate are the highest priority in Ethiopia. FDI has been highly recognized by the government of Ethiopia for its contributions to employment opportunity and in the achievement of poverty reduction. However, most researches that have been conducted on FDI focus on its impacts of national economic growth and development as well as on the trends of FDI inflow. This particular research tries to assess the contributions of FDI in the development of specific area through different mechanisms like local employment opportunity, backward and forward linkage, revenue generation, technology transfer and other spillover effects. This research also tries to investigate the challenges and negative externalities associated with foreign direct investment. The intention is without proper governance an increase in investment may exacerbate or reinforce existing pattern of greedy consumption by the rich, marginalization of the poor and environmental devastation all which today characterize the global economy. Hence this research can help the government to take some corrective measures in managing foreign direct investment for better implementation. It can also be used as a background for other researchers who are interested in conducting research related to FDI.

1.6 Scope of the Study

Both the theoretical aspect and an empirical evidence show that FDI is wider in concepts and in application that can be dealt both with macrolevel and microlevel issues. However, this research is limited to assess the effectiveness of foreign direct investment with in the geographic boundary of Special Zone of Oromia. It covered 18 foreign direct investments in different sectors which are randomly selected out of the 53 foreign direct investments that have taken the investment licences and entered the operation stage. Since the Special Zone is recently recognized as one of the zones of the Oromia regions it is rather difficult to limit the time for which the data to be taken. The researcher opted to consider FDI that are currently licenced and started work in the Special Zone of Oromia..

1.7. Limitations of the Study

As researches conducted so far on FDI in Ethiopia is limited, the study was constrained by the availability of empirical literature. Pertaining to the nature of businessmen there were fear and reservations in revealing all necessary information regarding revenue generation and environmental impacts of FDI. In addition to these some of the respondents were unwilling to give information due to lack of sufficient time and other reasons. Even though these limitations are inevitable the researcher tried to handle the difficulties by different mechanisms. Such as briefly explaining to the respondents the purpose of the study to be for academic, applying efficient use of time and other resources and attempting to triangulate data to avoid data inconsistency and exploring different data sources for empirical literatures.

1.8. The Organization of the Study

The paper is organized in five chapters. The first chapter deals with the introduction part under which the background, the objectives, significance, scope and limitations of the study are comprised. Chapter two briefly discusses both the empirical and theoretical literatures. The methodology, background of the study area, data source and method of collection, sample size and sampling techniques and data analysis are included in chapter three. Chapter four provides data presentations as well as the summary of the findings. The last chapter dealt with, conclusion and possible recommendations.

Chapter Two: Review of Related Literature

2.1. Theoretical Literature Review

2.1.1 Main Concepts and Definitions of FDI

FDI is the investment made by a company outside its home country. It is the flow of long-term capital based on long term profit consideration involved in international production (Caves, 1996). This definition is correct but not complete as the important issues of control and management are not included in it. Inter-national investment can take two forms. It could either be portfolio investment, where the investors buy some non-controlling portion of the stock, bond or any other financial security, or direct investment where the investor participates in the control and management of such business venture. This is the type of investment by multinational companies and it tends to contribute more to economic growth than the portfolio investment.

Lipsey (1999) said internationalized production arises from foreign direct investment. According to him, this is the investment that involves some degree of control of the acquired or created firm which is in any other country apart from the investors' country. This involvement in the control of the investment is the main feature that distinguishes FDI from portfolio investment.

FDI is considered a type of investment that includes the insertion of foreign funds into an entity that operates outside the country of origin of the investor. Grcic & Babic (2001) stated that FDI has specific features in comparison with other forms of capital and financial transactions and unlike classical loan it is more based on investors' long-term interest in the area in which they invest. Generally, firms invest in countries with favorable economic and political environment in order to minimize transaction costs and maximize their profit.

There are two types of FDI known, horizontal and vertical; however in practice the difference between these types is often unclear. Demekas et al. (2005) in his research stated that horizontal FDI is targeted towards the local markets of the host country,

when the national production is considered more profitable in the domestic market than in international market, the source countries instead of considering exports, expand their activity in the market of the host country. Vertical FDI is oriented on minimizing the costs of investment. In this case MNEs choose the location of each entity in order to minimize global costs. Thus, investors based on these differences choose to expand their activities in different countries. Accordingly market size would represent one of the main determinants for horizontal FDI and cost of labor- for vertical FDI. Although, Demekas et al. (2005) suggests that horizontal FDIs are observed on a large scale in comparison with vertical FDI, both types can be encountered simultaneously.

Foreign Direct Investment (FDI) refers to capital inflows from abroad that invest in the production capacity of the economy and are usually preferred over other forms of external finance because they are non-debt creating, non-volatile and their returns depend on the performance of the projects financed by the investors. FDI also facilitates international trade and transfer of knowledge, skills and technology.

It is furthermore described as a source of economic development, modernization, and employment generation, whereby the overall benefits (dependent on the policies of the host government) trigger technology spillovers, assist human capital formation, contribute to international trade integration and particularly exports, help create a more competitive business environment, enhance enterprise development, increase total factor productivity and, more generally, improve the efficiency of resource use (OECD, 2002). FDI is widely perceived to help host countries in catching up economically and integrating themselves into the international division of labor. Accordingly, policymakers around the world consider raising the attractiveness to FDI to be a major policy challenge. However, it is still disputed what drives FDI and, in particular, how effective specific policy measures are in attracting FDI.

In an era of increasing world trade and globalization, FDI has grown at phenomenal rate, especially in the past two decades. In the globalized world economy of the twenty-first century, the world market for foreign investments has become more competitive and developing countries are becoming more attractive to foreign investors. Developing countries view foreign investment as vital to prosperity and are changing their policies

and regulations to attract it. Developing countries have made considerable efforts over the past decade to improve their investment climate by offering a wide range of government promotional policies. These countries have acknowledged that FDI can be a positive contributor to economic growth, transfer of technology and management skills, and a higher standard of living (OECD, 2002).

2.1.2 The Schools of Thought in FDI

2.1.2.1 The Pro-FDI School

The pro-FDI School of thought provides idea in favour of FDI. Its proponents propagate the idea that foreign direct investments are important to the development of the third world countries. Harry Johnson (1977) for example, has argued that foreign investment brings to the host country cheap capital, advanced technology, superior management ability, and superior knowledge of foreign markets for both final products and capital goods, intermediate inputs, and raw materials. According to Johnson the diffusion of technology and the transfer of management expertise from industrial to developing countries are the most important external means by which the developing countries can improve their standard of living.

2.1.2.2 The Dependencia School

As opposed to the pro-FDI perspective, the Dependencia School has emphasized the risks that foreign investments pose for the third world. Theotonio (1973) argued that economic difficulties of developing countries originate from the relationship of the advanced countries with developing countries. Ronald (1974) concluded that MNCs transfer technologies to developing countries that result in mass unemployment. They monopolize rather than inject new capital resource and they displace rather than generate or reinforce local businesses. The Dependencia School denies the benefits of FDI to developing countries. It rather belams FDI as cause for the poverty and under development of the developing countries. This school of thought is against the contributions of FDI to employment generation in which FDI is highly dependent on capital than labor and the implication is that developing countries should not open their

economies to foreign investors. However in the contemporary world the third world countries cannot avoid economic integration.

2.1.2.3 The Bargaining School

A third approach, that of the bargaining school has suggested that distribution of benefits of gains emerge from negotiation between foreign firms and the host countries governments, the bargaining school has found that foreign direct investment often occur in industries in which market imperfections create opportunities for firms to enjoy relatively high profits through foreign operations (Stephan, 1976).

According to the Bargaining perspective, developing countries can learn how to extract greater benefits from foreign firms. The main concept underlying the Bargaining school is there is a kind of win-win strategy in which both FDI and the host countries get their respective advantages. The implication is that foreign direct investment ought to be permitted, even encouraged by host governments and that these governments ought to build the national institutions needed to enhance the country's share of the resulting benefits.

2.1.2.4 The Structuralist School

The Structuralist School believes that there are substantial opportunities that the host countries obtain from multinational corporations. The structuralist's analysis of MNCs effects on third world economies has been in basic agreement with that of the dependency approach. However it has argued that developing countries may in fact experience a long term decrease in their power over high-technology manufacturing MNCs. The structuralist approach, combines elements of the dependency and bargaining schools in that developing countries learn more from foreign direct investments but there must be tight limits on the degree to which host countries can reduce their dependency and increase their share of the gains (Moran, 1974). According to this school of thought developing countries should adjust their strategies like adopting technologies that fit their situations to get benefits from foreign investors

Investment is of particular importance to the poor. Through investment the productive capacity can be built and knowledge, skills, technology can be acquired. Through institutional collective action stagnant pattern of poverty and marginalization can be transformed into dynamic pattern of economic development and social inclusion. With development comes the potential for greater equity within and between nations. Greater equity, in turn, enhances peace and security which create greater attraction for foreign direct investment. Foreign investment can be strategically decisive in two ways. On one hand, transnational corporations—the primary source of foreign direct investment (FDI) can potentially transfer technologies, skills and global market links which are lacking domestically, thus stimulating industry growth. On the other hand adopting the rules which govern international investment can dramatically shape both the domestic investment climate and domestic policy options (Lyuba, 2004).

Despite the benefits that can be derived from FDI, it should be noted that it can also bring some negative impacts. For instance activities of MNEs can displace local firms that can not cope with the competition from foreign firms, thereby reducing the growth of the local firms (Jones, 1996). This can happen when domestic firms are unable to produce their products that can compete in the market with the products of FDI.

Also if proper regulation is not in place in the host country, FDI can serve as a source of capital flight from the developing countries to the developed ones. For instance due to some specific risks in the host country (economic and political risks), there could be large flow of capital from the host country to the home country if there is no legislation against such practice. This can have adverse effect on the host economy specially if such capital is sourced for within the host country. Finally, due to MNEs' higher production capacity, FDI can cause large scale environmental damage which sometimes is not well taken care of (Bora, 2002).

2.1.3 The FDI Regulatory Framework in Ethiopia

The present regulatory regime governing FDI in Ethiopia is based on a series of Investment Proclamations issued between 1996 and 1998, principally Proclamations 71/1996, 37/1996, 351/1998, 361/1998 and 116/1998. Although other proclamations

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

2.1.3.1 Economic Sectors Open to FDI in Ethiopia

According to Investment Proclamation 769/2012 of Ethiopia, foreign investors are encouraged to invest in all economic sectors, except those currently reserved for domestic private and state investment, with the domestic private investor category including foreign nationals who are permanent residents in Ethiopia. There is a continuous review of the sectors closed to FDI. Indeed, the amendments to the Investment Code made in June 1998 have opened up energy generation and telecommunication services to the private sector, both foreign and domestic. Under this Proclamation, the generation of electricity from hydro-power is allowed for both foreign and domestic investors without any limitation on generation capacity. In addition, private investors, both foreign and domestic, are permitted to invest, in partnership with the Government, in defense industries and telecommunication services.

Investment areas open to foreign investors include manufacturing, agriculture, service and trade sectors. The manufacturing sub-sectors open to foreign investors are the varieties of industries such as food, beverage, textile and textile products, leather and its products, wood products, paper and paper products, chemical and chemical products, basic pharmaceutical products, rubber and plastic products and other non metal products, basic metal (excluding mining of minerals), computer, electronic and optical products, electrical products, machineries and equipment, vehicles, household furniture industries are currently open to foreign investors. Agriculture sub-sectors include floriculture, crop production, animal production, mixed farming, forestry and integrated agriculture with manufacturing.

Other include information communication technology, generation, transmission and supply of electrical energy, hotel and tourism (star designated hotel and resort, motel, lodges and restaurant) grade one tour operation, construction contracting, real estate development, education and training, health services by constructing own building, architectural and engineering works, publishing, import trade (importation of LPG and bituman), export trade (excluding raw coffee, chat, oil seeds, pulses, precious minerals, natural forestry products, hides and skins bought from the market, and live sheep, goats, camel, equines and cattle not raised by the investor.), whole sale trade (supply of petroleum and its by products as well as whole sale of own products) (Ethiopian Investment Guide, 2013).

2.1.3.2 Ownership Limitation and Requirement

Under Proclamation 37/1996 a minimum investment sum is required for both wholly-owned operations and joint-ventures with Ethiopian companies or individuals. The value of the investment must be in either cash or in-kind. For wholly owned FDI into the open sectors, an initial investment of \$500,000 is required and in the case of engineering or technical consultancy an initial investment of US \$100,000. For joint-ventures with Ethiopian investors, the foreign partner is expected to contribute \$300,000, with this minimum equity requirement representing either cash or the value of the capital equipment imported to establish the venture. There is also a further requirement stipulating that Ethiopian partners must hold in excess of 27 per cent of the equity in each joint-venture.

The Investment Proclamation 769/2012 revised the capital required of foreign investors. The minimum capital required of foreign investors is \$200 thousand per project. However if foreign investor invests in partnership with domestic investor; the minimum capital required of foreign investors is \$ 150 thousand per project. The minimum entry capital required of foreign investor investing in areas of architectural, engineering work or related technical consultancy services, technical testing and analysis and publishing work is \$100 thousand where the ownership is fully foreign owned, and \$50 thousand where the investment is made jointly with domestic partners. A foreign investor reinvesting his/her profits or dividends generated from existing enterprise is not required to allocate

a minimum capital. The Investment Proclamations made at different times provide amendments in some of the provisions while maintaining other provisions .

If the Government wishes to give priority to attracting larger FDI projects, it may be right to have a threshold level to ration the presently limited FDI promotional and management capability in EIA and the regional promotion agencies. However, a minimum investment requirement is not a common feature of investment regulatory regimes of most host countries that are competing to attract FDI.

Apart from these minimum capitalization conditions, the investment code does not require FDI to meet specific performance goals or guidelines through their operations. There are no requirements in terms of export levels, minimization of foreign trade balances, foreign exchange restrictions for imports, minimum local content levels in manufactured goods, or employment limits on expatriate staff. Once an investment project is established and operational, it is clearly left to a company's managers to make all key decisions without Government authorization or interference.

2.1.3.3 Monitoring and Reporting Requirements

There is currently a requirement for both FDI and domestic investors, under Proclamation 37/1996, to submit progress reports to EIA on the status of projects every six months once the original investment permit has been issued. The purpose of this is for EIA to be regularly informed on progress and also to identify (as early as possible) emerging problems in order that EIA or other Government agencies can help resolve the problem or constraint. Staff in the Project Evaluation, Follow-Up and Consultancy Service Departments of EIA also undertakes (when resources and workloads allow) monitoring of major or sensitive FDI projects to assess progress against the original plan and intentions submitted to EIA to gain their permit. Should variations from the original proposals occur, the EIA seeks to understand why?, and if necessary will help investors bring it back on track where the original plans have not been rendered inappropriate through external economic or market change.

2.1.3.4 Fiscal Incentives for FDI

Since 1991, Ethiopia has introduced a combination of investment guarantees and investment incentive measures designed to provide a supportive and reassuring business environment for potential foreign investors. These are broadly in line with the guarantees and incentives of competitor nations and are being reviewed by Government on a continuing basis.

Investment incentives for FDIs are significant and include 100 per cent exemption from customs duties and import taxes on all capital equipment and up to 15 per cent on spare parts; exemption from export taxes (except for coffee); income tax holidays varying from one to five years (depending on the sector and region within Ethiopia); tax deductible research and development expenditure; no taxes on the remittance of capital; the carrying forward of initial operating losses; and investor choice in depreciation models. These incentives apply to eligible sectors open to FDI.

