



Netherlands Embassy
Addis Ababa, Ethiopia



Leiden
The Netherlands



Universiteit
Leiden

Leiden – The Hague
The Netherlands

StRA Briefing Paper no. 3

The Impact of Foreign Direct Investment (FDI) on Industrial Development in Oromia Region: the Case of the Manufacturing Sector

Teshome Adugna, PhD¹

¹ Affiliation: Oromia Investment and Industry Bureau, Addis Ababa

* Correspondence: a.teshom@gmail.com

Abstract:

Foreign Direct Investment (FDI) is one of the most important sources of manufacturing development and hence economic growth and export earnings. The major objective of this study was to analyze the trends and structure of Foreign Direct Investment in Oromia Regional State, Ethiopia. The study used secondary data collected from different sources, such as the Oromia Investment Commission, the National Bank of Ethiopia, the Central Statistical Agency and the Oromia Planning and Economic Development Commission. It covers the period between 2002 and 2021. The simple descriptive method of data analysis was used to analyze the data. The study revealed that the volume of FDI in the region were on the decrease in the last five years. More than 60 percent of FDI was concentrated in the manufacturing sector during the entire study period. Most of the FDI concentrated in one zone, the Oromia Special Zone around Addis Ababa. There are various challenges that affect the trends and structure of FDI in the region: the overall decline, the low or unstable sectoral growth rate of FDI, ‘low ownership’ of the regional state in FDI operations, lack of clear regulatory frameworks, weak regional institutional capacity, poor labor forces, and absence of clear FDI policy and strategies. Giving policy priority to the development of FDI by addressing the above challenges would be necessary to realize the desired regional manufacturing development through FDI.

Keywords: foreign direct investment, industrial sector, manufacturing, economic growth, Oromia, Ethiopia

Citation: Teshome Adugna. 2022.
‘The Impact of FDI on Industrial Development in Oromia: the Case of the Manufacturing Sector’. Leiden-Addis Ababa: ASCL-RNA.

Academic Editor:
Prof. Jon Abbink, ASCL
(g.j.abbink@asc.leidenuniv.nl)

Published: May 2022

Publisher’s Note: ASCL and the NL Embassy stays neutral with regard to jurisdictional claims in published maps, institutional affiliations, etc.



Copyright: © 2022 by the authors. Submitted for possible open access publication under the terms and conditions of the Creative Commons Attribution (CC BY) license (<https://creativecommons.org/licenses/by/4.0/>).

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29
30
31
32
33
34
35
36

1. Introduction

Foreign Direct Investment (FDI) - investment made by a company outside its home country - is one of the most important sources of manufacturing development in developing country, including Ethiopia. FDI is the flow of long-term capital towards in international production based on long-term profit considerations. Many developed and developing countries are achieving fast industrial development and transformation through higher FDI via development of the manufacturing sectors. In this form, economic (GDP) growth and export earnings can be significantly accelerated. The overall objective of the study was to understand the impact of foreign direct investment on the manufacturing sector in Oromia Region, focusing on: identifying the trends and distribution of FDI in the Region, analyze its impact on manufacturing sector development and output, identify the major challenges of FDI in the further development of the manufacturing sector, and to generate policy recommendations to enhance the attraction and role of FDI in the manufacturing sector in the region.

2. Methods

The study used both primary and secondary data collected from different sources, such as the Oromia Investment Commission, the National Bank of Ethiopia, the Central Statistical Agency and the Oromia Planning and Economic Development Commission. The study period was covered between 2002 and 2018. Qualitative data also were also collected, through structured questionnaires and in-depth interviews with key informants, to get detailed information about FDI and procedures and practices in the manufacturing sector in the region. Dukem town was the main case study location for collecting detailed information about the impacts of FDI on manufacturing output in the region. The sample frame consisted of all foreign investment projects in its Eastern Industrial Zone (EIZ). A stratified sampling method was used to collect the primary data. The relevant strata were formed to reveal the effects of FDI on the manufacturing sector. A 202 sample manufacturing employees were contacted, and covered about 35 different types of the manufacturing firms in the EIZ included in the study. The sample covered more than half of the FDI projects in the manufacturing sector in the zone. The simple descriptive method of data analysis was used to analyze the data.

