THE ASSESSMENT OF TAX INCENTIVES AND FDI IN ETHIOPIA

BY

ALEMSEGED AWOL

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APPROVED BY BOARD OF EXAMINERS

Dean, Graduate Studies ________________ **Signature** ____________

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Internal Examiner ________________ **Signature** ____________

DECLARATION

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of Dr. Abebaw Kassie. All sources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

Alemseged Awol

Name *Signature* *Date*

ENDORSEMENT

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

Advisor Signature	***Date***

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List of Acronyms

FDRE: Federal Democratic Republic of Ethiopia

NBE: National Bank of Ethiopia

ERCA: Ethiopian Revenue and Customs Authority

IMF: International Monetary Fund

ECI: Ethiopian Investment Commission

FDI: Foreign Direct Investment

WTO: World Trade Organization

SADC: South African Development Community

UNCTAD: United Nations Conference on Trade and Development

LLDC: Landlocked Developing Countries

MNE: Multinational Enterprises

SME: Small and Medium Enterprises

OCED: Organization for Economic Co-operation and Development

TNCs: Transnational Companies

HQ: Head Quarter

OLI: Ownership, Location and Internalization

ERP: Economic Reform Programme

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Abstract

The study attempts to assess the tax incentives and foreign direct investment (FDI) in Ethiopia. To this end, the study has reviewed theoretical explanations and relevant empirical literatures focusing on the topic related to developing countries. The role of investment in the country's overall development is vital. Ethiopia one of the developing countries, try to increase foreign and domestic private investment by creating a good investment climate through adjusting the rules and regulations of tax policy and investment with the provision of different types of incentives. The objective of the study is to identify the effect of tax incentives on the inflow of foreign direct investment (FDI) into the country. And it also identified whether there are any determinants other than tax related incentives that can affect the inflow of FDI. To answer this, the study adopts descriptive research method. Primary and secondary data collected from ERCA and EIC in addition to the questionnaire distributed to foreign investors who got investment license from federal investment commission and works in Addis Ababa and around. Response from the questionnaire shows that, tax related incentives have a great role to attract foreign international companies to do their businesses in the country. There are no options other than giving tax incentives for the country because of the poor infrastructure facilitates and improper bureaucracy which have much power that hinder the whole investment climate. To compensate such weaknesses, providing tax related privileges for FDI is the only option so as to increase the involvement of foreign international companies. Other than tax related incentives market size of the country, law labor cost, infrastructure development, political stability, financial support and the availability of land, shades in different industrial zones build by both the government and private owners have also much power to increase the involvement of multi- national companies in the country. Hence, to increase the number of foreign direct investors into the country, the government of the country must give enough attention to advertise the country's potential investment opportunities to the outside world. The tax policy must be revised based on best experiences of other countries and tax administration processes must adopts such experiences so as to deliver best services by decreasing the corruptions which exists there. The implementation of those privileges must be clear and the service delivery system at ERCA and EIC need improvement. The ongoing infrastructure development must be done in a good manner to facilitate and support the overall country's development in general and to increase the efficiency of foreign investors in particular. Political stability must also get enough attention because it is the main determinant which affects directly not only FDI all citizens in the country. We lose not only the potential FDI that comes in to the country, investors can go out of if there is no peace in the country. Controlling and administrating of those privileges given to both local and foreign investors must do properly by both ERCA and EIC. Further the study recommended that, the government should continue working on improving the trade investment environment of the country.

CHAPTER ONE

1. Introduction

This study focused to assess tax related incentives and foreign direct investment (FDI) and other determinants that have effect on attracting foreign investment. The chapter gets the scene for the study by discussing in broad terms the background of the study, the problem statement and objective of the study. It also defines the study scope and its significance.

1.1 Background of the Study

Governments need to perform various functions in the field of political, social and economic activities to maximize social and economic welfare. In order to perform these duties and functions governments require large amount of resources called public revenues. Public revenue consists of taxes, revenue from administrative activities like fines, fees, gifts and grants. However, taxes are the first and foremost important sources of public revenue which are central to the current economic growth and development agenda. The importance of taxation as a veritable tool of economic growth and development depends on a proper tax system which has the capacity to generate revenue through tax. While fulfilling the revenue function, taxes also have a pervasive influence on economic decisions of individuals and businesses, and on social equity. (SADC, 2004).

Giving the above discussed benefits of taxes, governments continually re-examined their tax policies to ensure that they are in good condition to attract trade and investment. Many developing nations face pressure to sweeten their tax incentive programmes to compete with tax breaks offered in other parts of the world (Klemm, 2009).

Ethiopia has implemented Economic Reform Programme (ERP) since 1992/93 with the support of World Bank, International Monetary Fund, foreign governments and other multilateral institutions. The tax reform has got momentum in 1999 when the “Revenue Board” scaled up to the level Ministry “Ministry of Revenue” and the reform expanded from tax policy measures to administrative reform. The reform measures are intended to encourage trade, investment and hence development; broadening the tax base and increase Government revenues to support social programmes and alleviate poverty; strengthen the enforcement capacity of the tax and customs authorities; and promoting equity in the tax system. On the other hand the country has formulated its first investment proclamation on 1992 (proclamation no.15/1992) since then amendments were made in accordance with the situation. The investment proclamations formulated from time to time has taken tremendous measures that will help to create accumulation of resources by both the foreign and local investors.

Beyond the domestic market, investors also attracted by the common market for eastern and southern Africa (COMMESA). The country also qualifies for preferential access to European Union market under the EU’s Everything-But-Arms (EBA) initiative and to USA markets under the African Growth and Opportunity Act (AGOA) and the General Systems of Preference (GSP). Thus, most Ethiopian origin products can enter into these markets without quota and duty.

Based on the country's investment guide (2015), the Ethiopian tax law provides for the direct and indirect taxes. The direct taxes are divided into five categories: personal income tax, rental tax, withholding tax, corporate tax. The main types of indirect taxes applicable to the country are VAT, customs duty, excise and turnover taxes.

From this foreign direct investment (FDI), Addis Ababa takes the lion share because of its potential market size for those company's products and services, the availability of infrastructure and other reasons mentioned above. When we see the map of investment in our country, it is mainly concentrated in the capital and its surrounding areas-Oromiya region special zones. (Ethiopian investment commission 1992-2015)

Foreign Direct Investment (FDI) affects economic growth of developing countries positively through transfer of capital, know-how, and technology (Li and Liu (2005)). It increases activity not only in FDI beneficiary firms. The effect can spread to other firms in the country and sectors through technology spillover, human and capital formation and increasing competition, thus raising productivity for the whole economy. FDI can accelerate growth in the ways of generating employment in the host countries, fulfilling saving gap and huge investment demand and sharing knowledge and management skills through backward and forward linkage in the host countries (Frenkel, Funke et al. (2004)). Some points which supports the concept that FDI promotes growth are explained by, Agrawal and Khan (2011):

1. FDI acts as a vehicle for the transfer of advanced manufacturing technologies from the Developed countries (DCs) to the Less Developed countries (LDCs),
2. FDI increases competition in the host country's markets,
3. FDI helps the host countries improve their foreign exchange reserves (or balance-of-payments position)by increasing exports,
4. FDI brings along with it the management know-how needed to run the facilities,
5. FDI provides the financial resources needed by the host country,
6. FDI enhances the training and employment opportunities for the people of the host country,
7. FDI reduces the burden of imports on the host countries through import subs
8. FDI acts as catalyst for increasing domestic savings and investment.