Investment guarantees for FDIs include full repatriation of capital and profits encompassing not only profits, dividends and interest payments on foreign loans but also on asset sale proceeds and technology transfer payments. There is also a guarantee against expropriation, except in major cases of public interest when full market value compensation will be paid promptly. These guarantees and incentives are clearly presented by EIA and the Government in current promotional material.

The documentation and monitoring of these by EIA also appears to be efficient. There has as yet been a review on the relative attractiveness and neither benefits of the present guarantees and incentive of programs with recent foreign investors nor any comparative benchmarking of the Ethiopian incentive package with those in competitor nations. The perception of both the Government and existing foreign executives is that that prime investment promotion challenge for Ethiopia is not in relation to the FDI incentive package. Rather, it is in relation to the external perceptions of Ethiopia as documented by the prevailing international media picture, in particular following the recent regional conflict.

The investment incentives offered to FDI's locating in Ethiopia are designed primarily to be effective through the reduction of corporate taxes, and import duties, including the carry forward of initial operating losses to offset against subsequent profits. Whilst this is standard for emerging economies, it must be noted that Southern European, Latin American and Asian countries seeking inward investment often include investment grants and other financial support usually tied to employment, export and capital commitment goals. Such grants and/or loans may be reinforced by the provision of sites and property with rent-free periods running up to five years and by the State picking up part or all of the initial vocational skills training costs for locally recruited employees. The financial constraints facing Ethiopia makes such direct financial contributions to the costs of new capital investment by FDI's almost impossible, but EIA and other agencies should be aware that the corporate views of the main Northern Hemisphere FDI home countries will be colored by their experience as inward investors elsewhere.

As Ethiopia aspires to attract Greenfield investments by corporations which have no previous knowledge of the country EIA staff must be able to positively respond to possible FDI concerns about incentives other than tax holidays and free import duties. Discussions, during the Mission to Ethiopia revealed that a considered response on this will at present be unlikely. Again, this gives support to the need for enhanced project development knowledge within, EIA, especially in terms of financial aspects and investment targeting.

2.1.4 Institutional Framework of FDI Promotion in Ethiopia

The principal Government agency responsible for most aspects of FDI in Ethiopia is the EIA which has the lead remit for promoting, coordinating, managing and monitoring all types of inward investment including joint-ventures. EIA reports to the Board of Investment (BOI) chaired by the Prime Minister. The General Manager of EIA is one of the seven Board Members of BOI. EIA is still a relatively young agency in comparison with its regional and international investment promotion competitors. It is seriously under resourced; has not yet evolved a strategic planned approach to its promotion activities;

and is constrained by a current lack of operational integration with the emerging strategies of the other key Government ministries and agencies.

A number of other Government agencies and private sector organizations are involved alongside, EIA in delivering or contributing to Ethiopia's investment promotion effort. In the State sector, these include the Ethiopian Privatization Agency (EPA), established through Proclamation 87/1994 to privatize over 200 state enterprises accounting for some 20 per cent of GDP the Ministry of Trade and Industry; the ministries and agencies associated with specific sectors such as mining and tourism; the Ministry of Foreign Affairs; the Development Bank of Ethiopia; and the ministries dealing with taxation remits including customs. Of these EPA is potentially the most important as it regards FDI as an important privatization mechanism. The Regional Investment Promotion Agencies, known as investment bureaus, also have an important contribution to make in identifying, defining and promoting specific investment project opportunities and in encouraging FDI into their region.

The Ethiopian private sector plays a much smaller role in FDI promotion than in many similar emerging economies. This is the case, principally because of the absence of international commercial banking and financial services companies, as these remain reserved sectors for Government and Ethiopian investors. There are thus few effective private sector links into the international corporate community. The national and city Chambers of Commerce are perhaps the most active (but irregular) participants in the FDI process but, will become a more important part of the FDI delivery framework in Ethiopia. It is suggested that there is merit in directly involving key private sector organizations and enterprises in investment promotion.

2.1.5 Benefits and Costs of FDI

The potential impact of FDI on host countries is a matter of controversy. Some concentrate on the benefits that can be gained from foreign corporations operating in host countries. Such benefits can result from transfer of resources that might be scarce in the host country. There are people who argue that FDI is an important source of private external finance for developing countries, the host countries should prepare to effectively

exploite the benefits (Mallampally and Sauvant, 1999). While others argue that FDI is the cost to host countries by crowding out local investors.

As for the benefits, these are numerous and consist of transferring technology to the host countries, expanding trade, creating jobs and speeding economic development and integration into global markets. FDI allows the transfer of technology not only defined as scientific processes but also in terms of organizational, marketing and managerial skills which has an efficiency enhancing effect on the locally owned firms. Furthermore, a MNC is itself likely to use host country resources more efficiently because of its superior technology. FDI is probably the most important channel through which advanced technology is transferred to developing countries. On the employment level, recipients of FDI often gain valuable employee training in the course of operating the new businesses, which contributes to human capital development in the host country. MNCs can fill critical management gaps, facilitating employment of local labor and transferring skills to local managers and entrepreneurs. Another benefit is that profits generated by FDI contribute to corporate tax revenues in the host country (Mallampally and Sauvant, 1999).

Besides being able to provide the much needed resources leading to accelerated capital formation, FDI also can facilitate transfer of technology, organizational capabilities, management skills, and a higher standard of living. Grosse (1988) suggests that the potential impacts of FDI are broadly positive. He argues that FDI seems to offer net benefits to host countries that cannot obtain such benefits from alternative sources, either because of non availability or because of higher costs. The proponents of FDI also emphasize its role in accessing international marketing networks. On the other hand, there are many who question the appropriateness of FDI as a tool to enhance growth in the host economy. Such views may range from skeptics who cast some doubts about the benefits of FDI in the host country, to those who strongly emphasize the need for further research on the consequences of FDI on the host countries. One of the main reasons behind this view is that it questions the appropriateness of the transfer of resources, especially those related to technology transfer. This view also concentrates on the

negative aspects of FDI, such as remittances of profits and fees paid to the mother company.

Furthermore, there are number of examples of problems that can be brought about by FDI. These may include the fact that foreign owners generally expect to take the profits back home with them. Moreover, the sovereignty of companies and national economic policies can be reduced by foreign ownership since FDI is not only a transfer of ownership from domestic to foreign residents but also a transfer of management and control to the foreign companies over host's country firms.

Hanson (2001), in his study on whether policies to promote FDI make economic sense, concludes that: "There clearly is a need for much more research on the consequences of FDI, but the impression from the literature is that countries should be skeptical about claims that promoting FDI will raise their welfare".

The costs and benefits of FDI are the subject of intense debate, as governments try to devise ways to harness MNCs' economic and political power (Grosse, 1988). The levels of positive and negative impacts (costs and benefits) can vary between different countries depending on the host country itself, as well as the investing company, and the interaction between those two. Geographic location, GDP, per capita income, economic environment, investment climate, economic policies and technology base might be some of the influencing factors.

2.1.6 The Effect of FDI on Employment and Wages

One of the main motivations to attract FDI by host countries is its potential to create employment opportunities. However, there is an opposing view that FDI can reduce employment through divestment and the closure of production facilities. From a general point of view, FDI is capable of increasing employment directly by setting up new facilities, or indirectly by stimulating employment in distribution. Generally the main reason for which most developing countries attract FDI is its potential to create employment opportunity. In his analysis of the employment effects of MNCs, Vaitos

(1976) provides evidence to indicate that the overall employment effects of MNCs' activities on their host countries have been relatively small.

2.1.7 The Effect of FDI on Trade Flows

Foreign direct investment has a positive effect on trade flows in the host countries in two ways. The first way is through backward linkage by which local suppliers provide raw materials or the necessary inputs to FDI. The second way is through forward linkages by which local customers or distributors create market chain to sale finished or semi-finished products to users. Another possible way of enhancing trade flows occurs when subsidiaries import parts and capital equipment from the parent MNC, which is located in the home country (Goldberg and Klein, 1998).

Foreign direct investment directed into developing countries affects their trade flows with industrial countries, even after controlling for the effect of the exchange rate. Hence, it seems that through FDI, MNCs do affect the size and direction of trade flows. In a study of FDI and industrialization in the ASEAN (Association of South-East Asian Nations) countries, Hiemenz (1987) emphasizes the importance of the direct contributions by MNCs to the expansion of manufacturing exports which represents a second area of interest next to technologies.

One of the main issues concerning the relationship between FDI and trade is whether production and sales by MNCs in a foreign market affects trade flows and exports to the same market. Study conducted in USA revealed that FDI has a positive effect on exports. Production in a foreign country usually requires the import of intermediate products from the home country. If a foreign subsidiary can produce goods more cheaply abroad and export them to the home country, then this obviously means that FDI leads to increasing imports by the home country and increasing exports by the host country. Some empirical studies based on cross-sectional industry and firm level data indicate a positive relationship. Blomstrom (1999) found a predominantly positive relationship.

2.1.8 FDI and Technology

The interaction between FDI and technology is considered to be of great importance in the discussion of FDI. The reason for this is that technology can play an important role in economic growth, capital accumulation, production and even changes in the organization of social relations. Technology transfer from FDI by MNCs may present important benefits to host countries.. Blomstrom (1989) indicates that local firms may become more efficient in the presence of MNCs due to technological spillovers. Kokko (1994) points out that the technology and productivity of local firms may improve as foreign firms enter the market and demonstrate new technologies, provide technical assistance to their local suppliers and customers, and train workers and managers who may be later employed by local firms.

However, Blomstrom (1999) emphasizes the role of the local firms and their policies as an important factor in the technology transfer process. There are several ways in which technology transfer may be diffused, including technical assistance, training, consultancy, supervision and know-how. It is important to consider the mechanisms by which foreign technology is transferred to, and absorbed by, the host country, and how it affects this country's economy. The technology transferred should be appropriate too and relevant to the needs of the host economy, and particular problems in this respect have led to situations where the anticipated positive effects of technology on developing countries have not taken place.

Lall and Streeten (1977) point out that FDI may not present the anticipated benefits of technology diffusion due to the appropriateness of technology with respect to the products that are made with the technology transferred, and to the factor endowments of host countries. Lall and Streeten also argue that it is in the nature of MNCs that their products are excessively sophisticated in comparison to the needs of developing countries. Sometimes MNCs pass on old technologies, which can be too capital-intensive for the local developing economy. Some of the disadvantages that may result are mentioned by Moosa (2002), who lists worsening employment, worsening income

inequality, distorting influences on the technology used by other firms, and bias in production towards sophisticated and differentiated products.

Many developing countries have adopted more liberalized policies towards MNCs as a means to encourage FDI. One of their main drivers was the need for new technologies as they realized that multinationals could play a key role in technology diffusion and the production of technologically advanced products. However, there are still some suspicions that much of the modern technology introduced by MNCs cannot be adapted to suit many developing countries.

2.1.9 FDI and Training

The effect of FDI on training of employees, especially local employees, is a significant matter for both the investing firm and the host country. Foreign firms might consider the cost of training locals, but at the same time they may realize that such expenditure may be important for their investment. Foreign subsidiaries may sometimes choose to rely on expatriate personnel, at least at the beginning of their investment, however they might have a strong incentive to start using more locals due to cost considerations. Sometimes host governments may put pressure on foreign investing firms to use local employees. Moreover, the cost of an employment tends to be higher than that of local personnel in developing countries. It appears to be difficult to quantify the effects of FDI on the training of locals since the combination of local and foreign personnel that foreign firms use is difficult to ascertain. Reuber (1973) conclude that even allowing for the fact that training costs could not be properly identified; costs of training locals are not large enough to make a significant contribution to the improvement of the skills of locals.

2.1.10 FDI and Inter-Industry Linkages

FDI can influence the economy of the host country via inter-industry linkages. To the extent that foreign subsidiaries establish links with local suppliers for locally-produced materials and parts, FDI can help to provide local firms with increased opportunities that in turn affect their employment and income positions. These are called backward linkages. Forward linkages can also be established for distribution purposes .Affiliates of

foreign MNCs can potentially improve development. Linkages with MNCs help local firms to learn new and better production methods. For their part, MNCs often rely on good quality and timely local supplies. Well-developed suppliers can stimulate more investment and help to improve the developmental impact of FDI. Foreign direct investment is likely to have more beneficial impact on development with more and better linkages between MNCs and local firms (Te Velde, 2002).

2.1.11 FDI and the Environment

Some developing countries may choose to ease their environmental regulations as a means to attract FDI. In spite of the fact the MNCs might contribute to the development in the host country, MNCs, especially those with significant financial, political and negotiating power, can cause damage to the host's environment. Indeed, multinationals in manufacturing and chemicals might cause damage to the environment through waste, emissions and smoke from their operations. In many cases, one of the reasons behind MNCs' location decisions in developing countries is that these countries have less restricted environmental requirements. It seems that it is more likely that FDI has a negative impact on the environment in a developing country than it does in a developed country. This is due to the reason that most developing countries have less effective environmental laws. A major motivation for the anti globalization movement is the environmental damage that may be caused by FDI and the operations of MNCs in developing countries (OECD, 1999).

There is obviously some concern about the environmental effects of FDI that has prompted the OECD to issue some guidelines for how MNCs should tackle environmental issues. The OECD's guidelines on the environment encourages MNCs to provide information on the potential environmental impact of their activities, consult with the communities directly affected by the environmental policies, and maintain contingency plans for preventing, mitigating and controlling serious environmental damage.

2.1.12 Impact of FDI on Developing Economies

Developing countries, emerging economies and countries in transition increasingly view FDI as a source of economic development, income growth and employment. The level of importance of FDI to a certain country may depend on the degree of progress and availability of resources in that country. Countries with limited capacities and resources view FDI as a remedy for their constraints. Nevertheless, foreign investors are more attracted to countries with growing economies and various business opportunities because investment requires a foundation that aids in the achievement of investment goals and objectives. The positive aspects of FDI by MNCs are not only capital, which was previously sought by some developing countries, but also other important factors. MNCs can produce a positive impact on employment and tax revenues, and can provide skills, management know-how and access to marketing networks. Therefore, most developing and even developed countries are welcoming FDI and are competing to attract it (Lall and Streeten, 1977).

There is a basic assumption that FDI raises income and social welfare in the host country unless the optimum conditions are significantly distorted by protection, monopoly and externalities (Lall and Streeten, 1977). However, MNCs expand their operations internationally as means of utilizing the advantages they possess and/or advantages in the targeted host economy to maximize profits worldwide. In the process they shift resources to areas where returns are high and input costs are relatively low. Generally, MNCs tend to take advantage of market imperfections, casting doubts upon the assumption that FDI is always welfare improving.

The effects of FDI on the host country can be economic, political or social. The economic effects of FDI may include the implications for economic variables such as output, the balance of payments and market structure. The political effects include the issues related to national sovereignty and the possibility that MNCs may jeopardize national independence.

The social issues may include the creation of foreign elite in the host country and the cultural effects on the local population, such as customs and tastes. Social issues are more

likely to arise when there are significant economic, social, and cultural differences between the investing and host countries. Johnson (1977) points out that FDI brings to the host economy a package of cheap capital, advanced technology, superior management ability, and superior knowledge of foreign markets. He mentions that developing countries can improve their standard of living through the most important external means, namely the diffusion of technology and the transfer of management expertise from industrial to developing countries. He also claims that managers and workers trained by MNCs can be available for local firms, and the competition introduced by MNCs encourages local firms to aspire to greater efficiency.