3. Trends and Structure of FDI in Oromia

In 1997, the total number of FDI investment projects in Oromia Region was only one. In 2000 the number of FDI in the region increased to 3 and in 2005 to 26. Table 1 below shows the increase in the number of new FDI projects in the region in the 2000-2021 period. In 2010 the new number of FDI projects that received a license was 24, meaning a 7,6 percent decline as compared 2005. In 2015 and 2020, FDI projects increased with 22 and 4 respectively. Recent data has shown that in 2022 the new FDI projects received by the region so far were 10. This indicates a 150 percent increased as compared to 2021.

Table 1. The increase in the number of FDI in Oromia between 2000 and 2021

Year	New no. of FDI projects	Growth or decline
2000	3	-
2005	26	766% increase
2010	24	7.6% decline
2015	22	8.3% decline
2020	4	81% decline
2021	10	150% increase

Source: Oromia Investment and Industry Bureau, 2022

A significant increase in FDI flows into the region was observed since 2002, after a major reform was conducted at the national and regional level to increase/promote regional investments. Between 2000 and 2005 the FDI then increased with more than 23 new projects. However, as we saw, between 2005 and 2010 the total number of FDI decreased by two. In 2010 the new total FDI in the region reached only 24, which was less than five years before. The highest FDI in the region was received in 2008: around 132 new FDI projects in the Region. The second highest number of new FDI projects was achieved in 2004 and 2015, when Oromia Region managed to get 27 projects. Between 2015 and 2020, the region experienced a declining trend of FDI, but in 2021, new FDI projects have started to increase again.

Our study shows the structure of FDI in its distribution by location and sub-sectors. The *total* number of FDI operating in Oromia up to 2021 was 464. Most of the FDI in the region was in the manufacturing sector: around 231 FDI projects. In the agricultural and services sector, the FDI projects were 99 and 61 respectively. That means the manufacturing sector took 59.1 percent of the total FDI in the region. The agricultural sector took 25 percent of the total. The remaining share was taken by the service sector.

The other method of looking at the structure of the FDI in the region was to see the special *distribution* of FDI in the region. The study looked at the urban, rural and zonal distribution of FDI revealing that in 2016 the total number of FDI in the urban and rural areas was 210 and 181, respectively: the urban area took 53.7 percent of the total FDI in the region, of which 64 percent was invested in the *manufacturing* sector. The remaining 36 percent of FDI manufacturing was invested in the rural areas. More detailed analysis of FDI revealed that again 63 percent of the FDI was concentrated in one zone: the Oromia Special Administrative Zone.

4. Discussion

FDI affects the structure of the manufacturing sector in various ways. It not only changes the total production of the manufacturing sector in the host countries, but also improves productivity and diversifies the types of manufacturing. If developing well, FDI can be considered as an engine of manufacturing development: it can generate productivity spillovers for the host economy, increase the volume of investment and firm production efficiency, expand the existing stock of technological and marketing knowledge, facilitate the access to leading technology, generate chains

of new local suppliers, and open access to new markets. FDI thus not only brings financial capital but also managerial techniques and entrepreneurial-technological skills that were lacking in many Least-Developed Countries (LDCs).

Though there are various indicators for evaluating the impacts of FDI on the development of manufacturing, this study focused primarily on the export, employment opportunities, and technology provision/transfer. One of the impacts of FDI on the manufacturing sector is the number and quality of new jobs created. The 2018 monthly report on employment opportunities indicated that the East Industrial Zone (EIZ) provided 14,000 jobs. The higher employment opportunity and higher wage payments in the EIZ clearly improved the contribution of the manufacturing sector in the regional and national economy. About 70 percent of the respondent agreed that the impact of FDI on employment opportunities in the manufacturing sector was positive.