As a result of these benefits, many developing countries, like Ethiopia, are now actively seeking for promoting FDI by trying to create a favorable environment for it. Some of the measures taken include economic and political reforms aiming at macroeconomic and political stability, investment in infrastructure and human capital and liberalization of trade (Haile and Assefa (2006)).

Despite mixed findings about the effect of FDI on the economic growth of a country, both developing and developed countries are making tremendous efforts to attract inward FDI. Many countries have changed their policies to facilitate the flow of FDI and operation of multinational corporations within their borders (Noorbakhsh et al., 2001). Others have removed barriers that earlier restricted FDI and offered tax incentives and subsidies (Herzer, Klasen& Nowak-Lehmann, 2008). However, such efforts may not yield a desirable outcome of attracting foreign capital without an empirical evidence of the mode of entry of MNEs into a foreign market (Agodo, 1978). Without such an understanding, measures taken by various countries to attract FDI may not be effective and ultimately may waste resources. Therefore, an understanding of the dynamics of the decision making process of MNEs to enter a given market is critical in understanding the levels of inward FDI.

Earlier research suggests that MNEs consider many factors in their decision to invest in a host country. Agodo (1978) showed that investments by U.S. manufacturers in Africa were determined by the expected return on investment, size of the domestic market, amount of raw material, political stability and a favorable investment climate. Contrary to the expectations, the rate of growth, wage levels and, tax concessions and tariff protection did not influence the decision.

There are two broad types of foreign investments that are crucial to developing countries to ensure growth and development: portfolio or indirect investment and foreign direct investment (FDI). Portfolio investment involves the purchase of a stake in an enterprise by a foreign equity investor. FDI is the acquisition and control of the productive operations of a firm in a foreign country (Muradzikwa 2002). Both investment types have received attention from policy makers. Most developing countries seek policies that lure portfolio investments in a bid to improve their financial deepening and innovation which are crucial to growth. However the most dominant investment type in Ethiopia is FDI. Therefore, this thesis is focused on FDI.

1.2 Statement of the Problem

In the growth and development literature, capital accumulation and industrialization are considered as the crucial and critical key to economic growth. Given this, many developing countries particularly Ethiopia which follows agricultural policy made a number of attempts to increase foreign direct investment. Tax incentives scheme are among the attempts made to create investment environment.

Now a day’s investment becomes special opportunity to any economy to grow. Beside this, it has many benefits for those countries in creating job opportunities, increasing the revenue collected from the sectors, getting foreign currencies that come from the export of goods and services, transfers technology from developed countries. To get these and others opportunities governments try to attract foreign investors.

FDI is one of the most striking features of the global economy. However, analogous to various economic arenas, FDI and its role have been a major agenda in various socio economic and political debates across the world.

On one hand, majority of scholars (most of whom are economists) argue in favor of FDI in that its benefit to boost the host country's economic growth, through technological transfer, emergence of globally integrated marketing networks, acting as an efficiency demonstration to local investors and so forth, by far outweighs its cost. They further argue that, through the creation of market access for exports, through resisting protectionist pressure in their home countries to favor imports from affiliates, foreign investors could contribute towards a positive balance of payment and increase government revenue of the host country. FDI considerably contributed for rapid economic growth in developing countries particularly for East Asians by way of augmenting export-led industrialization efforts (Athukorala and Worku, 2003).

While the critics (most of who are politicians) on the other hand, turn the other side of the coin by propagating the proverb, 'don't forget that a bee which holds honey on its mouth has also venom on her sting'. That is to mean that FDI is another new form of matured (economic) colonialism that disguises host country's people from the mainstream of development, moreover, the critics cement their argument further that FDI hinders the development of local firms, adversely affects income distributions or terms of trade or negatively influence and threaten governance and promote rent seeking in host countries.

Some further argue that the role of FDI even for the spectacular export take-off of East Asian newly industrialized countries in the 1960s was not as much as it has been mentioned in many literatures. The key role was played indigenous firms with the help of marketing services provided by foreign buyers- the japans trading houses and the large retail buying groups in developed countries. Perhaps the most important factor behind the East Asian experience was the unique entrepreneurial background of these countries (Athukorala, 1998).

Recognizing those aforementioned roles, almost all countries in the world including Ethiopia, despite with some skeptic views, are leaving their gates open for foreign investors. Accordingly, to reap the ample of fruits from these foreign investors, we should first of all identify the basic factors that determine the rate and level of such capital inflows and there by adjust our socioeconomic and political moods to the extent of maintaining our country's interest so as to maximize the developmental benefits of FDI inflows and minimize the potential adverse impacts.
Moreover, the problems faced by those already established foreign investments, such as lack of infrastructure, bureaucratic red tape and other latent hindrances should be critically identified and dealt with by the government and other concerned parties for the better performance of the sub sector.

Beside these there are debates on the effectiveness of tax policy and incentives in attracting foreign direct investment. Based on the regulation number 270/2012, any foreign investor who invest in areas of activities e.g. manufacturing, agriculture, agro-industries, generation, transmission and supply of electrical energy, Information and Communication Technology Development (ICT), tourism, construction, education and training, star designated hotel, specialized restaurant, architectural and engineering consultancy works, technical testing and analysis can capital goods leasing and importation of LPG and bitumen have incentives. Other than these areas of economic activities, there is no incentive scheme to foreign investors.

The country is giving these incentives since 1992 but still, the number of foreign direct investors in Ethiopia is not much enough, when we compare with the country's promising potential investment capacity.
As one of the developing countries, Ethiopia also has been undertaking tax reforms and introducing incentives since 1961 G.C. Most of these taxes have been reformed and amended following the policies of the past three governments in power. In the past decade following the general 1992 liberalization (or reform) policy of the country major reforms have occurred (Geda and Shimeles 2005).

The Ethiopian government implemented a series of re-form measures since 1992. Like deregulation, privatization, liberalization of foreign ex-change market, elimination of export tax except for coffee, lowering of maximum import duties and Provision of adequate incentives. The Ethiopian government has been also providing investment incentives to encourage private investment and to promote the inflows of foreign capital. Reduced Custom import duties, exemptions from payment of export customs duties, income tax holding, tax holidays and losses carried forward are some among the investment incentives given by Ethiopian government (Semiret 2013).

However as per National bank of Ethiopia annual reports for the past ten years, the sectorial distribution of investment in the manufacturing sector have been fluctuating and didn't make any significant change so far. The 2013/14 annual report of NBE shows that the industrial sector accounts for only 12.4% of GDP. Further as per EIC (2014) the industrial sector mainly comprises small and medium enterprise.

Beside these there are debates on the effectiveness of tax policy and incentives in attracting foreign direct investment. Countries will consider cost and benefit to decide on giving tax related privileges. This issue motivates me to work on it because there is a major problem in granted and controlling and administrating those privileges given and there is a big debate on providing tax related incentives to attract FDI. Therefore, this study tries to look at the effect of tax incentive schemes in supporting investment to attracting potential foreign investors taking Ethiopian case.