Grosse (1988) argues that development comes through the use of advanced techniques in production and marketing, training of local labor, and training and encouragement of suppliers and purchasers. He also points out that MNCs are the single most important vehicle for foreign investors, reflecting international transfer of funds, technology, management skills and products.

2.1.13 FDI and Development

Foreign direct investment's contribution to competitiveness and economic development has been widely debated (Dunning 1992; Lall 1993, 2001; Ozawa 1992). Particular in Asia examples are found of countries that have followed an export-oriented industrialization strategy supported by FDI inflows. Dunning and Narula (1996) explained that the linkage effects of FDI should also be seen in a dynamic perspective. First of all, dynamics concerns the deepness of upgrading in relation to local partners and/or subcontractors. If supply of cheap labor remains the only advantage, upgrading of local firms can remain shallow. Local component requirements can be enforced but that will at the same time involve risks in terms of uncompetitive production for a protected home market. Local capabilities can be upgraded through firm based learning processes with respect to technology and management. This kind of local upgrading has been experienced in the FDI dependent export industries of the old ASEAN countries.

Historical as well as institutional conditions are different. One cannot expect Vietnam to repeat the development of other regional Asian economies when conditions are different

and these other countries by their development themselves change condition. It is not likely to expect a constant linear development pattern. For latecomers to industrial development, FDI is often viewed as more important for the possibilities for catching up technology wise and for the enterprises to become competitive (Lall, 2001).

The effects of FDI in developing countries has a range of prospective benefits to the recipient country. At the macroeconomic level, FDI by definition brings new capital for investment, contributing to the balance of payments, adding to the country's capital stock, and potentially adding to future economic growth. FDI is also cited as a more stable type of capital flow, and thus is arguably more appropriate and development-friendly for low-income countries than portfolio flows. There is also some evidence that foreign investment can contribute to raising exports and integrating into global economic networks. At the microeconomic level there are also a range of purported benefits, especially higher productivity through new investment in physical and human capital, increased employment, enhanced management, and the transfer of technology. Foreign investment also is thought to have important spillover effects on local firms through supply and distribution chains, trading, and outsourcing (Blomstrom et al, 1997).

There are complaints that foreign firms merely exploit local labor and make no contribution to the wider economy, either through creating jobs, training workers, or in using local suppliers (Oxfam, 2003b). A frequent grievance against foreign investment is that, although the theory suggests capital inflows, in practice FDI can be a drain on foreign exchange. This is because foreign firms may be more likely to import materials (Chudnovsky and Lopez, 2000) and that foreign firms may remit profits (Oxfam, 2003a). More broadly, there is considerable concern that the interests of foreign firms will diverge from social development objectives or constrain governments' ability to promote economic development.

2.1.14 The Investment Climate

Investment climate refers to the totality of macroeconomic, political, policy, and institutional conditions in a country that, together with structural forces, determine private investment, enterprise performance, and growth. It consists of factors that act as

an incentive/disincentive in starting and running a business such as, but not limited to, financial services, governance, regulation, labor relations, conflict resolution, and infrastructure services. The structural factors that play an important role in the outcomes of investment climate include geography (determining flows of products and inputs and proximity to export markets), and level of development determining purchasing power of the domestic economy (UNIDO, 2002).

An investment climate of a country or a region determines the productivity and international competitiveness of the private sector as well as the perceptions of the entrepreneurs and thus is a key factor in their likelihood to invest in new ventures and to expand current businesses. The majority of investment climate variables are prone to change and can in fact be improved through appropriate policy reforms once their weaknesses are pinpointed. There are other components of an investment climate that are rigid and structural in nature and thus are less prone to change in the short to medium term through policy reforms. Indeed, these two groups of an investment climate (variable and fixed) are interwoven such that the success of policy reforms in changing the former also depends on the rigidity of the latter. Each of the variables of an investment climate affect performance and cost of doing business in a country in a variety of ways. Some mainly affect export performance and competitiveness in general, while others may affect starting a business in a given region within a country (OECD, 2000).

The absence of adequate supporting infrastructure: telecommunication; transport; power supply; skilled labour, discourage foreign investment because it increases transaction costs. Furthermore poor infrastructure reduces the productivity of investments thereby discouraging inflows. Asiedu (2002) and Morrisset (2000) provide evidence that good infrastructure has a positive impact on FDI flows to Africa. However, Onyeiwu and Shrestha (2004) find no evidence that infrastructure has any impact on FDI flows to Africa.

2.1.15 Impacts of FDI

There are many benefits of FDI both to the host country and the home country, these benefits are noted by different authors. For instance, Alfaro (2003) said that in addition to

the direct capital financing it supplies, FDI can serve as a source of valuable technology and know-how to the host developing countries by fostering linkages with local firms. These technological innovations by MNEs play a central role in the economy and they are some of the most important areas where MNEs serves as catalyst to growth in developing countries. MNEs have the financial strength to invest in large plants. This might be very difficult for local investors due to their lack of huge investment funds which MNEs can afford. Through FDI, scarce capital can be made available to the developing countries. This is very crucial to economic growth. Jones (1996) notes that the transfer of capital by MNEs can supplement domestic savings and contribute to domestic capital formation for countries that are capital constrained and this can increase domestic investment. Some investments are better off if managed under foreign control. This will put the level of government interference at its minimal. More often than not, FDI brings along solid ownership and independent management.

FDI has enormous potential to create jobs, raise productivity, enhance exports and transfer technology, foreign direct investment is a vital factor in the long-term economic development of the developing countries. Despite the benefits that can be derived from FDI, it should be noted that it can also bring about some negative impact. For instance activities of MNEs can displace local firms that can not cope with the competition from foreign firms, thereby reducing the growth of the local firms (Jones, 1996).

Also if proper regulation is not in place in the host country, FDI can serve as a source of capital flight from the developing countries to the developed ones. For instance due to some specific risks in the host country (economic and political risks), there could be large flow of capital from the host country to the home country if there is no legislation against such practice. This can have adverse effect on the host economy especially if such capital is sourced for within the host country. Finally, due to MNEs' higher production capacity, FDI can cause large scale environmental damage which sometimes is not well taken care of (Bora, 2002).

With the rise of globalization, Foreign Direct Investment has been seen as an important stimulus for productivity and economic growth for both developed and developing countries. Receiving foreign capital contributes to the economic growth thus countries

tend to develop sustainable conditions to attract investment inflows into their economies. Although the level of FDI increases continuously, the distribution between countries is unequal depending on market size, economic reforms and labor costs as the main factors attracting investment inflows without concentrating on the potential role of institutions. The quality of the institutional framework can be employed for explaining the cross country differences in attracting FDI. Daude & Stein (2004) emphasize the significance of institutional factors for the FDI levels, this fact also supported by Pournakis & Varsakelis (2002) and Fabry (2006). Institutions that serve the facilitations of FDI are necessary to help the flow of more FDI to the host countries.

Since the 1970s, a significant increase in the FDI inflows has been observed in the world economy. Moreover, the growth of FDI inflows has exceeded the growth in world trade and world output (Bissoon, 2011). According to Diaz (2004) during the second half of 1990's, worldwide FDI grew four times faster than the domestic output, twice as fast as domestic investment and three times as fast as exports. The trend however showed that most of the FDI inflows were absorbed by developed countries. The situation changed after 2007 when, for the first time, developing and transitional countries absorbed more than half of the global FDI inflows (UNCTAD, 2011).

For transition economies, increase in the FDI inflows represents a significant improvement for their economic growth strategy. Bevan & Estrin (2000) stated that the main problem of these economies is the lack of capital and technology necessary to spur growth while there are sufficient stocks of human capital. Focusing on CEE, the region became more eager and open to foreign investors after the political changes in the early 1990's. Their deteriorated economic conditions, has led them to begin massive restructuration in order to attract FDI.

Therefore, the foreign companies were expected to provide assistance through various channels. One of them would be competitiveness improvement via innovation in products, production processes and organizational issues. Secondly, it would provide a financial support in order to reduce the existent debt burden and finally would improve the social imbalances concerning level of poverty, job losses and low income (Pournakis & Varsakelis 2002).

Recipient countries should ensure that greater FDI, particularly in natural resources, translates into higher fiscal revenue, which can then be spent in priority areas. In the face of strong competition for FDI among recipient countries, LIC policymakers should carefully evaluate the benefits of policy incentives against the cost and the fiscal implications of such incentives to ensure that public resources are used for the highest priorities. Regional policy coordination could help countries limit incentive competition. Deeper regional integration could also make small LIC economies more attractive to FDI, notably by having regional projects especially in the power and transport sectors. Moreover; policies aimed at attracting FDI should avoid discriminating against domestic firms.

BRICs and LICs can cooperate more closely in promoting local employment and industrial linkages. While an important goal of attracting FDI is to increase local employment and strengthen local productive capacity, excessive local employment and input requirements could deter FDI inflows and undermine the efficiency of foreign invested firms. To avoid such an outcome, investors could be encouraged to hire and train more local workers while, at the same time, recipient countries could aim to facilitate firms' access to necessary skills, including by upgrading education programs and rationalizing labor market regulations. Similarly, linkages to local firms could be facilitated by encouraging joint ventures, improving internal transport systems, and ensuring equal access to industrial clustering by local firms (Broadman, 2006).

2.1.16 Attracting More FDI and Maximizing its Benefits

Given the relatively low saving rates and lack of technology and skills in most LICs, more FDI is needed to help strengthen domestic productive capacity and improve competitiveness. However, any fiscal incentive provided to FDI should be based on careful cost-benefit analysis in the context of articulating development priorities. Continued efforts should be made to improve the business environment, upgrade labor skills, foster technology transfer, and integrate FDI firms into local economies (OECD, 2002).

2.2 Empirical Literature Review

2.2.1 FDI and Externality Effects

An example of empirical evidence that fits this alternative scenario is offered by Barrios (2000). Estimating FDI-induced externality effects for a large panel of Spanish manufacturing firms, he finds a structural difference between high tech and low tech industries. However, in high tech industries there is no significant effect from foreign participation, whereas in low tech industries the estimated significant effect is negative. However, when considering that it is likely that foreign and Spanish firms are in direct competition in low tech industries due to the relative limited size of technological differences, the estimated negative externality effect can be interpreted as a negative competition effect.

A similar type of finding is presented by Zukowska-Gagelmann, who estimates externality effects from FDI for a large set of manufacturing plants in Poland for the period 1993-1997. Summarising the main results, Zukowska-Gagelmann (2000) states that 'FDI is found to have a negative impact on the performance of the most productive local firms in high competition industries. By contrast, the effect on the least productive state firms in low competition industries is positive'. Again, the difference in estimated effect of FDI can be explained by the presence or absence of negative externality effects from direct competition between foreign-owned and domestic firms, indicated by the size of the technology gap.

Castellani and Zanfei (2003) use a firm-level data base of manufacturing firms in France, Italy and Spain for the period 1993-1997. Their empirical findings are in support of the interpretation of the technology gap representing the presence or absence of direct competition. Their estimations indicate the significant presence of positive FDI-induced externalities, but only in those industries that are characterised by large technology gaps, suggesting the absence of negative (pecuniary) externalities that may arise when FDI and domestic firms are in direct competition for market shares.

Therefore, it appears that the expected effect of the level of technological differences or technological complexity may be to stimulate either positive and negative FDI-induced

externalities, depending on whether it represents the capacity of domestic firms to absorb technology, or alternatively indicates the presence of direct competition between domestic and foreign-owned firms.

Several empirical studies have addressed the question whether the presence of FDI has resulted in the occurrence of externalities in Mexico. Ramirez(2000) conducts a longitudinal study of short and long term effects of FDI on measured labour productivity for the overall Mexican economy between 1960 and 1995. His findings indicate that changes in both the domestic and (lagged) foreign capital stock are positively related to changes in domestic productivity. He interprets this positive relation between changes in overall labour productivity and foreign capital stock as evidence of the occurrence of FDI- induced externalities in the Mexican economy.

Aitken et al. (1997) offer evidence of the occurrence of externalities arising from demonstration effects related to knowledge and information about exporting practices to international markets. They analyse a large sample of Mexican and foreign firms for the period 1984-1990, finding that those Mexican firms that are located in close proximity to foreign exporting firms are more likely to be engaged in exporting activities themselves. Such a positive relation does not exist when replacing the geographical concentration of foreign-owned exporting activity by overall exporting activity, suggesting a unique contribution from FDI to export activities by Mexican firms. An attempt to identify significant externalities from the presence of FDI through human capital accumulation and labour turnover was unsuccessful.

A study suggesting that the presence of FDI may lead to negative effects is presented by Grether (1999), who analyses the process of technology diffusion in the Mexican economy, using the same database as Aitken et al. (1997). If demonstration/imitation effects from the presence of FDI exist, there should be a positive association between the industry-wideshare of foreign participation and the rate of industry-wide technology diffusion, *ceteris paribus*. However, his results show a significant negative association between the two variables ,suggesting that foreign firms may be trying to prevent new technology being imitated and copied by domestic firms.

Meller and Mizala (1982) discovered that US affiliates in seven developing countries were using some labor-saving policies when compared to local firms in the same line of manufacturing. They found that these US affiliates created five percent fewer jobs than their local rivals. Graham and Krugman (1991) also conclude that the net impact of FDI on US employment is approximately zero. On the other hand, studies by the United Nations Centre on Transnational Corporations (UNCTC, 1981) on international automobile firms in India, Morocco and Peru have concluded that FDI can have a substantial and positive indirect effect on employment.

The effect of FDI on wages and salaries is related to the employment issue. Some studies have argued that MNCs pay higher wages than local firms in the same industry (Stewart (1976); Dunning (1976)). A possible explanation for this is that foreign firms may offer higher wages to attract qualified people to their jobs. In his study of 500 US affiliates in the UK, Dunning (1976) points out that these affiliates tend to pay above average wages when compared to the yearly wage bill per capita.

Feenstra and Hanson (1994) discovered an increase in the relative wages of skilled workers in Mexico during the 1980s. They found that the reason behind wage inequality in Mexico is the increase in the relative demand for skilled labor because capital inflows shifted production towards relatively skill-intensive products. They found that the growth in FDI is positively correlated with the relative demand for skilled labor. In addition to MNCs' direct employment effects, they might also have an indirect effect on employment through backward linkages with local suppliers or forward linkages with local customers or distributors. These linkages might also have an effect on stimulating trade flows.

2.2.2 Barriers to FDI

Many of the purported benefits of FDI are frequently challenged directly, both on ideological and empirical grounds. There is a common critique that foreign investors crowd out local firms that cannot compete because of size, financing, marketing power, or other unfair advantage (Dunning, 1993) .

According to the World Bank (2004) assessment on the business environment that faces firms operating in Uganda, Kenya, and Tanzania, both foreign and domestic firms face several constraints that impede their day-to-day operations. Apart from the somewhat predictable complaints about the cost of finance and tax rates, firms complain about macroeconomic instability, the availability of reliable electric power, corruption, tax administration, and crime. A higher proportion of foreign firms complain about corruption in all three countries, suggesting that foreign firms bear a greater burden of non-official payments, or at least are more sensitive to their prevalence.