Another impact of FDI on the structure of the manufacturing sector is the amount of export revenue generated by FDI, due to increasing manufacturing output. The total export contribution of the EIZ was around U\$ 26.8 billion (above 770 Million Birr) in 2018. The increase in export sector earnings from the EIZ not only affected the national economy but it also increased the relative contribution of the manufacturing sector to it. This increase enhanced the competitive advantages of the national economy.

There are other impacts of FDI on the manufacturing sector in the region: expansion of the opportunity to access international markets, increasing government revenue, and providing/transferring modern technology. Around 24% of the respondents said that the FDI increased the role of technology in the manufacturing sector. The respondents in the EIZ said that FDI is in this respect more efficient than the domestic investment projects. Out of 195 respondents, 110 (or 56%) confirmed this. In general it can be said that the availability of FDI projects in the manufacturing sector in the Oromia Region would increase production and the productivities, also in other sectors.

In addition, 52% of the respondent agreed that FDI projects were more innovative as compared to the domestic. The level of innovation in the manufacturing sector obviously affected the structure and quality of the sector in the region. But a poor working environment and relatively low wage payment in FDI firms in the manufacturing sector may affect the positive impact of FDI. The above analysis certainly indicated that FDI has a strong impact on the development of the manufacturing sector in the Oromia region.

5. Recommendations

The economic transformation in Oromia National Regional State highly depends on the development of FDI in the manufacturing sector. FDI not only increases the number of manufacturing enterprises but also modernizes the sector by increasing productivity and production. It also provides management skills and new technology that can transform the manufacturing sector in the region. According to the study, FDI in the manufacturing sector provides employment opportunities, government tax revenue, higher wages, and enhances manufacturing efficiency and output, and finally provides access to international market and new technology.

However, during the last two decades the Oromia regional state could not get the full expected benefit from FDI in the manufacturing sector. Challenges that hinder the development of FDI include:

- lack of adequate and efficient human resources,
- weak infrastructural development,
- poor awareness about FDI,
- political instability,
- low ‘ownership’ of the Regional State in FDI licensing and related activities,
- lack of clear regulatory frameworks,
- lack of local and international markets,
- weak regional institutional capacity,
- poor institutional integration between federal and regional state, and
- absence of clear FDI policy and strategies.

Hence the following the major *recommendations* to improve the potential of and impact of FDI on the Oromia Region manufacturing sector.

First, the government must focus on *creating awareness* about the FDI in manufacturing development in the region. The study revealed that only 43 percent of respondent do now *know* about FDI. Even most of them who knew about FDI got their information in their work places. The regional state must focus on awareness creation on the benefits of FDI in the regional economic and manufacturing development.

Second, the policy focus should be on *guaranteeing industrial peace and political stability* in the region. The regional state must work hard on building industrial peace that enhances the relationship between foreign firms and local workers. The government must strengthen its institutional capacity in maintaining both foreign firms and employees’ peaceful working environment in the manufacturing sector. In addition to wage security, all concerned body focus on worker safety that may affect the productivity of the works in the foreign firms.

Third, needed is the provision of *infrastructure* that facilitate the effectiveness of FDI in the manufacturing sector. According to the study outcome, a good infrastructure is a major challenge for foreign firms in the manufacturing sector. The government must use all alternative approaches in the development of infrastructure sector, including private and public partnership and direct government provisions of important infrastructure would increase the impact of FDI on the manufacturing development. Efficient provisions of infrastructure reduce the costs of production and improve the regional competitiveness of the manufacturing sector.

Fourth, FDI is to be is encouraged in the *export* sector. Most of the FDI in manufacturing sector so far in Oromia produces for the local market rather than the international market. This affects the development of other local firms. It creates a crowding-out effect. The regional government should work on facilitating and providing important incentives for FDI firms working in the manufacturing sector to supply their products to the international market. This not only will increase foreign earning capacity of the regional state but also domestic manufacturing sectors.