1.3 Basic Research Questions

To investigate the research title stated above the following research questions were proposed;

- Are tax incentives significant in attracting FDI in Ethiopia?
- What are the other factors which affects the inflow of FDI into Ethiopia?

1.4 Objective of the Study

1.4.1 General Objective

The core objective of the study is to assess the effect of tax policy and incentives given by the federal government of Ethiopian to increase the inflow of foreign direct investment.

1.4.2 Specific Objective

The specific targets to be undertaken under this study are:

- To examine the trend of investment;
- To identify whether tax incentives have role in attracting foreign direct investment;
- To identify whether there is any determinant other than tax incentives that affect the in-flow of foreign direct investment in Ethiopia.

1.5 Hypothesis

In order to identify the impact of tax policy and incentives on FDI, the research develops the following hypothesises:

H01: There is no significant impact of tax incentives on the flow of FDI.
H02: There is no significant impact of inflation on the flow of FDI.
H03: There is no significant impact of loan interest rate on the flow of FDI.
H04: There is no significant impact of infrastructure development on the flow of FDI.
H05: There is no significant impact of factor cost on the flow of FDI.
H06: There is no significant impact of market size on the flow of FDI.

1.6 Significance of the Study

It is widely known that there is a mutual interdependence among countries of the world. Particularly less developed countries tend to depend highly on developed countries for finance, technology, and technical work force while the developed countries depend on the less developed countries for their raw materials. Due to this interdependence among less developed countries and developed countries FDI throughout the world has been growing rapidly. Similarly the inflow of FDI in Ethiopia has been increasing after the liberalization policy by EPRDF. However data from World Bank indicates that the performance of Ethiopia in attracting FDI as compared to other sub-Saharan countries is very low.

Considering this performance of FDI in Ethiopia this study aims to answer two questions. The first question is: are tax related incentives are significant to attract FDI in to Ethiopia? This is an important issue that needs to be addressed in order to know whether incentives privileged to foreign investors are enough and they can play the needed role to attract more FDI into the country. So that it can be possible to make the appropriate policy reforms that will help enhance this performance. The second question this study addresses is: What are the other factors which affects the inflow of FDI into Ethiopia? This question needs to be answered because there are many factors that can influence the inflow of FDI into the host country.

The increasing demand for FDI has encouraged a large amount of empirical literature on FDI. Researchers have recognized different variables that determine FDI in developing countries and particularly in Ethiopia. These variables vary significantly from study to study. Erdal and Mahmut (2008), on their study on developing countries, conclude that infrastructure and degree of trade openness have a positive and the most significant impact on attracting FDI inflows while inflation and tax rates present negative signs. Another study by Anyanwu (2011) on the determinants of FDI inflows to Africa finds that market size, high government consumption and natural resource endowment attract FDI inflows to Africa while financial development has a negative effect. There are also a number of studies conducted regarding determinants of FDI inflows in the case of Ethiopia. Getinet and Hirut (2006) analyze determinants of FDI in Ethiopia and find that growth of real GDP, export orientation and liberalization promote the inflow of FDI.

While macroeconomic instability and poor infrastructure deter the FDI inflow to Ethiopia. A firm level investigation by Henok (2014) on the determinants and impediments of FDI in Ethiopia shows that domestic and regional market seeking, political and social stability and investment incentives were found to be the main determinants of FDI, whereas exchange rate volatility, corruption, and lack of clear policies and regulatory impediments were identified as the three main factors that have the potential to deter foreign investment in Ethiopia.

Taking into account the above lines of enquiry and observing the contradiction, this study explores various determinants that currently affect FDI in the case of Ethiopia. The numbers of research conducted on this area regarding Ethiopia are very few. But considering the fact that determinants of FDI vary significantly across economies due to socio-economic and social conditions of a country, it is crucial to conduct country specific studies such as this study. In addition, as opposed to the few studies those were conducted regarding the factors that affect the inflow of FDI into Ethiopia, this study uses a more recent data in order to make the analysis more accurate.

1.7 Delimitation/ Scope of the Study

In fact, this research has tried to access the effects of tax policy and incentives on the flow of foreign direct investment in to the country. The study compares and contrast the amount of foreign direct investment based on the tax policy reform and the time when different types of incentives come to work. Respondents also must have experience with these incentives to be included as a sample. The study covers construction, agriculture, manufacturing, agro-processing, education, health, ICT infrastructure and electric and water supply from the period 1992 to 2016.

As for the limitations, apart from the theoretically identified panel data analysis shortcomings like design and data collection problems and measurement errors, this study faced challenges from the fact that the investment data is not collected primarily for this type of analysis, and the division of the sectors was very much aggregated even though most of them are fundamentally different.

1.8 Definition of Basic Terms

- **Tax holidays:** Temporary exemption of a new firm or investment from certain specified taxes, typically at least corporate income tax. Sometimes administrative requirements are also waived, notably the need to file tax returns. Partial tax holidays offer reduced obligations rather than full exemption.
- **Special zones:** Geographically limited areas in which qualified firms can locate and thus benefit from exemption of varying scope of taxes and/or administrative requirements. Zones are often aimed at exporters and located close to a port. In some countries, however, qualifying companies can be declared "zones" irrespective of their location.
- **Investment tax credit:** Deduction of a certain fraction of an investment from the tax liability. Rules differ regarding excess credits (credits in excess of tax liability) and include the possibility that they may be lost, carried forward or refunded.
- **Investment allowance:** Deduction of a certain fraction of an investment from taxable profits (in addition to depreciation). The value of an allowance is the product of the allowance and the tax rate. Unlike a tax credit, its value will thus vary across firms unless there is a single tax rate. Moreover, the value is affected by changes to the tax rate, with a tax cut reducing it.
- **Accelerated depreciation:** Depreciation at a faster schedule than available for the rest of the economy. This can be implemented in many different ways, including a higher first year depreciation allowances, or increased depreciation rates. Tax payments in nominal terms are unaffected, but their net present value is reduced and the liquidity of firms is improved.
- **Reduced tax rates:** Reduction in a tax rate, typically the corporate income tax rate. Exemptions from various taxes: Exemption from certain taxes, often those collected at the border such as tariffs, excises and VAT on imported inputs.
- **Financing incentives:** Reductions in tax rates applying to providers of funds, e.g., reduced withholding taxes on dividends.

** Source: Klemm, Alexander, 2009, "Causes, Benefits, and Risks of Business Tax Incentives," International Monetary Fund, Washington, D.C.

1.9 Organization of the Research

This study is organized in to five chapters. The first chapter is introduction to the study. It contains background of the study, statement of problem, research questions, objectives, significance and limitation of the study.

The second chapter is the literature review of the study. In this part literatures related to the study are reviewed. It includes review of different books for identifying the main theoretical perspectives.

The third chapter explains methods of the study. In this chapter the type and design of the study, the subjects and sampling of the study, sources and tools of data collection, procedures of data collection and the data analysis techniques also discussed.

The fourth chapter is about the results and discussion of the results of the study. In this part of the study the analyses of the collected data are summarized, and then findings are discussed and interpreted.

The fifth chapter includes the summary, conclusions and recommendations of the study based on the findings.