2.2.3 Impacts of FDI on Employment

Federico and Alfredo (2007) assessed the impact of Italy's outward foreign direct investment (FDI) on local (domestic) employment growth between 1996 and 2001 for 12 manufacturing industries and 103 administrative provinces. Their main result was that, controlling for the local industrial structure and area fixed effects, FDI is associated with faster local employment growth, relatively to the national industry average. They also found that employment in small plants was not negatively influenced by higher levels of FDI. Their findings didn't support the idea that FDI was detrimental to local employment growth in the home country.

While the recent increase in foreign direct investment (FDI) to African countries is a welcome development, the question remains as to the impact of these resource inflows on economic development. Ndikumana and Verick (2008) investigated a key channel of the impact of FDI on development is through its effects on domestic factor markets, especially domestic investment and employment. In this context, they analyzed the two-way linkages between FDI and domestic investment in Sub-Saharan Africa. Their results suggested that firstly, FDI crowds in domestic investment, and secondly, countries will gain much from measures aimed at improving the domestic investment climate. Moreover, they identified alternatives to resource endowments as a means of attracting foreign investment to non-resource rich countries.

Buffie (1993) analyzed the impact of foreign investment on employment and domestic capital accumulation in a two-sector dual economy model. He found that foreign

investment in the high-wage manufacturing sector crowded out domestic capital on a greater than one-for-one basis and lowered the level of manufacturing sector employment in the long-run. By contrast, foreign investment in an enclave sector or in the primary export sector crowded in domestic capital and unambiguously reduces under employment. Furthermore, under weak conditions, foreign investment in the enclave or primary export sector was unambiguously welfare enhancing viewed over the entire transition path.

MNE employment has a direct and indirect impact on domestic employment: FDI often generates new employment (direct employment is higher in green field 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 (1999) estimated that FDI in developing countries created about 26 million direct jobs and 41.6 million indirect jobs in 1997 (a multiplier of about 1.6). Iyanda(1999) obtained a higher estimate for Namibia: about 2 to 4 jobs were created for each worker(directly)employed by foreign affiliate.

2.2.4 MNE Employment Fosters Technological Transfers

One of the most common and least expensive ways by which foreign technology gets diffused in host countries is through labor turnover, as domestic employees (especially employees in higher level positions) move from foreign firms to domestic firms. Bloom (1992) found substantial technological transfer in South Korea when production managers left multinationals to join domestic firms. Indeed, foreign firms sometimes pay higher wages in order to retain their workers, and thereby prevent domestic firms from appropriating their superior technology (Glass and Saggi, 2002).

Haddad and Harrison's (1991) study of the FDI effects on the manufacturing industries in Morocco. They suggest that large technology gaps between foreign affiliates and local firms and/or the advanced MNC technology inhibit technology spillovers. Kokko (1994) points out that the occurrence of technology transfer spillovers may be influenced by various host country and industry characteristics. He further suggests that spillovers are negatively related to the complexity of MNC technology, or the technology gap between

MNCs and local firms in Sweden. Technology transfer can occur if the technology brought by FDI is compatible with the level of the host country.

2.2.5 MNE Employment Enhances the Productivity of the Labor Force in Host Country

Several studies have shown that workers in foreign owned enterprises (FOEs) are more productive than workers in domestic owned enterprises (DOEs). For example, Harrison (1996) analyzed differences in labor productivity between FOEs and locally owned firms in Morocco and Cote d'Ivoire. In 8 out of 12 industries in Morocco, output per worker was higher in FOEs than in domestically owned firms, with a difference in productivity ranging from 50% in electronics to about 130% in nonmetallic minerals. In Cote d'Ivoire, the productivity gap existed in fewer industries (3 out of 12), however the gap was wider: ranging from 50% in chemicals to about 500% in oil.

Ramachandran and Shah (1998) also reported that added value per worker is 59% higher for wholly owned foreign enterprises than for local firms in Kenya, 178% higher for FOEs in Zimbabwe and 1,422% higher for FOEs in Ghana. The worker productivity gap may be partly explained by the differences in training opportunities for workers.

2.2.6 Foreign Direct Investment Linkages with Local Firms

Turning to a brief analysis of the empirical literature on this issue, one of the first contributions is Hobday (1995) which finds several cases of backward linkage effects to local suppliers driven by multinationals in East-Asia. FDI created demand for local suppliers and enhanced quality, productivity and variety. In turn, the development of intermediate-goods supply and productivity led to forward linkages to final-good producers, increasing the number of both multinationals and domestic producers. Thus, a second-round backward linkage effect followed.

Alfaro and Rodriguez-Clare (2004) test the theoretical predictions of Rodriguez-Clare (1996) using plant-level data from several Latin America countries and provide evidence

that multinationals' linkage potential is higher than that of domestic firms in Brazil, Chile and Venezuela.

Javorcik (2004) finds evidence on firm-level data from Lithuania of positive productivity spillovers from FDI through contracts between foreign affiliates and their local suppliers. More specifically, such effects occur when the ownership of investment projects is shared between domestic and foreign firms; in that case multinationals do not prevent technology leakages, as they can gain from performance improvements of intermediate input suppliers.

Chapter Three: Methodology

3.1 General Background of the Study Area

3.1.1 Location and Population of Special Zone of Oromia

This particular study was conducted on FDI operating in the Special Zone of Oromia which is found surrounding Addis Ababa. It is located at 08°30'00" _ 09°19'0905" North Latitude and 38°21'45"-39°10'54" East Longitude, It is bounded by North Shoa zone, East Shoa zone, South West shoa zone and West Shoa zone from North, East, South and West respectively. The total area of SZO is 800 square kilo meter with 64% of plane topography, with the rest percent of the area having mountainous and sloppy topography. Based on the survey results (CSA, 2007), there are 48,382 urban populations with 24,239 males and 24,143 females. Likewise there are 554,855 rural populations with 281,632 males and 273,223 females. Generally the total population living in SZO is 603,237. The major ethnic groups living in Special Zone of Oromia include Oromo, Amhara, Gurage, and Tigray. Besides these other ethnic groups are also living specially in urban areas of the Special Zone of Oromia.

3.1.2 Climate Condition and Major Economic Activity of Special Zone of Oromia

Regarding the weather condition, it is one of the areas with the highest annual rainfall and moderate temperature. From the total area of the Zone 49.1% is high land (Dega), 49.56% medium altitude (woyenadega) and the rest 1.03% of the area is low land (kola). The major known rivers like Awash, Abba Samuel, Sibilu, Akaki, Bole Alaltu, Atebela and Holota are found in the SZO. The major economic activity of the area is agriculture where both crop production and animal husbandry are undertaken. From the total population of the Special Zone of Oromia, 75% of the population is dependent on agriculture. The rest of the population are earning their live by trading, small scale industries and small and micro enterprises.

3.2 Research Method

This research aims to assess the effectiveness of foreign direct investment and its challenges in Special Zone of Oromia. In this regard the descriptive type of research design was used to explain the contributions of foreign direct investment in the development of the area in terms of employment, revenue generation, linkage with local investment and it also tried to see the challenges encountered by foreign direct investments in the Zone. For the purpose of this research, the researcher adopted mixed methods which incorporates quantitative and qualitative techniques. Mixed methods research is defined as the class of research where the researcher mixes or combines quantitative and qualitative research techniques, methods, approaches, concepts or language into a single study (Johnson and Onwuegbuzie, 2004). It is a research in which the investigator collects and analyses data integrates the findings and draws inferences using both qualitative and quantitative approaches in a single study.

Qualitative research is helpful because FDI is implemented through organizations and by human beings with different cultural backgrounds, motivations, knowledge, stand points and so on, that act within particular contexts in certain boundaries. These aspects involve the complex process in which FDI is operating. In order to capture, interpret and explicate the ways people in particular settings come to understand, account for, take action, and otherwise manage their day-to-day situations” (Miles & Huberman 1994, p.7), it is necessary to develop a methodology of research which is adequate for this kind of complex environment. Hence the purpose of the qualitative research method is to discover concepts and relationships in these kinds of settings, using several tools, which might consist of interviews and observations.

The quantitative method were employed based on available data such as the number of employee, the amount of revenue generated and the the number of FDI operating in the SZO. This method employs statistical measures like percentage and frequency. In light of the objectives of the study; the research design for this assessment is descriptive. According to Brockington 2003 (cited in Solomon 2011, p. 24), a descriptive research is used to obtain information concerning the status of the phenomena to describe, "What

exists" with respect to variables or conditions in a situation. It also used to answer the questions who, what, where, when and how of the research problem. Therefore, in this study descriptive method of research is a fact finding study; where data obtained from respondents were recorded, described, analysed, and interpreted by the researcher.

3.3 Data Sources and Methodes of Collection

In order to undertake this research both primary and secondary data were used. The primary data were obtained through questionnaires and interviews. Secondary data were collected through the inspection of all available documents (published and unpublished) of different sources.

In this paper, a survey method of data collection technique was adopted; where questionnaire and interview were used as the main instruments of data collection from the primary sources. The questionnaire consists of both open and closed ended questions which were prepared and distributed to selected respondents from SZO Investment office Land Administration Office, Revenue and Custom Office, Agriculture and Rural Development Office, Road Authority, Small and Micro Enterprize Office Oromia Investment Commission, Oromia Revenue and Custom Bureau. Additionally eighteen randomly selected FDI owners in operation were provided by questionnaire. Interviews were conducted face to face with purposively selected individuals from Oromia Investment Commission, Oromia Special Zone Investment office. The interview guide was structured and semi-structured type that enabled the interviewee to follow logical sequence of predetermine questions as well as probing for further information

3.4. Sample Size and Sampling Techniques

The choice of sampling techniques/design by the researcher depends on the type of research and type of conclusion that she/he would like to draw (Kothari, 1995). Therefore, the researcher employed stratified sampling followed by random sampling technique for selection of FDI samples. The samples used for analysis were selected from the total population of 53 foreign direct investments in the Special Zone of Oromia which are currently under business operation, Since there are similarities among investments in

the same sector stratified random sampling was used to select samples from each sector. First the strata was formed based on sector of FDI then the sample were selected from each stratum. In special zone of Oromia there are 101 foreign direct investments that took investment licence to invest in different sectors. Some of the foreign direct investments are under construction and others are recently licenced. From the total FDI that took the investment licence there are 53 foreign direct investments that are fully operating their business. The investments are of different types namely agriculture, manufacturing Hotel and turism, construction, trade and Real state etc. (Oromia investment commission, 2013). For the selection of sample experts purposive sampling technique was used to get a person from different sectors that can better provide information on FDI.

Based on the data obtained from Oromia Investment Commission there are 53 foreign direct investments that are currently operating their business in different sectors. For the purpose of this research eighteen foreign direct investments operating in the zone were considered to be the representative samples. The other samples for the research will be officials and experts from regional and zonal offices. Accordingly 60 experts were selected purposely with the intention of obtaining the person that can provide more information about FDI operating in the Special Zone. For the interview two individuals were selected from SZO investment Office and Oromia Investment Commission. The two Officials are the heads of the offices who were believed to be an appropriate persons to provide reliable information.

3.5 Data Presentation and Analysis

Data presentation techniques are used depending on the nature of the data. In this research paper the data were presented by using table and textually in a narrative descriptions form.

According to Kumar (2005), in order to analyse qualitative data, the researcher needs to do content analysis. This is a process that involves analyzing the contents of questionnaires and interviews so as to identify main themes. These themes must then be coded and responses be classified under the main themes by using Microsoft excel and

SPSS. The last but most important step was integrating the main themes and responses. Therefore, in this study, all data collected were integrated with the review literature in order to assess the investment effectiveness and its challenges. To simplify the data analysis, the raw data was coded and entered into computer for processing by using the statistical package for social studies (SPSS). Since, the research is descriptive and both qualitative and quantitative data analysis techniques were employed. Specifically, simple statistical analyses like percentage, frequency, tabulation were used in order to analyze the data easily.

Chaptre Four: Data Presentation, Analysis and Interpretation

4.1 Introduction

In this chapter an attempt was made to data presentation, analysis and interpretation. The information available for this purpose was collected using different techniques such as; questionnaires, interview, different secondary sources (both published and unpublished) were accessed. Following the data presentation in tabular form, discussions, analysis and interpretations were made based on the responses of experts and FDI owners/managers. The responses made by the two interviewees were also used in analysis and interpretations.

4.2. Response Rate

In this study the researcher selected 78 respondents for questionnaires out of which 60 respondents were a group of experts selected from different sectoral bureaus such as Oromia Investment Commission(8), Oromia Revenue and Custom Authority(6), and from different sectors of special Zone offices like Investment Office (10), Land administration office (6), Road Authority (4), Revenue and Custom Athourity (9),Agriculture and Rural Development office(7) and Small and Micro Enterprize Office (10). Eighteen FDI owners (managers) were also provided by questionnaires. From the total respondents of the 78 that were provided with questionnaires two from government office and three FDI owners failed to fill the questionnaires.

Regarding the interview,two officials were selected from Oromia Investment Commission and Special Zone of Oromia.Both Oromia Investment Commission head and Special Zone of Oromia investment Office head were properly responded to the interview questions. The response rate was 94% Since from the total 80 respondents five were failed to respond.

4.3 Demographic Characteristics of the Respondents

The socio demographic data presented in Table 1 below refers to experts from Oromia Investment Commission (8 respondents), Oromia Revenue and Custom Authority (6 respondents), and from different sectors of special Zone offices like Investment Office (10 respondents), Land administration office (6 respondents), Road Authority (4 respondents), Revenue and Custom Authority (9 respondents), Agriculture and Rural Development office (7 respondents) and Small and Micro Enterprise Office (10 respondents).

The socio-demographic characteristics of the respondents have distinction among the respondents. As depicted in Table 1, 90% of the respondents are males while the remaining 10% are Females. The majority of the respondents' age falls in the category of 26-30 and 31-35 years which corresponds to 47% and 36% respectively. The age category 30-40 is 7% and age of the respondents greater than 40 are only 5%.

As revealed in Table 1 the marital status of the respondents corresponds to two categories that is married and single. Those respondents with single marital status are 28% and married respondents are 72%.

As to the educational background of the respondents, 5% of the respondents are Diploma holders, 76% are Degree holders and 19% of the respondents are masters and above. The work experience of the respondents are presented in Table 1, As shown in Table 1, 53% of the respondents have 6-10 years of experience, 41% of the respondents have 11-15 years of experience and 5% of the respondents have 16 and above years of experience. The respondents are qualified and experienced and hence the information provided by them is reliable.

Table 1 : Socio-Demographic Characteristics of the Respondents

Respondents' Background	Socio-demographic Characteristic	Number of respondents	Percentage
Age	20—25 years	3	5
	26—30 years	27	46.55
	31—35 years	21	36.2
	36—40 years	4	6.8
	Above 40 years	3	5
Sex	Male	52	89.6
	Female	6	10.4
Marital Status	Single	16	27.6
	Married	42	72.4
	Divorced	-	
	Widowed	-	
	Separated	-	
Educational level	Certificate and below	-	
	Diploma	3	5
	Degree	44	75.8
	Masters and above	11	18.96
Work Experience	0-5 years	-	
	6-10 years	31	53.44
	11-15 years	24	41.37
	16 years and above	3	5

Source :Field survey(April 2014)

4.4 Status of FDI Projects in Oromia Special Zone by Sectors

As revealed in Table 2, from the total 101 foreign direct investments that took investment licence only 53 (52%) have started production while others are under constructions and still there are someFDIs that have not started even construction.This shows that there is delay in projects in starting the actual projects.According to the information obtained

from SZO Investment Office, an investor is expected to start construction within six months and actual operation in one-two years depending on the type of projects .