Fifth recommendations include *stronger supervision* of FDI in the manufacturing sector, increasing the *efficiency and skills* of the local employees, design and implement *effective FDI policy and*

strategy, provide and design effective FDI tax incentives and other related supports which increase the regional investment climates. 195
196
197

It might also be recommended that the federal government must speed up WTO membership, so as to provide investment security and to access the international markets for the foreign investors. 198
199
The last but not the least recommendation is liberalizing of the selected economic sectors such as 200
201
financial and logistics sectors that provide good opportunity for the FDI other than manufacturing 202
203
sectors. 204

6. Conclusion 204

Economic transformation and growth in Oromia highly depends on the development of the manufacturing sector. It will need a higher level of investment and technology use and transfer, as compared to the agricultural and service sectors. FDI in manufacturing is important to accelerate regional economic growth. At the regional level, FDI in the manufacturing sector provides more employment opportunity, government tax revenue, provides additional wage payments, enhances manufacturing efficiency and output and (in principle) provides access to international market and new technology. 205
206
207
208
209
210
211

But FDI in the Region is volatile and was not high as expected according to the perceived potential available in the region. The challenges hindering the development of FDI were enumerated above and need urgent attention, not in the least security issues, training of the work force, better ‘ownership’ of the regional state in FDI operations, a clear regulatory framework, and improving the regional institutional capacity and longer-term FDI policy and strategies. Giving priority to the development of FDI by addressing such challenges is necessary to realize structural change and stable growth in the regional economy. 212
213
214
215
216
217
218
219

7. References 220

- Abdul Karim, Noor Al-Huda; Winters, Paul C.; Coelli, Tim J. & Fleming, Euan (2003), Foreign Direct Investment In Manufacturing Sector In Malaysia, School of Economics, Faculty of Economics, Business and Law, University of New England. Paper prepared for the 47th Annual Conference of the Australian Agricultural and Resource Economics Society (AARES), Fremantle, 11-14 February 2003. 222
223
224
225
226
- Anthony, Onyinye I., et al. (2016), Manufacturing output and Foreign Direct Investment in Nigeria: new evidence. *International Journal of Academic Research in Economics and Management* 5(2): 55-64. 227
228
229
- Bwalya, S.M. (2006). Foreign direct investment and technology spillovers: Evidence from panel data analysis of manufacturing firms in Zambia. *Journal of Development Economics* 81: 514–526. 230
231
232
- Ekienabor, Ehijiele; Aguwamba, Sunday & Liman, Nuruddeen (2016), Foreign Direct Investment and its effect on the manufacturing sector in Nigeria. *International Journal of Scientific and Research Publications* 6(5): 671-679. 233
234
235

-
- Hunya, Gábor (2002): Restructuring through FDI in Romanian manufacturing. *Economic Systems* 26(4): 387-394. 236
237
- Kappel, Robert; Birte Pfeiffer & Helmut Reisen (2017). *Compact with Africa Fostering private long-term investment in Africa*. Bonn: Deutsches Institut für Entwicklungspolitik. 238
239
- Masron, Tajul Ariffin & Hassan, Mohd Khairul Hisyam (2016), US Foreign Direct Investment (FDI) and manufacturing sector in Malaysia. *Asian Academy of Management Journal* 21(1): 89–110. 240
242
- NBE (2016/17), *Annual Report of the National Economy*, Addis Ababa: NBE 243
- OECD (2005), *Investment for Africa Development: Making it Happen*. Roundtable organised under the joint auspices of NEPAD and the OECD Investment Committee, sponsored by the Government of Uganda, with the co-operation of JICA and JETRO of Japan 244
245
246
- UNCTAD (2018), *Investment and new industrial policy*. In: *World Investment Report*. Geneva: UNCTAD. 247
248
- Zámborský, Peter (2006), *FDI and OECD Industry Productivity: Technology, Capital and Country Size*. Unpublished paper (Available at: <https://core.ac.uk/display/101194792>). 249
250