CHATER TWO

2. LITRATURE REVIEW

2.1 Theoretical Review

2.1.1 Main Concepts and Definition of FDI

Foreign direct investment has been defined in different ways by scholars of institutional economics. Pettinger (2012) sees FDI as a movement of capital from one country (known as origin) to another country (known as host) which is meant to acquire physical capital such as factories or machines. The acquisition must be a lasting interest which involves control of at least 10% share or vote of an enterprise doing business outside the investor's home country. Mwilima (2003) clearly states that for a foreign investment to be defined as direct, an individual or entity must make a lasting interest in the management of an enterprise doing business in a foreign country which must include having at least 10% voting stock and equity share in that enterprise.

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

The motivation of the direct investor is a strategic long-term relationship with the direct investment enterprise to ensure a significant degree of influence by the direct investor in the management of the direct investment enterprise. (OECD, 2008).

The foreign direct investor could be an individual, a group of related individuals, an incorporated or unincorporated enterprise, a public or private enterprise, a group of related enterprises, a government body, an estate, trust or other societal organization.

According to the OECD benchmark definition of FDI the main financial instrument components of FDI are equity and debt instruments. Equity includes common and preferred shares, reserves, capital contributions and reinvestment of earnings. All cross-border positions and transactions in equity between FDI related enterprises are included in FDI. Dividends, distributed branch earnings, reinvested earnings and undistributed branch earnings are components of FDI income on equity.

The companies that make FDI are Multi-National Companies (MNE). They produce value added in more than one country and own this process. These companies may prefer to produce where the product will be marketed instead of producing in the home country and export it. If this preference is analyzed at country or the source of investment points of view instead of firm viewpoint, one encounters with the subject of FDI (Muratet al. 2005). In other words it is referred to as multi-national company on the micro level and FDI on the macro level.

2.1.2 Basic Investment Theories

There are different theories that have been put forward by different researchers to explain foreign direct investment. However no single theory fits the different types of direct investment made by a particular multinational company or country in any region.

There are four types of FDI theories that tried to explain why multinational companies prefer to operate in foreign countries. These are neoclassical, product life cycle, internalization and eclectic theories of FDI.

2.1.2.1 The Early Neoclassical and Portfolio Investment Approaches

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

2.1.2.2 The Product Life Cycle Theory of FDI

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

2.1.2.3 Internalization Theory of FDI

To increase profitability, some transactions should be carried out within a firm rather than between firms and this is one of the reasons why multinational companies exist. In other words, there are transactions that should be "internalized" to reduce transaction costs and hence increase profitability. This theory may answer the question why production is carried out by the same firm in different locations. One of the reasons of internalization is market imperfection. Any kind of economically useful knowledge can be called technology. Mostly, technologies or knowhow can be sold and licensed. However, sometimes, there are technologies that are embodied in the mind of a group of individuals and not possible to write or sale to other parties. This difficulty of marketing and pricing know how forces multinational companies to open a subsidiary in a foreign country instead of selling the technology. In addition, a number of problems may arise if an output of a firm is an input to other firm in other country. (Krugman and Obstfeld, 2003).

2.1.2.4 The Eclectic Theory of FDI

John Dunning developed an eclectic theory of FDI, which is called *OLI paradigm*. O, L and I refer ownership advantage, location advantage and internalization conditions, respectively.

Operating in a foreign country market has many costs and these "costs of foreignness" include a failure of knowledge about local market conditions, cultural, legal and many other costs. Therefore, foreign firms should have some advantages that can offset these costs. Ownership advantage is a firm specific advantage that gives power to firms over their competitors. This includes advantage in technology, in management techniques, easy access to finance, economies of scale and capacity to coordinate activities. Unlike ownership advantages, location advantages are country specific advantages. Transnational Companies (TNCs) in order to fully reap the benefit of firm specific advantages, they should consider the location advantage of the host country. This includes accessibility and low cost of natural resource, adequate infrastructure, political and macroeconomic stability. As a consequence, the location advantage of the host country is one essential factor that determines the investment decision of TNCs. Internalization is multinational companies' ability to internalize some activities to protect their exclusive right on tangible and intangible assets, and defend their competitive advantage from rival firms. Accordingly, all the three conditions must be met before transnational companies open a subsidiary in a foreign country (Soderstein (1992), Laar (2004).

2.2 Empirical Evidences

The dynamics of foreign direct investment is more likely related to economic fundamentals. Different researches try to see how effective tax policy and incentives were by comparing the costs and benefits. Empirical literatures on the effectiveness of tax policy and incentives in determining foreign direct investment are mixed.

There are arguments for and against of tax incentives in different literatures and empirical works. Arguments in favor of investment tax incentives are widely known. According to proponents, tax incentives clearly enhance returns on investment; they may be justified by positive externalities stemming from investments; they are relatively easy to target and fine tune; they signal openness to private investment; they are useful in a world of capital mobility; they are necessary for responding to tax competition from other jurisdictions; and they compensate for other deficiencies in the investment climate. Another common argument is that incentives can actually enhance revenue by stimulating investments that generate other taxable income via employment and linkage effects. Tax incentives also offer political advantages over direct expenditure programs to stimulate investment (SADC, 2004)

Among the studies that found insignificant impact of incentives are a broad cross country analysis in Eastern Caribbean Currency Union member countries by Chai and Goyal (2008). The study used primary surveys that involved the investors themselves that have already received some sort of incentive packages. They have found that the benefit of tax concessions in terms of attracting FDI is very limited compared to its cost in terms of foregone revenue, by using cross country analysis.

A joint study by justice network Africa and Action Aid international on tax competition in east Africa has indicated Kenya, Uganda, Tanzania and Rwanda are losing up to USD 2.8 billion a year because of the tax incentives they offer to FDI companies. Hence, they suggest these kinds of incentives should stop because they are costly and inefficient.

A study by Wells and Allen (2001) presents another case against incentives, consistent result with the above findings. The study is based on Indonesian experience where tax holiday were offered for foreign investors and then dropped. In this study, it is found that foreign investment continued to grow even after the tax holiday is dropped proving the negligible role of tax incentives in attracting foreign direct investment. This could be a strong case against incentive schemes as it has showed an actual natural experiment outcome.

A study by Tuomi (2009) that focused on middle income country, particularly on South Africa, looked at the topic from microeconomic perspectives by using firm level data. He found that investment climate is more important than incentives. According to this study, incentives play a negligible role in attracting foreign firms and countries economic, social and institutional fundamentals are more important. The study also argues there are cases in which incentives may play a positive role. This could be related to Forsyth's (1972) argument that once the decision to set up in a broad area is made inducements and incentives may affect the decision regarding the more precise location as referred in Morisset and Pirnia (2000).

On the other hand, most of the studies conducted in the past decade have shown positive impact of incentives on FDI inflow. Supporters of tax incentives argue that fiscal incentives are needed to increase investment which in turn generates economic and social benefit through its spillover effect on local firms, nurturing domestic production and building local capabilities. It is also believed, Productivity of local firms also increases as a result of forward and backward leakage with foreign firms. (Madies and Dethier, 2010) Some of the researchers tried to identify which type of incentives work best instead of generalizing. Emmanuel Cleeve (2008) in his study on the effectiveness of fiscal incentives to attract FDI in 16 Sub-Sahara African countries, for the period 1990-2000 using pooled data, found that among fiscal incentives tax holidays were the most effective and while the other concessions seem to cause an ad-verse effect specially in countries that offered too many concessions. According to this study all fiscal incentives may not benefit the economy through attracting FDI, because some fiscal incentives may result in economic distortions. The study recommended that countries should be selective in their fiscal incentives.