Based on the data obtained from Special Zone of Oromia Investment Office, from the total 101 investments that took investment licences 53 investments are agriculture while 40 are industry and 8 are service sectors. From the total 53 investments in agriculture 48 of the investments are flowericulture subsector while four of them are fruit and vegetable farms and the remaining one is production of hybrid seeds. Regarding the industry sector the most dominant subsector is the manufacturing in which the construction materials such as cement, bricks, electric materials and steels are produced. There are only two agro-processing industries in the Zone. From the two agro-processing industries a single dairy farm and milk processing is in operation while the second agro processing industry is a potato and corn chips factory which is under construction. In general from the total 40 investments in industry only 19 of them are in operation.

Based on this data it can be inferred that the performance of industry sector is low. Regardless of the emphasis of the government towards the transition to industry, the percentage of projects in operation is 35% while that of agriculture sector is 64%. Regarding the service sector the percentage of projects in operation is 63%. On average the percentage of all the projects in operation is 53%. The main reason for the low performance of all projects in general and industry sector in particular is delay in projects. It is also possible to infer that there is a weak follow up in insisting the project owners to start the projects as per the standard time set. The reluctance of project owners to start the operation and a weak follow up ultimately resulted in low effectiveness of FDI in achieving the objectives of creating more jobs and be more reliable source of revenue to enhance the development of SZO.

Table 2: Status of the FDI Projects in Oromia Special Zone by Sectors

S.N	Sector	Number of projects licenced	Status of the projects				Percentage of the projects in operation
			Operatio nal	Under constru ction	Not implime nted	Abandaned	
1	Agriculture	53	34	11	8	-	64
2	Industry	40	14	19	6	1	35
3	Service	8	5	3	-	-	62.5
	Total	101	53	33	14	1	52.5

Source: Oromia Special Zone Investment Office (2014)

As stated in some literatures, there are complaints that foreign firms merely exploit local labor and make no contribution to the economy, either through creating jobs, training workers, or creating linkages with local suppliers (Oxfam 2003b). According to the secondary data from the Special Zone of Oromia Investment Office, the actual employment opportunity is 60% .About 40% of planned employment opportunity is not realized.This shows that the contribution of FDI to employment in the Special Zone of Oromia does not meet the planned target.This evidence is supported by the responses of the majority of the respondents to the question that refers to the contribution of FDI to employment in the Special Zone in which 80% of them responded employment contribution of FDI is low. This is further supported by interview made with Oromia Special Zone and Oromia Investment Commission heads. The responses made by these two individuals regarding the contribution of FDI to employment is not effective one.The low contribution of FDI to employment emanats from both failure of starting operation and failure to employe as it was planned in the original proposal.

Table 3: Employment Opportunity of FDI in the Zone

Planned Employment opportunity	Number of employees	Actual Employment Opportunity	Percentage of actual employment
Permanant	9524	5129	53.85
Temporary	12232	7243	59.21
Total	21756	13115	60.28

Source: Oromia Special Zone Investment Office (2014)

As indicated in Table 4, the actual capital of the projects was small when compared with the proposed capital except in few years. More over the actual capital used in the project implementation did not increase constantly through the ten years period. There is rather fluctuation in actual capital used in operational projects. This indicates that FDI's do not implement the project capital as proposed. According to Oromia Investment Commission, at the very beginning of the project an investor is expected to show the bank statement that shows a minimum capital of 30% of the total capital required for full implementation of the project. There are exceptions in which an investor does not required to show the initial bank statement. The primary cause for the minimum actual capital is delaying in project implementation. The other cause could be lack of capital obtained from the Development Bank of Ethiopia.

**Table 4: Comparison of Proposed Capitals and Actual Capital of FDI in SZO
(2001-2012)**

years	Proposed capital(in Birr)	Actual capital(in Birr)	Percentage
2001	58,000000	17,839,761	31
2002	56,000000	82,804,09.5	15
2003	27,601 365	15,600,132	56.51
2004	224271323	672813400	300
2005	1,230,00000	124,369,200	101
2006	414,564,000	36,900,000	9
2007	18,500,000	5,550,000	30
2008	300,000	90,000	30
2009	2,000000	86033700	430
2010	286,779,000	600,000,000	21
2011	316,305,457	94,891,637	30
2012	151,511,433	55,453,425	37
Total	5,568,352,088	1,717,821,664	31

Source: Special Zone of Oromia Investment Office (2014)

4.5 Contribution of Foreign Direct Investment to the Development of SZO

As stated in literature the costs and benefits of FDI are the subject of intense debate, The levels of positive and negative impacts (costs and benefits) can vary between different countries depending on the host country itself, as well as the investing company, and the interaction between those two. Geographic location, GDP, per capita income, economic environment, investment climate, economic policies and technology base might be some of the influencing factors (Grosse, 1988).

In line with this theoretical literature, the researcher attempted to assess the extent of development contributed to Special Zone of Oromia by Foreign direct investments. The majority of respondents from a group of experts responded that the contribution of FDI to

the development of the Zone is low. As presented in Table 5, from the total 58 respondents 43 of them (74%) responded that contribution of FDI to development of SZO is low. While 16% and 10% of the respondents replied great and very great respectively. The Officials from regional and Special Zone Investment Offices also responded that FDI contribution to the development of the Zone is low regardless of the potential of the Zone.

They enumerated different reasons for low contributions such as capital flight back to their home, remittance to their home rather than reinvesting their corporate profits, delays in commencing the actual business operation, low employment opportunity to local people, negative impacts on environment and dislocating people from their land. Thus it can be inferred that more development opportunities would have been created by FDI if they had operated to their full capacities and as well as through expanding their business by reinvesting their profits and more importantly the investment activities should be environmentally friendly.

Table 5: FDI Contribution to Development of SZO

Extent of contribution	Number of respondents	Percentage
Very Great	6	10.34
Great	9	15.55
Low	43	74.15
Total	58	100

Source: field survey (April, 2014)

4.6 Foreign Direct Investment Preference to Factor of Production

Developing countries, emerging economies and countries in transition increasingly view FDI as a source of economic development, income growth and employment. The level of importance of FDI to a certain country may depend on the degree of progress and availability of resources in that country. Countries with limited capacities and resources view FDI as a remedy for their constraints. Nevertheless, foreign investors are more

attracted to countries with growing economies and various business opportunities because investment requires a foundation that aids in the achievement of investment goals and objectives (Streeten,1997).With the intention of achieving the investment objectives FDI prefer to use more of one factor of production than other factor.

According to the responses of the respondents, FDI in SZO prefer to use more labor than capital and technology. As depicted below in Table 6, the majority (62%) of the respondents replied that FDI in SZO prefer more labor than capital and technology ,while 19% of the respondents replied more capital than labor and technology.However there are few respondents corresponding to 12% and 7% that replied technology and labor and capital in proportion respectively.

The respondents reasoned out the availability of relatively cheap labor and business nature are the rationale to prefer more labor than capital. Those respondents whose reason is cheap labor are 76% while those who reasoned out business nature governs the choice of factor of production are 21%. Few respondents that are 3% replied that job opportunity is the rationale to prefer labor.Based on the secondary data of SZO investment office the majority of FDI in operation are flowericultures which are labor intensive than capital.It can be analyzed from the known fact that labor is cheap in Ethiopia than capital and this could be the rationale for using relatively more labor than capital. Moreover FDI owners are employing more labor than using capital intensively to gain an advantage of maximizing profits. This indicates only a relative use of more labor than capital and does not imply the employment of enough labor in SZO.

Table 6: Foreign Investors Preference and Rationales to Factors of Production

Factor of production	Number of respondents	Percentage	Rationales for preference	Number of respondents	Percentage
Labor	36	62	Cheap labor	44	76
Capital	11	19	For the sake of job opportunity	2	3.4
Technology	7	12	The nature of business	12	20.6
Capital and labor in proportion	4	7	Total	58	100
Total	58	100			

Source: field survey (April,2014)

4.7 FDI Local Employment Opportunity and Labor Availability in SZO

As can be evidenced by literature, one of the motivations to attract FDI is its potential to create employment opportunity. A study conducted in Italy by Federico and Alfredo (2007) revealed that FDI is associated with faster local employment growth. In this study the researcher attempted to find the employment opportunity to local people in SZO by foreign investments.

The result of the responses given by the respondents shows that the employment opportunity is low, although labor is available in the Zone. From the total respondents 64% perceived the actual employment opportunity of FDI in SZO to be low, while 22% and 14% perceived FDI employment opportunity to be great and very great respectively. This is also supported by the interview conducted with SZO Investment head. Moreover the data obtained from SZO Investment Office reveals that the actual employment opportunity created in the Zone is 60% when compared to the plan in their proposals. It is possible to infer from the unmet employment plan of FDI in SZO, FDI owners plan maximum employment opportunity that lacks implementation. This can be taken as one of the evidences that there is lack of effectiveness in contributing to the development of SZO in terms of employment opportunity.

Table 7: Local Employment opportunity and unskilled labor availability in SZO

Employment opportunity	Number of respondents	Percentage	Unskilled Labor availability	Number of respondents	Percentage
Very great	8	13.79	Available	55	94.82
Great	13	22.41	Less available	3	5
Low	37	63.79	Not available	-	-
Total	58	100	Total	58	100

Source: field Survey (April ,2014)

As depicted by the above Table 7, the majority of the respondents (64%) responded that the employment opportunity created to local people by FDI is low. On the other hand the majority of the respondents(95%) replied that unskilled labor is available in SZO. From the two scenarios it can be analysed that regardless of unskilled labor availability in SZO, the employment opportunity created by FDI is low that implies ineffectiveness of FDI in creating employment opportunity as it wished to be.

Regarding the availability of skilled labor in SZO and source of labor to FDI employment, 72% of the respondents replied that skilled labor is less available. While 27% of them responded that skilled labor is available in SZO. Concerning the source of labor to FDI 40% of respondents chosen the source of labor to be indeterminate (any else where). While 23% and 31% of the respondents replied SZO and Addis Ababa respectively to be sources of labor. Only 7% of the respondents replied that FDI home country is the source of labor.

To sum up taking the three all together, labor availability, actual employment opportunity and employment plan stated in proposal. Although labor specially unskilled labor is available in SZO, the FDIs in operation are not capable to employ the existing labor to meet what was in their original proposal. The failure to employ the labor emanates from the fallacy inculcated in their proposal so as to obtain the investment land and the capital they require. Investments in certain location is deemed to be a source of local employment opportunity as far as the labor is available with the intention of compensating the effect of eviction and other negative externalities. However FDI used to employ labor from every where without exhaustively considering local employment opportunity.

Table 8: Skilled labor Availability in SZO and Source of Labor to FDI

Skilled labor availability	Number of respondents	Percentage	Source of labor	Number of respondents	Percentage
Available	16	27.59	Indeterminate	23	39.65
Less available	42	72.41	Addis Ababa	18	31
Not available			SZO	13	22.41
Total	58	100	FDI home country	4	6.8

Source : Field Survey (April 2014).

4.8 The Wage and Salary Paid by FDI and its Productivity

An empirical literature by Feenstra and Hanson (1994) in Mexico revealed that there was a relative increase in wages of skilled workers. The reason they found for wage inequality was a shift in production towards skill-intensive products due to capital inflow.

Here the intention of the researcher is to find out whether the FDI operating in SZO pay higher wages and salary than domestic firms in similar industries. However the responses provided by the majority of the respondents (76%) revealed that FDI pays similar wage and salary as that of domestic firms. Few respondents (16%) and 9% replied that FDI pays higher and very high salary and wage respectively when compared with the local or domestic firms.

Regarding the productivity of FDI operating in SZO, the majority of respondents(85%) replied that the productivity of FDI is good. While 7% and 9% of the respondents replied very good and poor respectively. It can be concluded that if FDI had paid higher wages and salary it would have induced the motivation of workers for highest productivity at the same time improved the income of the employed individuals.

Table 9:Wages and salary and productivity of FDI

Wage and salary of FDI vs domestic firm	Respondents	Percentage	Productivity of FDI	Respondents	Percentage
Very high	5	8.6	Excellent	-	-
Higher	9	15.5	Very good	4	6.8
The same	44	75.86	Good	49	84.5
Low	-	-	Poor	5	8.6
Total	58	100	Total	58	100

Source: Field Survey (2014)

4.9 The Level of Revenue Generated to Local Government in SZO by FDI

According to the respondents the revenue generated by FDI in SZO is not encouraging. About 70% of the respondents confirmed that the revenue generated by FDI in SZO is below the average which corresponds to minimum as responded by 40% and very minimum as replied by 29% of the respondents. While 26% of the respondents replied that the revenue generated in SZO is average (medium). The revenue most relevant to the contribution of SZO development is the income tax collected from employees in FDI and corporate profit taxes. Nevertheless the employment opportunity is not as it was expected. This is also supported by interview with the two officials from Oromia Investment Commission and head of Oromia Special Zone Investment Office. The two officials explained that the revenue generated in the Zone is minimum.

So many justifications were forwarded by the respondents for the revenue to be minimum. For one thing, FDIs do not implement their full capacities of their project proposals. Some foreign investors are land speculators in such a way that they transfer their land to others. Moreover some foreign investors intentionally change their business to PLC (private Limited Company) to avoid paying Corporate profit taxes to regional revenue authority rather pay to federal revenue and Custom Authority. They further explained that occasionally there are foreign investors that exploit the advantages of tax holiday for some 5 years and change their business to other new PLCs. Therefore it can be concluded that the contribution of FDI to revenue generation is not a rewarding one because of low employment opportunity and failure to pay profit taxes where the profit is obtained.

Table 10: Level of Revenue Generated by FDI in SZO

Level of Revenue Generated by FDI	Number of Respondents	Percentage
Maximum	3	5
Average	14	24.13
Minimum	24	41.37
Very Minimum	17	29.31
Total	58	100

Source: Field Survey (April 2014)

4.10 Linkage and Spill over Effect of FDI

As explained in many literatures foreign direct investment is highly demanded not merely to capital inflow but also for its linkage and spillover effects that bring comprehensive development. Foreign direct investments create a backward linkage when it utilizes the necessary inputs for its production from domestic firms there by encouraging local firms capacity of supplying inputs. On the other hand, FDI can supply finished products to local firms as market chain. Moreover when there is relationship between domestic and foreign investors, there will be spillover effects and technology transfer that enhance local productivity and domestic trade.

As shown in the Table 11, the linkage between foreign direct investment and the domestic firms exists to some extent. But the majority of the respondents 62% and 67% for backward and forward linkages respectively confirmed that there is no linkage. Regarding the strength of the linkage, those respondents that confirmed the existence of linkage responded that the bond between FDI and domestic firm is weak. Therefore it can be analyzed that there is an occasionally created linkage but with weak interaction.

Table 11: Linkage and Spill over Effects of FDI

Backward linkage	Respondant	Percentage	Forward linkage	Respondents	Percentage
Yes	22	38	Yes	19	33
No	36	62	No	39	67
Total	58	100	Total	58	100
Strength of linkage	Respondents	Percentage	Strength of linkage	Respondents	Percentage
Very strong	-	-	Very strong	-	-
Strong	2	9	Strong		
Weak	16	73	Weak	12	63
Very weak	4	18	Very weak	7	37
Total	22	100	Total	19	100

Source: Field Survey (April 2014)

4.11 Technology Transfer from FDI to Local Firms and Forum for Experience Sharing

Technology transfer is one of the primary objectives of enhancing economic growth, capital accumulation, production and even changes in the organization of social relations. Literatures point out that the technology and productivity of local firms may improve as foreign firms enter the market and demonstrate new technologies, provide technical assistance to their local suppliers and customers, and train workers and managers who may be later employed by local firms.

As depicted in Table 12 there is no arrangement for experience sharing among FDI and local firms. Based on the survey result the technology transfer from FDI to local firms rarely occurs in SZO which was confirmed by 29% of the respondents. While the majority of the respondents(71%) confirmed that there is no technology transfer at all.

Table 12: Technology Transfer and Forum for Experience Sharing

Technology transfer	Respondents	Percentage	Forum for experience sharing	Respondents	Percentage
Yes	17	29.31	Yes	3	5
No	41	70.68	No	55	95
Total	58	100	Total	58	100

Source :field survey (April 2014)

4.12 Technology Transfer and Conditions on What it Depends

As informed by the majority of the respondents technology transfer between foreign investors and the domestic firms is enforceable by the agreement. Contrary to this fact technology transfer remains poor. From this it can be understood that although technology transfer is one of the criteria in FDI agreement, there is no follow up for effective implementation. Those respondents that believe the technology transfer themselves witnessed the technology transfer to be low. Since technology transfer is one of the contributions of FDI aimed at promoting local productivity , the low transfer of technology in SZO indicates that the effectiveness of FDI in development of the Zone is minimal.

Table 13: Technology Transfer and Conditions on What it Depends

Technology transfer	Respondents	Percentage	Conditions on what technology transfer depends	Number of respondent	Percentage
Poor	13	76.5	Willingnes of FDI owners	3	17.64
Good	4	23.5	Enforceable by agreement	14	82.36
Very good	-	-	Willingness of domestic investment owners		
Excellent	-	-	Total	17	100
Total	17	100			

Source :Field Survey (April, 2014)

4.13 Lack of Infrastructure as Challenges Impeding FDI Effectiveness in SZO

According to the survey result depicted in Table 14, lack of infrastructure is one of the obstacles to the effectiveness of FDI in SZO. This is also supported by the information provided by FDI owners. The majority of FDI owners confirmed that lack of infrastructure is one of the factors severely inhibiting FDI effectiveness.

Regarding the responsibility of providing the infrastructures, the respondents replied that the major responsibility remains with the federal government while the town administration and the regional government share equal responsibility. Besides these investors are also responsible to provide some of the infrastructure (Table 14).

In summary, lack of infrastructure provision is one of the major impediments to FDI effectiveness. Since each body has its own share in the provision of infrastructures, if each body does not fully recognize its own responsibility in infrastructure provision lack of infrastructure is inevitable and lack of infrastructures in turn result in low inflow of FDI and moreover it remains to be a cause to the delay of the project and ultimately hamper the effectiveness of FDI in development. Regarding the challenges of FDI, the head of SZO Investment Office has mentioned that infrastructures like power supply, access road and water supply are among the most serious challenges retarding the effectiveness of FDI implementation in the Zone.

Table 14: Lack of Infrastructure as a Challenge to the Effectiveness of FDI in SZO

lack of infrastructure as an obstacle to the effectiveness of FDI	Number of respondents	Percentage
Yes	48	82.75
No	10	17.25
Total	58	100
Responsible body for provision	Number of respondents	Percentage
Investors	9	15.51
Town administration	14	24.13
Federal Government	21	36.2
Regional government	14	24.13
Total	58	100

Source:Field survey (April 2014)

4.14 Impacts of FDI on Environment and the Measures Taken

It is stated in the literature that some developing countries may relax their environmental regulations as a means to attract FDI. Foreign Direct investors especially those with significant financial, political and negotiating power, can cause damage to the host's environment. Indeed FDI in manufacturing and chemicals might cause damage to the environment through waste, emissions and smoke from their operations.

Regarding the environmental friendliness of FDI, the majority of the respondents (71%) declared that FDI operations are not environmentally friendly, while 17% of the respondents replied that FDI businesses are partially environmentally friendly and the rest of the respondents (12%) witnessed that FDI's operate in environmentally friendly way.

The respondents enumerated some negative impacts of FDI on environment such as air pollution, water pollution (both surface and ground). This is supported by the interview conducted with officials that replied although every investor provides environmental impact assessment document at the initial stage of investment, some of the investors fail to build treatment plant to reverse the environmental impacts. From these it is possible to infer that any investment endeavour that does not care for the environment is likely to bring a challenge than a contribution to the development.

Table 15: Impacts of FDI on Environment and the Measure Taken

1. Does FDI business environmentally friendly	Number of respondents	Percentage
Yes	7	12
Partially	10	17.24
No	41	70.6
Total	58	100
2. Is there any Measure taken against negative impacts of FDI	Number of respondents	Percentage
Yes	12	20.68
No	46	79.32
Total	58	100

Source: Field survey April 2014

In order to collect foreign investors' opinions and claims regarding their investment challenges and opportunities in SZO, the researcher distributed questionnaires to 18 selected sample foreign direct investment owners operating in SZO in which 15 of them properly responded. Their responses are organized and presented as below and the researcher tried to analyse their responses.

4.15 Foreign Investors Opinions and Claims about Investment Challenges and Opportunities in SZO

❖ Reasons to Select SZO for Investment and Factors to be Considered in any Locations

According to the responses provided by FDI owners selected as sample respondents, the reason for selecting SZO as investment location is its proximity to the capital city Addis. This corresponds to 53% of the respondents. The other respondents, 27% responded cheap labor as a reason to select SZO. The fact that SZO is located at the vicinity of Addis Ababa, it creates opportunity to easily export the products to the required destinations and since Addis Ababa is the center towards which the labor migrates, labor is available for an employment in SZO. From this it can be analysed that foreign investors are very sensitive to location advantages that maximize their returns.

Regarding the factors to be considered by FDI in selecting investment location, all of the respondents (100%) chose security as the highest priority, the rest of the respondents 80%, 73% and 67% replied market accessibility, land price and labor availability respectively. From this it can be concluded that all the factors are important to attract FDI.

Table 16: Reasons to Select SZO by FDI Owners and Factors for Investment Location

Reasons to select SZO for investment	Number of respondents	Percentage	Factors to be considered to invest in any location	Number of respondents	Percentage
Proximity to A.A,	8	53.33	Security	15	100
Cheap labor	4	26.67	Labor availability	10	66.66
Infrastructure availability			Market accessibility	12	80
Weather suitability	2	13.33	Land price	11	73
Raw material availability	1	6	Total	15	100
Total	15	100			

Source:Field survey (April 2014)

❖ Foreign Investors Knowledge and Satisfaction with Ethiopia Investment Policy

According to Table 16, all the respondents replied that they have clear and adequate knowledge about investment policy of Ethiopia, however their level of satisfaction with the investment policy of the country is not uniform. As depicted by the Table 17, 27% of the respondents are highly satisfied with the current policy of Ethiopia, while 60% of the respondents confirmed that they are satisfied and 13% are partially satisfied.

Table 17: Foreign Investors Knowledge and Satisfaction with Ethiopia Investment policy

Knowledge of FDI about Ethiopia investment policy	Number of respondents	Percentage	Level of Satisfaction With investment policy	Number of respondents	Percentage
Yes	15	100	Highly satisfied	4	26.66
No			Satisfied	9	60
Total	15	100	Partially satisfied	2	13.33
			Disatisfied		
			Total	15	100

Source: Field Survey (April 2014)

❖ **Satisfaction of FDI with Incentives of SZO Investment Office and Oromia Investment Commission**

As shown in Table 18, the majority of the respondents(73%) recognize the incentives provided by regional and zonal Investment Office, while 27% of the respondents do not recognize the incentive provided. All of the respondents that recognize the incentive provision confirmed that they are satisfied by the incentive provided. Those who recognized the incentive provision explained that incentive such as ensuring secure environment, maintaining effective date of tax holidays and provision of investment land.

Table 18: Incentive to FDI and the Satisfaction with the Incentives

IS there incentives to FDI	Respondents	Percentage	Are you satisfied by the incentive	Respondents	Percentage
Yes	11	73.33	Yes	11	100
No	4	26.66	No		
Total	15	100	Total	11	100

Source :field Survey (April 2014)

❖ **Institutional Bureaucracy as Challenges of FDI**

The process of obtaining an investment licence takes not more than 4 hours if all the necessary requirements are fulfilled by an investor (EIA investment guide 2013). While the process of land provision takes not more than a month (Special Zone Investment Office, 2014). Since land is provided by lease price which will be determined through auction, the notice for lease auction stays on board for ten days.

According to the survey result, 60% of the respondents revealed that they have spent less than 5 hours to obtain an investment licence. This is almost in conformity with the standard set by EIA to provide the licence. However 27% and 13% of the respondents replied that it took them 5-8 hours and 9-12 hours respectively. This shows that 40% of the investors seeking an investment licence obtain beyond the standard time set by IEA. Since the standard time for provision of licence is 4 hours and all respondents

replied that they obtain licence in one working day, it seems insignificant. However the failure to meet the standard time indicates that there is an institutional bureaucracy that limit the effectiveness of FDI.

Regarding the time spent to obtain land for an investment after registration, 13% of the respondents spent less than 2 months, 33% took 3-5 months, the majority (40%) took 6-8 months and 13% spent above 8 months. This fact indicates there is more bureaucracy in obtaining the land than receiving the licence. The table below presents the above situation.

Table 19: Challenges Related to Institutional Bureaucracy.

Time taken to obtain investment licence	Respondents	Percentage	Time taken to obtain investment land	Respondents	Percentage
Less than 5 hours	9	60	Less than 2 months	2	13.33
5-8 hours	4	26.66	3-5 months	5	33.33
9 -12 hours	2	13.33	6-8 months	6	40
Above 12hours	-	-	Above 8 months	2	13.33
Total	15	100	Total	15	100

Source: Field survey (2014)

❖ **FDI Owners Comments on Services Rendered by SZO Investment Office**

Foreign investors require different services from different sectoral offices. However the services rendered by Zonal Investment Office is more important than the services provided by other sectors. The table 2 presents the responses of FDI owners regarding the services provided to them by SZO investment office. The majority of the sample respondents (53%) replied that the services provided by SZO Investment Office is poor, 27% and 20% of the respondents commented the services to be good and very good respectively. From this it can be deduced that the services provided by Investment Office either retard or enhance the investment meaning the faster the services provided, while other factors kept constant, the shorter the duration in which the projects start operation.

Table 20: Comments by FDI Owners on Services Rendered by SZO Investment Office.

FDI comment on service provided by SZO investment office	Number of repondants	Percentage
Excellent	-	
Very good	3	20
Good	4	26.66
Poor	8	53.3
Total	15	100

Source: Field Survey (April 2014)

❖ FDI Owners Responses to the Tax Fairness

As depicted by Table 21, all the respondents succinctly replied that the tax they are paying is fair. Moreover the respondents provided taxation as a factor inhibiting FDI effectiveness in SZO is negligible. This is in agreement with the responses offered by experts regarding the incentives available to foreign investors. The responses by experts were tax holiday, tax exemption and duty free import of goods. Here it can be inferred that taxation is not a threat, it is rather an incentive to promote foreign investors.

Table 21: FDI Owners Responses to the Tax Fairness

Is the tax you pay fair?	Number of respondents	Percentage
Yes	15	100
No	-	-
Total	15	100

Source : Field Survey (april 2014)

❖ Organizational Efficiency of FDI in Starting Actual Business

FDIs are expected to start their actual business within six months after securing the investment land. However due to organizational inefficiencies they took longer time to

start their project work. As depicted below in Table 22, only 20% of the business owners took 6 months to start their business. While 47% of the respondents confirmed that it took 6 months to one year. The rest 20% and 13% of the respondents took 1 to 1.5 year and two years and above respectively. In general, 80% of the respondents did not start the actual business within the limit set to start the business. This indicates that there are some efficiency barriers that deter FDI from starting their project works.

Table 22: Organizational Efficiency of FDI in Starting Actual Business

Time taken to start actual business	Number of respondents	Percentage
6 months	3	20
6 months-1 year	7	46.66
1-1.5 year	3	20
2 years and above	2	13.33
Total	15	100

Source: Field Survey (April 2014)

❖ FDI Owners Future Plan about their Investments

In response to the questions whether investors have intentions to shift their current business to other business or terminate their investments, all of them responded that they do not have plan either to shift or terminate their investments. From this it is possible to infer that the FDI is promising on the basis of business sustainability. However there is no any promise with the current foreign investors in transforming the current investment activities from one sector to the other sector as they want to continue with the existing business. From this it can be concluded that the transformation from Agriculture to Industry is probably done by new entry of FDI rather than by the existing FDI.

Table 23: FDI Owners Future Plan about their Investments

Do you have a plan to shift your business	Number of respondents	Percentage	Do you have a plan to terminate your business	Number of respondents	Percentage
Yes			Yes		
NO	15	100	No	15	100
Total	15	100	Total	15	100

Source: Field survey (April 2014)

❖ Factors Inhibiting the Effectiveness of FDI in SZO

It is natural to have some factors that challenge the effectiveness of foreign direct investments in any location. However the degree to which these factors affect the investment varies from place to place. There might be numerous factors that inhibit the effectiveness of FDI in SZO. The researcher listed lack of infrastructure, Lack of capital, Inaccessibility of the market, Institutional bureaucracy, Corruption, Shortage of raw materials, Lack of unskilled man power, Lack of skilled man power, Taxation, Investment policy, Law and its climate and Land rent and lease price . Hence those factors that are presented below in Table 24 are not an exhaustive list. The researcher wanted to identify some major factors and to what degree they have been challenging the investment effectiveness. The response of the sample FDI owners are presented in Table 24. And the analysis is based on the responses of FDI owners to these factors.

Table 24: Factors Inhibiting the Effectiveness of FDI in SZO

Factors inhibiting the effectiveness of FDI	Degree of severity									
	High		Medium		Low		Negligible			
	Frequency	%	Frequency	%	Frequency	%	Frequency	%	Total	%
Lack of infrastructure	11	73.33	3	20	1	6.6	-		15	100
Lack of capital	6	40	7	46.66	2	13.33			15	100
Inaccessibility of the market	2	13.33	2	13.33	5	33.33	6	40	15	100
Institutional bureaucracy	9	60	4	26.66	2	13.33	-		15	100
Corruption	5	33.33	4	26.66	5	33.33	1	6.6	15	100
Shortage of raw materials					4	26.6	11	73.33	15	100
Lack of Skilled man power	3	20	7	46.66	5	33.33			15	100
Lack of unskilled man power					2	13.33	13	86.66	15	100
Taxation					1	6.6	14	93.33	15	100
Investment policy, law and its climate					3	20	12	80	15	100
Land rent and lease price			6	40	9	60			15	100

Source: field survey April 2014

❖ Lack of Infrastructures

Infrastructures such as electric power supply, water supply, access roads, telecommunication and internet services are some of the basic facilities required by FDI. In line with this fact, the researcher attempted to assess whether the lack of these infrastructures is critical to the operation of FDI or negligible.