Blomstrom and Kokko (2003) also argue that under a certain condition tax incentives increase investment; create job opportunity and leads to overall growth. According to them incentives should be given for foreign firms that are engaged in activities that have strong potential for spill over, activities that create linkage between local and foreign firms, education, training and R & D. They are also of the view that it is necessary to build the absorbing capacity of the local firms at the same time. It is under these conditions that tax incentives will have a significant impact on increasing investment.

Mudambi (1995), unlike the other studies in the 1990s, in his study found that corporate tax rate has a significant effect in attracting foreign direct investment suggesting low tax rate have a persistent effect on multinational enterprises location decision. His finding also shows that labor cost is an important determinant of MNE investment, which is in line with the other studies that identified re-source and other economic fundamentals as the main factors attracting FDI. On the other hand infrastructural factor found ineffective in their investment decision.

On the other hand, Tanzi and Zee (2002) witnessed a mixed result; Countries experience a success and failure story of using tax incentives as a means to attract foreign direct investment. In East Asian countries (Taiwan, Korea and Singapore) tax incentives were found successful. In these countries tax incentives encouraged rapid industrialization through attracting FDI. In addition there are also countries cited such as Ireland and Mauritius where tax incentives are effective. In contrast in Malaysia, Indonesia, Thailand and Philippines tax incentives appeared ineffective in achieving its goal. This finding strongly supports that view that the effectiveness of the incentives depends on the economic fundamentals and specific situations of every country.

Another strong support comes from Margalioth (2003) who argued that tax incentives are good and appropriate policies to attract FDI to developing countries. He justified the effectiveness of incentives by addressing the main arguments forwarded by the opponents of tax incentives. These arguments are: incentives distort behavior, they are harmful and ineffective and incentive may also divert focus from other important determinants of FDI. But according to Margalioth as far as incentives attract FDI that would not come otherwise, it is not inefficient even if it create distortion. His arguments have the notion that the effectiveness of the incentive schemes should only be evaluated against its primary goal of attracting FDI. Furthermore, tax incentives become ineffective only if it is given to FDI that would have come even without the incentives. So it is not the incentives that are ineffective rather it is the administration and the implementation of the incentives that are no effective. In addition he argues that incentives are not given as compensation to other determinants of FDI rather it is an addition to the other policy efforts.

Interest rate, inflation, market openness, infrastructure, cost of production, availability of natural resources or inputs for production, location of the country are common variables used by many researchers when they study the effect of tax incentives on FDI. Methodologically, most of the studies employed a cross sectional analysis, time series analysis for specific countries and surveys on investors and government officials. However, none of them analyzed the impact of tax policy and incentives on different sectors; this study is believed to fill this gap by taking sectors as cross sectional units and applying panel data analysis technique, and focusing on one country, Ethiopia.

2.3 Determinant of Foreign Direct Investment

Basically, many factors could promote or hinder investment process. Some of them are socio-economic; others are financial while others are institutional. Though there are extensive literatures in this frame, this study considers only some of the important determinants of investment.

2.3.1 Size of Domestic Market and Trade Openness

Trade openness refers to a degree of which countries or economies permit or have international trade with others. Trade activities include import and export, inter countries investment, borrowing and lending, and repatriation of funds abroad. Open economies mean greater market opportunities.

Ethiopia has a large population and thus potentially one of the largest domestic markets in Africa. Beyond the domestic market, by virtue of its membership of the Common Market for Eastern and Southern Africa (COMESA) embracing 19countries with a population of 40 million, Ethiopia enjoys preferential market access to these countries. Ethiopia’s proximity to the Middle East also offers potential market opportunities.

The country also qualifies for preferential access to European Union market under EU’s Everything-But-Arms (EBA) initiative and to USA markets under the African Growth and Opportunities Act (AGOA) and the Generalized System of Preference (GSP). Thus most Ethiopian products can enter into these markets quota and duty free. Furthermore, broad ranges of manufactured goods from Ethiopia are entitled to preferential access under the generalized System of Preference (GSP) in USA. Most countries of the EU and other developed countries. No quota restrictions are placed on Ethiopian exports falling under the 4800 products currently eligible for GSP treatment (EIC, 2015).

2.3.2 Inflation and Exchange Rate

Inflation is a real fact of today which cannot be ignored. Even the most developed states have an inflation of several percent. In an economy with a growth dynamic changes taking place in prices constantly. Organized markets for securities and other goods are normal for prices to change from one transaction to another. Sometimes, the price of a good or service may be a trend upwards or downwards for a period of months or years. However, that price changes are the result of the change request or offer for goods and services does not imply, necessarily, some change in the general level of prices. Increasing the price of goods or services may be offset by the decrease of others, so that the average price may remain more or less constant. A change in the average level of prices is if there is a tendency for more prices to move up or down. It can thus appreciate that inflation represents the accelerated growth, and the general level of prices, matched by increased money, low purchasing power of money and depreciation under the influence of economic, monetary, social, and domestic and foreign policies (Bercea & Băndoi 2008).

A stability of the macro environment encourages growth given that it leads firms to act in a rational manner. That's because, in a context of low inflation, suitable deficit and public debt, more risk-averse investment behavior is limited and access to financial and capital markets is less difficult. This is especially important in African countries where there may be a dearth of entrepreneurship (Samuel & Aram 2012).

On the other hand, maintaining stable exchange rates prove to be important insofar as it affects long run growth. Indeed, avoiding exchange rate misalignments could protect exporters from an overvaluation phenomenon that affects competitiveness as well as importers from undervaluation that affects purchases and investment programs. Moreover, exchange rate volatility makes difficult and expensive for developing countries to hedge their exchange rate risks, especially small and medium sized firms (Samouel & Aram 2012).

2.3.3 Access to Credit and the Cost of Finance

Within Africa the share of domestic credit to the private sector in GDP is very low in many countries. African firms also face very high costs of finance for investment which, as shown in empirical studies, constrains investment (UNCTAD, 2014).

Shortage of capital hinders the ability of some industries to enhance quality and productivity by acquiring new techniques. The unsatisfactory credit provision and backward service rendering hinders the productivity of the firms.

2.3.4 Domestic Saving/Internal Funds

Investment can be financed through both domestic and external sources. However, given the challenges facing African countries in accessing external finance, they tend to rely more on domestic sources for investment. But Africa generally has low savings ratios relative to investment requirements and also relative to what is observed in other continents (UNCTAD, 2014). As the rate of domestic saving increases financing capacity for investment also increases which leads to higher investment rate.

2.3.5 Incentives

Investment incentives are measurable economic advantages that governments provide to specific enterprises or groups of enterprises, with the goal of steering investment into favored sectors or regions or of influencing the character of such investments (Sebastian 2009). These benefits can be fiscal (as with tax concessions) or non-fiscal (as with grants, loans, or rebates to support business development or enhance competitiveness). Tax and non-tax incentives have both been widely used to promote investment (Sebastian 2009).