The majority of the respondents (73 percent) replied that lack of infrastructures in SZO is highly critical in affecting FDI. Few respondents (20 percent) responded that lack of infrastructures is of a medium severity in affecting the effectiveness of FDI in SZO. From

this it is possible to infer that lack of infrastructures is one of the challenges that affect the performance of FDI in SZO.

❖ **Lack of Capital**

Capital availability is one of the driving forces for all investments in particular for foreign investments as they relatively demand more capital than domestic investments. Both the availability and the process of acquiring capital are the decisive factors in effecting the investments as per their schedule. As depicted by Table 24, some of the respondents (40%) replied that the severity of lack of capital is high, while the majority (47%) of the respondents confirmed that there is a medium severity of lack of capital and only 13% of the respondents stated the problem of capital scarcity is low. According to the responses of FDI owners, it is possible to conclude that there is lack of capital with a varying degree of severity ranging from high to low. However one of the purposes of attracting FDIs is the capital they bring to the host country. The capital includes the machineries used in the production and from this aspect sometimes the process of importing capital goods creates lack of capital.

❖ **Inaccessibility of the Market**

Market accessibility governs the destination of finished and semi-finished products of FDI. Hence it is by far the vital factor that determine the profitability and viability of the investment as well as the motivation of the investors. The researcher tried to assess whether the market inaccessibility is a severe problem to foreign investors in SZO. As shown in the Table 24, very few respondents (13%) replied market inaccessibility problem is highly severe, while the same proportion of the respondents (13%) replied market inaccessibility problem to be medium. However the majority (40%) responded that market inaccessibility problem to FDI is negligible and 33% of the respondent notified that market inaccessibility problem is low. The overall result shows market inaccessibility is not a severe problem that retard the effectiveness of FDI in SZO.

❖ **Institutional Bureaucracy**

The fact that FDI has many contact institutions to start the investment, may lengthen the duration of time to begin the actual business operation unless these institutions are efficient and effective in handling the issues of FDI. Contrary to the fact that less bureaucratic institutions are demanded by FDI owners, institutional bureaucracy is highly severe which was confirmed by the majority (60%) of the respondents. Similarly about a quarter of the respondents (27%) replied that there is institutional bureaucracy but with medium severity. Still there are few respondents (13%) who did not deny the existence of institutional bureaucracy but they confirmed its severity to be low. From this it can be inferred that there is institutional bureaucracy that challenges the effectiveness of FDI in SZO.

❖ **Corruption**

Corruption ranges from petty to grand corruption and usually takes place in a very hidden manner. It spoils good governance and diverts the resources from its planned use to personal benefits. Moreover from the virtue of business activities it affects free competition by favouring some and discouraging others. The researcher here wanted to know how severe is the problem of corruption in SZO. According to the response of FDI owners 33% of the respondents replied the degree of corruption severity is high while the same percent of the respondent replied the corruption severity to be low. The other 27% of the respondents recognized corruption severity to be medium while only 7% of the respondents replied corruption to be negligible in SZO related to FDI. It can be analysed from the reply of the respondents that the same proportion of the respondents put corruption severity in the two extremes that is high and low. From this it can be inferred that corruption is not easily understood by the respondents or otherwise people are reserved to reveal the problem of corruption severity. Regardless of the similarity of responses in the two extremes of severity, the result shows there is corruption that might impede the investment effectiveness in SZO.

❖ **Shortage of Raw Materials**

Availability of raw materials is one of the location advantages considered by investors. In line with this intention the researcher aimed to assess if shortage of raw materials to be taken as hinderance to FDI in SZO. Regarding the problem of raw materials, the majority of the respondents (73%) considered the problem of raw materials to be neglegible and some respondents replied shortage of raw materials is of low severity. Hence it can be concluded that raw materials availability in SZO is not taken as hindering factors.

❖ **Lack of Skilled Manpower**

Lack of skilled manpower is one of the critical factors that constrain the investment activities particularly in developing economies. In Ethiopia there is an availability of cheap labour however the question lies whether the available labor fits the business requirement interms of skill and know how. The intention of the researcher is to find out if the FDI operating in SZO encountered the problem of getting skilled manpower. From the total sample respondents 20% replied that skilled manpower is highly challenging. While the rest of respondents with 47% and 33% responded medium and low respectively to explain the problem of skilled manpower in terms of severity. From this response it can be analysed that FDI in SZO face the problem of skilled manpower that fits the context of their industries.

❖ **Lack of Unskilled Manpower**

Unskilled manpower is also the basic requirement of investments especially for labor intensive activities. As confirmed by the secondary data obtained from SZO investment office most FDI's are operating mainly in flowericulture subsectors where unskilled labor is highly demanded. The objective in here is to investigate if there is lack of unskilled manpower that might affect the effectiveness of FDI in SZO. As revealed in the above Table 24, the majority of the respondents (87%) replied that lack of unskilled manpower is neglegible and few respondents (13%) replied that there is low severity of unskilled manpower. Hence lack of unskilled manpower is not a challenge in SZO.

❖ **Taxation**

Taxation is one of the instruments of collecting revenue to support government expenditures. If there is no proper tax administration, it discourages business activities. The government of Ethiopia identified areas of investment eligible for exemption of customs duty and exemption of income tax to encourage the flow and operation of FDI. The response of FDI owners indicates that taxation is negligible as one of the factors that discourage FDI. This is supported by 93% of the respondents. From this it can be concluded that the government effort of relaxing tax to be paid by FDI is well recognized by FDI owners as incentive.

❖ **Investment Policy, Law and Climate**

The Government of Ethiopia in recognition of the role of private sectors in the economy has revised over four times the investment code in the last twenty one years. It revised the previously restricted sectors to be open for foreign investors. Investment areas open for foreign investors include Manufacturing, agriculture, Information Communication Technology, Generation, transmission and supply of electrical energy, Hotel and Tourism, Construction Contracting, Real State Development, Education and training, Health services, architect and Engineering works, publishing, import trade, Export trade and whole sale trade. The Investment climate in its wide context include taxation and the different incentives (Ethiopian Investment Agency, 2013). The aim of this section is to assess how FDI owners feel towards investment policy, Law and investment climate.

The majority of the respondents (80%) replied that there is no problem related to investment climate, policy and law. Few respondents (20%) responded that investment policy, law and climate are of low severity. From this it can be inferred that FDI in SZO does not constrained by investment policy, law and investment climate.

❖ **Land Rent and land Lease Price**

In Ethiopia, land is public property. Individuals, Companies and other Organization have only use right of land. The use right for investment purpose is acquired through rent and lease. The rural land is acquired through rent while urban land is acquired through

leasing. The lease and rental prices of urban and rural land vary according to location, type of investment and class of land.

The researcher want to know how the land rent and land lease prices are challenging FDI owners in SZO. From the total respondents 40% and 60% of the respondents replied medium and low severity of land rent and land lease respectively. According to Ethiopian Investment Agency investment guide, although the lease and rental prices of urban and rural land vary according to location, type of investment and class of land Urban land for investment activities is available on an auction basis. Industrial land in industrial zones is allocated to investors at fixed prices. Land for export-oriented industries is generally available at concessionary rate. The rental price of rural land is generally low. Therefore these rentals and lease prices are in conformity with FDI owners responses of medium and low severity of land lease and land rent prices.

❖ **Summary of the Chapter**

It is imperative to criticize the effectiveness of FDI depending on its contribution to employment opportunity, revenue generation, technology transfer and its harmony with the environment. Because of its enormous potential to create jobs, raise productivity, enhance the transfer of technology, foreign direct investment is a vital factor in the long-term economic development of the developing countries. Despite the benefits that can be derived from FDI, it should be noted that it can also bring about some negative impact. Based on these parameters and responses of the sample respondents the effectiveness of FDI in SZO is constrained by both FDI organizational and external factors that impeded its contribution to the development of the area. The low contributions of FDI to the development of SZO emanates from delay in operation and failure in meeting the planned full capacity productions which are mainly the result of inter organizational inefficiencies.

Based on the survey results, the most pronounced challenges affecting FDI effectiveness in SZO are lack of infrastructures, institutional bureaucracy, corruption, lack of skilled manpower and weak linkage of FDI and local firms. These challenges are persistently affecting the effectiveness of FDI in Special Zone of Oromia. The most source of

complaint regarding infrastructures are power supply and interruption, water supply and access road. With institutional bureaucracy the service deliveries of most organizations that facilitate the investment are poor. Since FDI requires services from Federal level organizations, Regional organizations, Zonal organizations and district or city administrations where the investments are implemented, the bureaucracy is too long and hence the complaint in this respect is genuine.

Regardless of these challenges, FDI in Ethiopia in general and in SZO in particular is increasing from year to year. The future of investment specially with potential foreign direct investment is promising for a number of reasons. Some of these reasons are the country's progress in power supply, transport sector development specially the railway construction and the widening global destination of Ethiopian Airlines which facilitate the fast delivery of imported goods for investments and the fast export of products to the market. Safe and secure working and living environments identified by the U.N. and the International Chamber of Commerce (ICC) as key assets for investors in Ethiopia

The large and fast growing domestic market offers good prospects for investment and the development of consumer goods industries such as food, beverages, tobacco, plastic products, soap and detergents, drugs and pharmaceuticals, paper and paper products and electrical and electronic products.

Ethiopia has an increasing opportunity of global market access for the destination of export products. It is located in the Horn of Africa at the crossroads between Africa, the Middle East and Asia, within easy reach of the major ports of the Horn. It's Membership of the Common Market for Eastern and Southern Africa (COMESA) embracing 23 countries with a population more than 300 million. Ethiopia also enjoys the benefits of preferential tariff rates on exports to these countries. Ethiopia is an ACP member (African, Caribbean and Pacific Group) and accession to the WTO is under negotiation.

Duty and quota free access into the U.S. (AGOA) and EU (EBA) markets. Export products from Ethiopia to the EU market are entitled to duty reductions or exemptions and are free from all quota restrictions under the terms of the Lome Convention. The trade preference accorded Ethiopia includes duty free entry of all industrial manufactured

products. Under the generalized system of preferences (GSP), a wide range of Ethiopia's manufactured products are entitled to preferential duty treatment in the United States, Canada, Japan and most EU countries.

Remittance out of Ethiopia from invested capital (dividends and interest) is permitted. Remittance also permitted for principal and interest payment on external loans, payments associated with technology transfer, proceeds from sales or liquidation of an enterprise, salaries and other payments. Government guarantees (Investment Code 1991) and constitutional protection from expropriation. Ethiopia is a signatory to the main international investment related institutions, for example, it is a Member of the Multilateral Investment Guarantee Agency (MIGA). Ethiopia is also a signatory of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States.

Significant Tax Incentives related to Customs Import Duty - 100% exemption on all import of investment capital goods (plant machinery, construction materials, etc.) including spare parts worth up to 15% of the imported investment capital goods; plus exemption for import of raw materials needed for the production of export goods. Export Customs Duty - Products and services developed in Ethiopia are exempted from export tax.

All these progresses in infrastructures and internal market opportunities and global market access offer the bright future of investment in general and the foreign direct investment in particular in Ethiopia and SZO too.

Chapter Five: Conclusions and Recommendations

5.1 Conclusions

The very essence of the study was to assess the effectiveness of FDI in the development of the Special Zone of Oromia and its Challenges and prospects. To put in another word, the study was aimed at finding out the contributions of FDI to local employment opportunity, revenue generation to local authority, technology transfer and linkage with domestic investments. The study was also intended to assess the negative impacts of FDI on the surrounding environment where the investments are taking place.

Special Zone of Oromia is found surrounding Addis Ababa. It was established as one of the zones in Oromia Regional State in 2007. It has unique characteristics than the rest of other zones in the region. It is more of urban nature accommodating different ethnic groups. The zone has a geographic area of 800 square kilometers and a population of 603,235. The main economic activity of the zone is agriculture by 75% of the population. Despite the fact that the zone is a newly established zone, its urban growth is one of the fastest in the region.

The researcher used the mixed methods of research where both qualitative and quantitative methods are effectively employed to meet the research objectives. The researcher selected the samples from a group of experts working in different offices and bureaus that have stakes in investment. The method of selection is purposive sampling in which experts with better knowledge and information about investment were selected from respective organizations whose work is related to investment in one way or other. There were 60 sample respondents out of which 58 were those that correctly responded to the questionnaires. The other samples used in this research were the 18 FDI owners that were randomly selected from the total 53 FDI currently operating in the SZO. However the sample FDI owners that were used in the analysis were 15. In addition to the above two groups of samples, two officials from SZO Investment Office and Oromia Investment Commission were selected for the interviews.

According to the data from SZO investment office there are 101 foreign direct investment projects that obtained investment licences, however there are only 53 projects that have started operations. There is delay in projects pertaining to organizational inefficiencies of project owners and other factors external to the organizations. The delay in projects in turn affects the effectiveness of FDI in contributing to the development of the SZO. There is also a drawback with FDI in operations regarding the local employment opportunity. For one thing FDI's are not capable of employing labor as per their project proposals and for another they don't consider the local employment opportunity.

According to the data obtained from SZO Investment Office, foreign investors are investing in all the three economic sectors namely Agriculture, Industry and Services. Regardless of the SZO potential to investment, the actual investment activities are not as expected. The very reason for low investment performance of the zone is that many investors did not enter the operation stage after taking the investment licence. This research tried to assess the low performance and low contribution of FDI in SZO and the challenges underlying it.

Based on the survey result, the contributions of FDI to the development of SZO is low regardless of the potential of the Zone. The low contributions to development are manifested by low local employment opportunity, low revenue generation, weak linkage of FDI and domestic firms in terms of technology transfer, skill development and other positive spillover effects. The level of revenue generated by FDI to local administrations is low because of low employment opportunity as the main source to local revenue is an employment income tax. The other source of revenue is profit tax which can be collected after tax holidays in which FDI's are opting to pay to either the federal or regional revenue and custom authority. One of the problems regarding the profit tax as explained by SZO investment office head and Oromia investment Commission head is that there are some FDI's that change their business licences to PLC so that they can pay the tax to the federal Revenue and Custom Authority instead of paying to the region.

The other negative impacts of FDI is its effect on the environment. As revealed by the responses of the respondents there are some FDI projects that release their wastes that

pollute air and water that create nuisance in the environment. According to the respondents, there is little measure taken against the harmful effects of waste release to the environment regardless of FDI obligations to protect the environment.

According to the responses of FDI owners, SZO is a preferred location to investment due to its proximity to Addis Ababa, weather suitability and abundance of labor with reasonable wages. However there are challenges mentioned by FDI owners that deter the effectiveness of FDI. These are lack of infrastructures, institutional bureaucracy, corruption, market inaccessibility, lack of skilled labor and land rent and lease price. The owners of FDI put these factors as challenges with a varying degree of severity from high to negligible.

5.2 Recommendations

- ❖ There should be enforcements by investment office and investment commission including cancellation of investment licences against those FDIs which donot start and implement the business as per the scheduled time and proposals.
- ❖ There should be training and development programs to produce skilled manpower that fulfill the demand of FDIs and the employment opportunity should exhaustively focus the local.
- ❖ There should be institutional reforms that reduce institutional bueareaucracy and results in effective collaboration between institutions that facilitate foreign direct investment. The Government should arrange a one shope services to investors.
- ❖ Corruption, land speculation and other forms of rent seeking have to be tackled with strict follow up and legal measures.
- ❖ Provision of basic infrastructures by government and other stakeholders has to be done with great emphasis.
- ❖ Technology transfer and other positive spillover effects to be achieved through linkage should be done with great concern.
- ❖ Foreign direct investment implimentations should result in save environment by the establishment of industry zone and treatment plants.The Government should conduct regular environmental auditing and urge FDI owners to environmental mainstreaming in their project activities.
- ❖ Performance related pay should be implemented to improve the wage and salary as well as the productivity of the employees.
- ❖ The government has to work more and more to attract FDIs with better potential to implement in industry sectors to ensure the transformation of the country at the same time the Special Zone of Oromia.

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Annex 2 investment Modalities and their Participation in pre and post reform periods in Ethiopia

Modalities	Pre –reform(1991-2000)		Post-reform(2001-2011)	
	Projects (%)	Capital (%)	Projects (%)	Capital (%)
Domestic	96.5	66.9	88.9	39.7
FDI	2.8	14.2	11.0	29.4
Government	0.7	18.9	0.2	36.9

Source: Ethiopian Investment Agency(2013)

Annex 3 Investment in operation by Modalities

Modalities	Pre –reform(1991-2000)		Post-reform(2001-2011)	
	Projects (%)	Capital (%)	Projects (%)	Capital (%)
Domestic	94.7	53.3	65.7	11.0
FDI	4.4	19.8	33.8	43.0
Government	0.8	27	0.4	46.0

Source Ethiopian Investment Agency (2013)

Annex 4 Pre –Reform (1991-2000) project implementation (in %)

Modalities	Licenced projects		operational		Implementation(%)	
	projects	Capital in million Birr	projects	Capital in million Birr	project	capital
Domestic	5440	39179	3050	20656	56.1	52.7
FDI	160	8399	143	7654	89.4	91.1
Government	37	11064	27	10435	73.0	94.3
Total	5637	58642	3220	38745	57.1	66.1

Source:Ethiopian Investment Agency

Annex 4 Post –Reform (2001-2011) project implementation (in %)

Modalities	Licenced projects		operational		Implementation(%)	
	projects	Capital in million Birr	projects	Capital in million Birr	Project	Capital
Domestic	46416	421297	4147	37610	9	9
FDI	5677	355253	2136	146373	38	41
Government	97	291743	28	153312	29	53
Total	52190	1068292	6311	337297	12	32

Source: Ethiopian Investment A

Appedix 1

Questionnaires to be Respondede by Experts

**ADDIS ABABA UNIVERSITY SCHOOL OF GRADUATE STUDIES FACULTY
OF BUSINESS AND ECONOMICS
DEPARTMENT OF PUBLIC ADMINISTRATION AND
DEVELOPMENTMANAGEMENT**

Dear respondents,

The objective of the questionnaires is to gather information or data on Foreign direct investment effectiveness in development, its challenges and prospects in Oromia special Zone. The study is required for the partial fulfilment of master's degree in Public Administration and Development Management. Dear respondents, you are expected to provide genuine, and reliable information with respect to foreign direct investment contributions to the development of Oromia special Zone and the challenges in the course of FDI implimentation . Your genuine information is highly desicive to the success of this study. Therefore, the researcher assures you that the information and the data you will provide is very confidential and only serves for academic purpose.

Thank you in advance for your cooperation.

PART I: General Information

Instructions: Please circle on the relevant alternatives of your respective answers and write your answer on the space provided.

1. Age: A. 20-25 B.26-30 C.31-35 D.36-40 E.above 40
2. Sex: A. Male B. Female
3. Marital status:
A. Single B. Married C. Divorced D. Widowed E. separated
4. Educational Background:
A. cirtificate B. Diploma C. Degree D. Masters Degree E. PhD

5. Work Experience:

- A) 0-5 years C) 11-15
- B) 6-10 years D) above 16 years

Part 2. Contributions of Foreign Direct Investment in the Development of the Special Zone

1. To what extent do you think the investment undertaken by foreigners contribute to the development of Oromia Special Zone?

- A) very great B) Great C) Low

2. If your answer for question number 1 is low, what could be the reasons for low contribution?

3. Do foreign investors provide some social infrastructures to the community?

- A) yes B) No

4. If your answer for question number 3 is yes, what are those infrastructures?

5. What foreign investors prefer to use in the production process intensively?

- A) labor B) capital C) technology D) both capital and labor proportionately

6. If your answer for question number 5 is labor intensive, what are the reasons?

- A) Availability of cheap labor B) for job opportunity C) Due to the business nature

7. How do you explain the employment opportunity created by FDI to local people in the Special Zone?

- A) very great
- B) Great
- C) D) low

8. How do you rate the availability of skilled labor in Oromia Special Zone?

- A) Available
- B) Not available
- C) less available .

9. How do you rate the availability of unskilled labor in Oromia Special Zone?

- A) Available
- B) Not available
- C) less available .

10. Where are the sources of labor for FDI employment?

- A) FDI home country
- B) Oromia Special zone
- C) Addis Ababa
- D) Any else where

11. How do you compare the wage and salary paid by foreign direct investors with that of domestic investors to their employees?

- A) Very high
- B) relatively higher
- C) the same as that of domestic investors
- D) lower

12. What is your opinion about the revenue generated by FDI operating in the Zone?

- A) Maximum
- B) Average
- C) Minimum
- D) Very minimum

13. If the revenue generated by FDI in the Zone is minimum, what do you think the reasons for minimum revenue generation?

14. How do you Judge the productivity of FDI ?

- A) Excellent
- B) Very good
- C) Good
- D) Poor

15. If the productivity of FDI is poor, what do you think the reasons?

Part 3. Linkage and spillover effects of FDI (foreign direct investment)

1. Is there a backward linkage where *FDIs use inputs from domestic investors* ?

- A) yes B) No

2. Is there forward linkage where FDIs supply finished or semi-finished products to local firms/distributors) created due to the operation of FDI?

- A) yes B) No

3. If there is any linkage between FDI and Domestic investment, to what degree they are linked?

- A) very strong B) strong C) Weak D) very weak

4. Is there any arrangement or forum for experience sharing among FDI and domestic investment?

- A) yes B) No

5. Does technology transfer from FDI to domestic investment take place to improve the productivity of local firms?

- A) yes B) No

6. If your answer to question number 5 is yes, How could you rate the technology transfer?

- A) Excellent B) Very good C) Good D) Poor

7. If technology transfer from FDI to domestic investment exists on what it depends?

- A) willingness of FDI owners B) enforceable by investment agreement C) willingness of domestic investment owners

Part 4.Challenges Hindering the Effectiveness of FDI

1.Does the lack of infrastructure provision can be considered as an obstacle to the effectiveness of FDI in Oromia Special Zone?

- A) yes
- B) No

2.If your answer to question 1 is yes, who is responsible for the provision?

- A) the investor
- B) the town administrator
- C) the federal government
- D) the regional government

4.Do foreign investors carry out their business in environmentally friendly ways?

- A) Yes
- B) Partially
- C) No

5. If your answer to question 4 is No, please specify the impacts of FDI activities on the environment

6.Is there any measure to be taken against any negative impacts of FDI on environment ?

- A) Yes
- B) No

7. If your answer to question number 6 is yes,List the measures (if any)

Part 5: Trends ,opportunities and prospects of FDI in the zone

1.What is the current trends of FDI flowing to Oromia Special zone?

- A) Increasing
- B) Decreasing
- C)Remain constant

2.Which sectors are dominantetly chosen by FDI?

- A) Agriculture
- B) Manufacturing
- C) Service sectors

3.What are the incentives available to foreign investors?

4. What are the potential problems and probable challenges to sustain FDI in your town.
Please list out them

5. Are there foreign direct investors in the Zone that terminate their business?
A) yes B) No

6) If your answer to question number 5 is yes what were the reasons?

I. Extra information

a. If you have more information and opinion regarding the effectiveness of FDI in development, its challenges and prospects in the special zone of Oromia, please avoid reservation in forwarding as your information is highly valuable to this study.

Appendix -2

Questionnaire to be responded by FDI Owners (managers).

ADDIS ABABA UNIVERSITY SCHOOL OF GRADUATE STUDIES.

FACULTY OF BUSINESS AND ECONOMICS.

DEPARTMENT OF PUBLIC ADMINISTRATION AND DEVELOPMENT
MANAGEMENT

Dear respondents,

The objective of these questionnaire is to gather information or data on Foreign direct investment effectiveness in development, its challenges and prospects in the special zone of Oromia. The study is required for the partial fulfilment of master's degree in Public Administration and Development Management. Dear respondents, you are expected to provide genuine, and reliable information with respect to foreign direct investment contributions to the development of Oromia special Zone and the challenges in the course of FDI implementation. Your genuine information is highly decisive to the success of this study. Therefore, the researcher assures you that the information and the data you will provide is very confidential and only serves for academic purpose.

Thank you in advance for your cooperation

Part 1. General Information

A. Name of FDI _____

B. Nationality _____

C. Year of establishment _____

D. Name of the town _____

E. Respondant occupation _____

F. Work experience _____

Part 2.Foreign Direct Investment Effectiveness and Contributions to Development

1. Why do you select Oromia Special zone (specific town) as the location of your investment than other areas?

- A. proximity to Addis Ababa
- B. Cheap labor
- C. infrastructure availabilty
- D. weather Suitabilty
- E. raw materials availabilty

2. what are the factors that you consider before you invest in certain location?

- A.Security
- B. labor availabilty
- C. Market acessibilty
- D.land price

3. Did you efficiently get your work permit during the initial period of your investment?

4. Do you have clear and adequate knowledge about the investment policy of Ethiopia?

- A.yes
- B.No

5.If your answer to question 4 is yes indicate the source of the information?

6. What is the level of your satisfaction with the investment policy?

- A.highly satisfied
- B.satisfied
- C.partially satisfied
- D.disatisfied

7. If you partially satisfied or disatisfied,please donot hesitate the source of your disatisfaction

8. Are there incentives which you are provided with from Oromia investment commission and Oromia Special zone office?

- A.Yes
- B. No

9.If your answer to question 8 is yes what are the incentives?

10. Are you satisfied by the incentives?

- A. Yes B.No

11. If your answer to question 10 is no,please specify what have to be improved with incentives?

Part 3.Challenges encountered by FDI

12. How long it takes you to get your investment licence?

- A. Less than 5 hours B. 5-8 hours C. 9 -12 hours D.Above 12 months

13 . How long it takes you to get land for investment?

- A.less than2 months B.3---5 months C.6__8 months D.above 8 months

14. how do you rate the service rendered by the special zone investment office?

- A. excellent B. Very good C.good D. poor

15. Do you think that the tax you are paying is fair?

- A.Yes B.No

16. If your answer to question 16 is no. Please explain why it is unfair

17.How long did it takes you to begin the actual business after you get your investment licence?

- A.6 months B.6months-1 year C.1year__1.5years D.2 years and above

18. Do you find the general investment climate of the zone conducive?

19. What investment opportunities do you observe other than the one you currently invested in? Please list them in order of your priority

20. Do you have a plan to shift your business to other investment?

A. yes B. No

21. If your answer to question 10 is yes, explain your reason?

22. Do you have a plan to terminate your investment?

A. Yes B. No

23. If your answer to question 12 is yes, please explain your reason to terminate

24. please put the (x)mark for the factors you believe inhibiting FDI effectiveness

	Factors inhibiting the effectiveness of FDI	Degree of severity			
		High	Medium	low	Negligible
1	Lack of infrastructure				
2	Lack of capital				
3	Inaccessbilty of the market				
4	Institutional bureaucracy				
5	Corruption				
6	Shortage of raw materials				
7	Lack Skilled man power				
8	Lack of unskilled man power				
9	Taxation				
10	Investment policy, law and its climate				
11	Land acquisition, , lease price and other land related problems				

5.Human resource information of your organisation

Employement condition	Plan	Actual
Permanant		
Casual		
Total		

Appendix- 3

Interview questions to Oromia Special Zone Investment Office
ADDIS ABABA UNIVERSITY SCHOOL OF GRADUATE STUDIES
FACULTY OF BUSINESS AND ECONOMICS
DEPARTMENT OF PUBLIC ADMINISTRATION AND
DEVELOPMENTMANAGEMENT

Dear respondents,

The objective of this interview is to gather information on Foreign direct investment effectiveness in development, its challenges and prospects in Oromia special zone. The study is required for the partial fulfilment of master's degree in Public Administration and Development Management. Dear respondents, you are expected to provide genuine, and reliable information with respect to foreign direct investment contributions to the development Oromia Special Zone and the challenges in the course of FDI implementation. Your genuine information is highly decisive to the success of this study. Therefore, the researcher assures you that the information you provide is very confidential and only serves for academic purpose.

Thank you in advance for your cooperation.

1. How could you describe the major contributions of FDI to poverty reduction in your Zone?
2. Do foreign direct investors reinvest their corporate revenue or remit their capital back to their home country?
3. How do you describe the role of FDI in promoting local employment and generation of fiscal revenue?
4. Could you explain the effect of FDI on local productivity and capacity improvement through backward and forward linkages with local firms?
5. How do you recognize the effectiveness of FDI in technology transfer and skill development of local firms through spillover effect?
6. How your organization is closely monitor and work with owners/managers of FDI to facilitate the work?

7. What are the incentives provided by your organization exclusively to foreign investors to promote their in flow?
8. What is the trend of FDI in flow currently looks like in the Special zone?
9. Are there foreign investors that delay longer time in starting actual business after taking land for investment?
10. What are the negative impacts of FDI activities on the surrounding environment?
11. What are the challenges facing the FDIs that deter their normal activities?
12. What is your comment on the overall FDI effectiveness and challenges in the Zone?

Appendix- 4

Interview questions to Oromia Investment Commission
ADDIS ABABA UNIVERSITY SCHOOL OF GRADUATE STUDIES
FACULTY OF BUSINESS AND ECONOMICS
DEPARTMENT OF PUBLIC ADMINISTRATION AND
DEVELOPMENTMANAGEMENT

Dear respondents,

The objective of this interview is to gather information on Foreign direct investment effectiveness in development, its challenges and prospects in Oromia special zone. The study is required for the partial fulfilment of master's degree in Public Administration and Development Management. Dear respondents, you are expected to provide genuine, and reliable information with respect to foreign direct investment contributions to the development Oromia Special Zone and the challenges in the course of FDI implementation. Your genuine information is highly decisive to the success of this study. Therefore, the researcher assures you that the information you provide is very confidential and only serves for academic purpose.

Thank you in advance for your cooperation.

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5. How do you recognize the effectiveness of FDI in technology transfer and skill development of local firms through spillover effect?
6. How your organization is closely monitor and work with owners/managers of FDI to facilitate the work?
7. What are the incentives provided by your organization exclusively to foreign investors to promote their in flow?

8. What is the trend of FDI in flow currently looks like in the Special zone?
9. Are there foreign investors that delay longer time in starting actual business after taking land for investment?
10. What are the negative impacts of FDI activities on the surrounding environment?
11. What are the challenges facing the FDIs that deter their normal activities?
12. What is your comment on the overall FDI effectiveness and challenges in the Zone?

Declaration

I, Shiferaw Negash, declare that this project paper is my original work and has not been presented for a degree in any other University, and that all source of materials used for the Study have been duly acknowledged.

Declared by:

Name: Shiferaw Negash

Signature: _____

Date: _____

Confirmed by Advisor:

Name: _____

Signature: _____

Date: _____

Place and date of submission: _____