Table 1: ***Governmental objectives and tax incentives use offered***

Objectives	***Rationale***	***Incentives offered***
Performance enhancement: Export promotion	Economies of scale in exporting, country image building, differences between the actual exchange rate and the equilibrium exchange rate	Exemption from import duties on capital goods, equipment or raw materials, parts and inputs related to the production process; exemption from export duties; preferential treatment of income from exports, income tax reduction for foreign exchange earnings; tax credits for domestic sales in return for export performance; duty drawbacks, tax credits for duties paid on imported materials; income tax credits on net local content in exports ; deduction of overseas expenditure and capital allowance for export industries; income tax reduction or credits for net value added,
Technology transfer	Spillover effects, risk aversion	Accelerated depreciation on machinery; income tax reduction/tax holiday; investment and reinvestment allowances ; allowances for skills training; reduction in tax for royalties/dividends
Performance enhancement: Employment/training	Imperfections in the labor market, such as a high minimum wage; spillover effects.	Tax holidays; allowances for job training expenses; deductions based on total number of employees; reduction in social security payments.
Performance enhancement: Domestic value addition	Problems of supplier development, spillover effects to downstream industries	Tax holidays; reduction from standard rate of income tax; loss carry forward and carry back for income tax purpose; deductions in income tax based on marketing and promotion; reductions in income tax based on total sales.
Sectorial investment	Spillover effects, industrial strategy and policy, national security	Exemption from import duties on capital goods, equipment or raw materials, parts and inputs related to the production process; accelerated depreciation on machinery; income tax reduction/tax holiday; investment and reinvestment allowances ; allowances for skills training; loss carry forward and carry back for tax purpose; preferential treatment of capital gains
Regional incentives	Shared infrastructure; equity considerations	Same as above.

Source: **UNCTAD**

2.3.6 Lending Interest Rate

The rate of return of an investment approached by literature through a real interest rate as a representative of the cost of capital is a possible determinant of private investment. The perceived negative relationship between interest rates and private investment is a long debated issue which pulls in a number of prior studies. Neo-classical theory Greene and Vilanueva (1991) suggests that, as high interest rates discourage investment by raising user cost of capital, private investment is negatively related to interest rate. Here, it's worth to make two distinctions: the interest rate would have a negative impact in the level of private investment made by domestic agents if the investment is financed in the local credit market. However, an increment in interest rate could have a positive effect in the capital flow from abroad, like it usually happens in emergent markets.

2.3.7 Infrastructure Availability

Countries with high infrastructure quality usually entails a developed network of roads, airports, sea ports, supply of water and electricity as well as internet networks and telephones with these characteristics countries would usually attract investment (Oniyewu and Shareshta 2005).

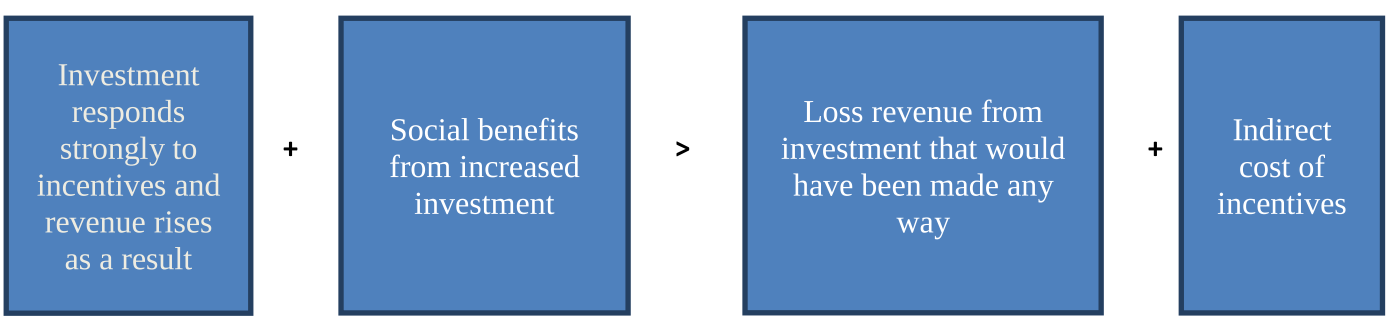
2.3.8 Availability of Natural Resources

The availability of natural resources in the country is a good opportunity to attract foreign investors. Companies are in search for raw materials that can be an input for their production.

Natural resources, historically, are the most important determinants of FDI. From the 19^{th}century up to the eve of the Second World War about 60% of the world stock of FDI was in natural resources. The need to secure economic and reliable sources of mineral and primary products for the (then) industrializing nations of Europe and North America, natural resources were the major reason for the expansion of FDI (Dunning, 1993). Birhanu (1999) noted that countries that have sufficient deposit of some minerals can attract foreign investors particularly those involved in exploitation of natural resources.

2.4 Conceptual Framework

This study investigates the effectiveness of incentives in promoting investment. In the study the dependent variable of the study is investment .The independent variables of the study are the availability (prevalence) tax (fiscal) incentive. The availability of fiscal incentives include two variables i.e. investment climate & political consideration. According to (James, 2009) tax incentive can be considered as beneficial when they satisfy the conditions mentioned below:



Conceptual Framework
Source: Sebastian James (2010), in practice investment policy & promotion.Vol 7 World Bank

CHAPTER THREE

3. RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

This chapter deals with the research design and the methodology that was used in gathering data for the study. It contains the research design, population and sampling technique, data collection instruments, data collection procedure and data analysis techniques and finally reliability, and validity section.

3.2 Research Design

A good research design allows researcher to draw valid inferences that can advance scientific knowledge. Valid inferences lead to theories that explain phenomenon (Plumper 2008).

To accomplish the above objective and to seek answer to the research questions, descriptive study used to obtain information about the effects of tax incentives on foreign direct investment. This research method helps in assessing the effects of incentives on the flow of foreign direct investment.

Both primary and secondary sources are used to conduct this research. Tax and incentives related data was taken. The data collected by employing a survey strategy to suggest possible reasons for the relationships between variables and to produce models of these relationships.

3.3 Population and Sampling Technique

Population consists of every element in the area of study. A sample is a random selection of element of a population for which inferences are drawn to represent the entire population (Moore et al, 2012).

For this study the source populations were the current government officials/employees in investment promotion department & duty free scheme department of Ethiopian Investment commission, Oromiya and Addis Ababa investment commission and Employees of Ethiopian revenues & Customs Authority incentive administration & investment promotion support team. Due to the difficulty in addressing all concerned government bodies throughout the country the researcher uses a convenience/deliberate sampling technique. It’s a non-probability sampling technique that involves purposive or deliberate selection of particular units of the universe for constituting a sample which represent the universe.

The preliminary survey undertaken by the researcher before questionnaire distribution indicated that there are two government offices & two departments that are considered to be most relevant for the study. The sample population of this study comprises employees from two different government bureaus. I.e. from federal, Oromiya and Addis Ababa investment the investment promotion & duty free scheme department and from Ethiopian revenues & customs Authority HQ support team for tax incentive & from kality Branch incentive administration department.

In order to gather appropriate information relevant to this study, the researcher takes foreign investors who invest in Ethiopia. It was difficult to exactly determine the exact number of respondents, since there are a number of foreign investors who invest in different types of economic activities. The researcher contact foreign investors who are resident in Addis Ababa and around. There are about 1,924 foreign investors who work around the capital city and the researcher take a sample of 155 by using non-probability sampling or purposive sampling by selecting particular units for inclusive in the sample based on the ease of access.

3.4 Data Sources

The study used secondary and primary data for analysis. Designing a good data collection instrument leads to accurate and quality results. Data collection methods include: direct observation and questionnaires (Glewwe and Grosh, 2000).

Data collection was done through both secondary and primary sources. Primary data sources included key informants for each case study. Secondary data sources mainly covered government publications, technical document, and annual reports. Secondary data covered different sources and provided an essential preparation for the interviews. Secondary data helped to cross-check official information, learn about major events, technical details, historical decisions and main organizational players and roles. They also supported the exploring of particular responses during interviews.

Secondary data was collected from, federal investment commission, Ethiopian revenue and customs authority, and previous studies both published and unpublished. The data was be used to analyze investments trends and revenue losses by the government through incentives.
The data was collected by questionnaire and interview.

The interviewees were chosen for their relevance to the conceptual questions rather than their representativeness. The interviewees were selected on the basis of their closeness to the topics of the study project and their levels of experience in management and organizational issues. It was deemed essential not to limit interviewees to is/it staff. The way in which the data collection was organized is described in detail in the next chapter.

3.5 Procedures of Data Collection

To get reliable information that helps to the paper, interview was held with respondents as an individuals and groups. In addition to these, questionnaire will also designed as open and closed ended. Observation may take place at some investment projects around Addis Ababa.

The questionnaire had four sections. The first section was on the background of the respondents, which request information on the age, sex, work experience, educational qualification. The second section is about the availability of tax incentive. The third section is about investment specially FDI trend. The fourth section is focused on the linkage/relationship linking investment & investment incentives

3.6 Methods of Data Analysis

Data analysis is a scientific fact finding process used to test hypothesis and draw inferences that later contribute to a theory. It simplifies a rather complicated process and makes it usefully to users of the information (Macintosh, 1996).

This study involved qualitative and quantitative data analysis. The researcher used comparative analysis for interview by using participants who have contacts with incentives and better knowledge with the topic. For the questionnaires, the data was analyzed using computing software, Microsoft excel spreadsheet and Statistical package for social sciences (SPSS) computer package. Mathematical model also used to analyze the relationship between different variables. Correlation analysis was carried out on FDI inflows and tax policy and incentives variables to establish whether there was any relationship.

3.7 Data Validity and Reliability

Validity refers to the appropriateness of the inferences made about the results of an assessment. Inferences being "conclusions derived from empirical evidence bearing on score meaning" (Messick, 1989). Secondly, validity is a matter of degree and not a specific value. Thirdly, validity is applied to a specific purpose or use and therefore is not valid for all purposes. Fourthly, validity is seen as a unitary concept, meaning that there are a number of different types of validity. Lastly, validity is concerned with an evaluative judgment about an assessment (Gregory, 2000). Of all the different types of validity that exist, construct validity is the most important form. Construct validity forms the basis for any other type of validity and from a scientific point of view is seen as the whole of validity (Mislevy, 2007).

Reliability reflects consistency and replicability over time. Furthermore, reliability is the degree to which a test is free from measurement errors, since the more measurement errors occur the less reliable the test (Fraenkel&Wallen, 2003; McMillan & Schumacher, 2001, 2006; Moss, 1994; Neuman, 2003).

In this study, empirical investigations took place by means of rich analyses, to determine the level of validity of the Picture Vocabulary Test. Following Messick's (1989) concept of validity and reliability interrelating within an assessment. These empirical investigations that took place lead the study to integrate a Positivist theoretical framework which aided in investigating the items and the level of validity of the assessment distinct from other factors.

3.8 Definitions of Variables

Though many variables have been proposed by literatures as the effect of tax incentives and other determinants on the flow of FDI, it is not possible to include all of them. Due to this fact the researcher chose few of them depending on previous studies specific to a country, the strength of the variable, availability of data. The main variables in the analysis for which data collected are:

3.8.1 Dependent Variable

Foreign Direct Investments (FDI): FDI are the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor (World Bank, World Development Indicators, 2012). In line with the approach used in the Literature, the dependent variable used in this study is measured as the log of net foreign direct investment net inflows.

3.8.2 Independent Variable

Tax Incentives: there are different types of tax incentives implemented by many developing countries and transition economies in attracting FDI inflow. Both domestic and foreign investors engaged on investment areas are eligible for investment incentives. To encourage private investment and increase inflow of foreign capital and technology to Ethiopia the government revised proclamation policy. The variable expected to be positively correlated with FDI inflow.

Market Size**:** the market size hypothesis states that multinational firms are attracted to a larger market in order to utilize resources efficiently and exploit economies of scale (Chakrabarti, 2001). Market size has been represented by real per capita GDP and growth rate of real GDP (as market growth potential). Real GDP per capita and Real GDP growth rates are included in the regression as measures of market attractiveness and FDI is expected to be positively related to these two variables.***

Inflation Rate: As it is defined in world development indicator (World Bank, 2014) the calculation of inflation is measured by the consumer price index which indicates the annual percentage change of the average consumer cost in acquiring a basket of goods and services over the interval time. In this context, high or volatile inflation rate signifies an explicit evidence of country's instability and presents a barricade for FDI inflow. High inflation acts as deterrent of FDI inflow. Rate of return on investment get reduced because of inflation (World Bank, 2014).

Political Instability: *It* is a dimension of governance which measures country risk with the expectation that it might have negative impact on inflows of FDI. Data for these indices are drawn from freedom house database. The variable expected to be positively correlated with FDI.

Infrastructure**:** infrastructure covers many dimensions ranging from roads, ports, railways and telecommunication systems to the level of institutional development. The availability of well-developed infrastructure will reduce the cost of doing business for foreign investors and enable them to maximize the rate of return on investment (Morriset, 2001). Therefore countries with good infrastructures are expected to attract more FDI. It is a standard practice to measure infrastructure by the number of telephone lines per 1000 people in a country. Asiedu (2004) argues that this measure does not include mobile phones. Moreover, it only captures existing infrastructure and fails to take into account potential infrastructure. The variable expected to be positively correlated with FDI.

******* The IMF International Financial Statistics Year Book reports GDP values using the local currencies, so annual average exchange rate is used to convert the local currency values into US$ equivalent. The nominal values of GDP were, then, converted into real value using GDP deflator.

3.9 Ethical Consideration

The study discussed ethical considerations. In order to address ethical consideration aspect in an effective manner the researcher considered the following points:

- Voluntary participation of respondents in the research is very important. Respondents are selected by checking their willingness to give information.
- Respondents should participate on the basis of informed consent. The researcher gives enough information about the research and explains the implication of their participation.
- The protection of the privacy of research participants ensured. The researcher even cannot know which respondent answer each questionnaire.
- There is no affiliation in any form and the source of funding to run this research covered by only the researcher.
- Any type of misleading information as well as representation of primary data findings have no any biased.

CHAPTER FOUR

4. DATA PRESENTATION AND ANALYSIS OF FINDINGS

4.1 Introduction

This chapter presents a discussion of the results and the process through which the results were obtained. First the background information of respondents is presented and discussed. The chapter also deals with the presentation and an analysis of data collected and discusses it in relation to tax incentives and foreign direct investment. The statistical methods used for analyzing the data collected include frequency results, descriptive statistics analysis, a correlation analysis, and simple linear regression analysis by using SPSS version 20.

4.2 Background Information of Respondents

A total of 155 questionnaires were sent among foreign direct investors who invest and resident in Addis Ababa and around - Eastern industry zone and Bole Lemi industry zone. There were also interviews with customs officers and investment officials - Addis Ababa, Oromiya and federal investment commissions. 155 questionnaires were sent and 114 questionnaires were returned which is 73.5% response rate. Most studies show that the response rate is ranging from 64% up to 85%, which indicates this response rate is averagely good.

4.3 Respondents Profile

From the 114 respondents 89 are male and the remaining 25 are female. The age composition of the respondent's shows that 7.9% of the respondents are between the age 18 and 25, 37.7% of respondents is between the age 26 and 35, 29.8% of respondents are between the age 36 and 45. The remaining respondents (24.6%) are over 45 ages.

Concerning the respondents work experience 11.4% of them has less than three years, 39.5% responds they have experienced between 3 and 6 years, 19.3% of them have from seven and ten years, 18.4% have experience between 11and 15 years. The reaming respondents (11.4%) have over 15 years' experience.

When we see the area of investments which the respondents participate, 18.4% are in manufacturing, 21.1% - agro-processing, 17.5 % - construction, 10.5% - agriculture, 21.9% - service sectors and the reaming 10.5% invested in other investment area. The response shows that, the necessary sectors that are privileged to tax incentives are touched.

Table 2: Tax incentives can stimulate FDI?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	99	86.8	86.8	86.8
	No	15	13.2	13.2	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

When there is a tax incentive, foreign investors wants to come to invest in the country, 86.8% of the respondents argued that privileges have a power to attract investors. The remaining 13.2% of them specifies tax incentives are not the major factors to stimulate foreign direct investment in Ethiopia.

Domestics and foreign tax policies affect the incentive to engage in FDI. According to (Imad, 2002) there are three approaches in which tax policies affect multinational company's decision making. First, tax on income earned from abroad operational will affect net return of foreign investment. Second, tax on income obtained in home country impacts the domestic net of return and eventually will affect fund allocation for foreign investment. Third, tax treatment affects the magnitude of cost of capital for both foreign investment and domestic investment.

Most investment policy measures introduced in 2016 aimed at investment promotion, facilitation and liberalization. Some 58 countries and economies adopted at least 124 investment policy measures – the highest number since 2006. Entry conditions for foreign investors were liberalized in a variety of industries, and numerous countries streamlined registration procedures, provided new investment incentives or continued privatization. (World economic report UNCTAD, 2017)

Different studies on the effect of tax policy and incentives shows, countries are very alert to revise their current investment policies so as to attract FDI. Tax incentives have much power to stimulate the flow of foreign direct investment in host country. The result is consistent to such arguments.

Table 3: Tax incentives are well communicated to investors?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Highly	31	27.2	27.2	27.2
	Medium	56	49.1	49.1	76.3
	Low	27	23.7	23.7	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

When investment incentives are granted it's obvious that it will help to attract investors to come and invest. Ethiopian investment commission and regional investment agencies promote the country's and their regional investment capacities which is suitable for investors throughout the world themselves and by using the country's embassies. 27.2% of the respondents indicated investment incentives have been highly communicated, 49.1% of them argued the promotion is medium and the remaining 23.7% tells the work is not as much and it is low.

Table 4: Did you get those incentives as per?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	46	40.4	40.4	40.4
	No	68	59.6	59.6	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

Based on the government's promotions that invite foreign investors, foreign and international companies have a desire to come and invest in Ethiopia. By assuming the promises given by the local government, investors come with a huge amount of capital, machinery, vehicles, spare parts and other goods and they apply to get those incentives. 40.4% of the respondents argued that they will get incentives as per and more than half of them (59.6%) of them says they didn't get the incentives that are promised at the promotion.

The promises given to foreign direct investors at the time of the promotion activity which has been done by federal investment commission and different embassies of the country is not consider the exact rules and regulations as well as the country's situations. This is the main problem that FDI faces when they come into action. The service delivery system related to tax administration and incentive privileges is not standardized like other countries.

Table 5: which are the major determinants of investment?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Tax factors	72	63.2	63.2	63.2
	Non-tax factors	42	36.8	36.8	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

Response gathered about the determinants of investment in Ethiopia, 63.2% of the respondents are responds that to invest in Ethiopia the major determinants are related to tax. But the remaining 36.8% argued the main factors are associated to non-tat factors.

According to Roca (2010), non-tax factors are more important when it comes to assessing the amount and the quality of the investment than the tax benefits, particularly in the case of developing countries. The nontax factors usually cited are political stability, legal security, undistorted macroeconomic politics, the quality of the workforce and the state of the infrastructure. But developing countries have not stopped using tax benefits with a view to increasing investment, particularly foreign direct investment (FDI).

Fiscal incentives are necessary to compensate for the extra expense foreign investors have to face when doing business, especially where there are significant shortcomings in the non-tax factors. But there are arguments in today’s global economy, characterized by high capital mobility; a low effective tax rate has to be offered to attract foreign investment. The procedure for reducing taxation on capital, which countries resort to so as to attract foreign investment is called tax competition. Although the rate of return of the taxes may then be positive in country A, the investment could be found in country B if; after tax, that rate is higher in B because of a lower taxation on the capital (Klemm, 2009). Eliminating the corporate income tax is the full application of increasing investment. But another way of getting into tax competition for mobile capital is by granting fiscal incentives. Easson&Zolt (2002) pointed out that designing tax incentives requires two basic decisions such as determining the types of investment and determining the form of tax incentive to adopt. Tax incentives for investment take a variety of forms such as investment allowances and credits, accelerated depreciation, reinvestment incentives, reduced import taxes and custom duties.

Table 6: Impact of tax incentives on investment

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	High	48	42.1	42.1	42.1
	Medium	34	29.8	29.8	71.9
	Low	21	18.4	18.4	90.4
	No impact	11	9.6	9.6	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

When companies import different types of product, they will pay customs duty and taxes based on the current customs value and tariffs. Revenue also collected based on the companies over all activities like VAT, income tax. 42.1% of the respondents agreed that the incentives given by the government support them by decreasing the costs of their companies. 29.8% says the effect of tax incentives is medium, 18.4% argued the effect is low. And the remaining 9.6 % of respondents announce that there is no impact on their investment.

According to Bond (2011), tax related privileges are among the most widely used incentives, especially in developing countries. Tax incentives are used by governments to help stimulate foreign investment, used in the hopes of increasing the gross domestic product (GDP) in developing countries. Tax incentives are a way in which governments attract foreign investors and often put in place in particular industries to help promote growth (Investopedia, 2011). Tax incentives have been a popular device for encouraging firms to locate in a particular area. Under a tax incentives, a firm is given a reduced (usually zero) tax rate for a specified period of time, at the end of which the firm begins to pay taxes at the usual rate and they are also free from imported taxes. This type of program has been used as one of the primary policy tools in a number of countries which are relying on an export-led growth policy (ibid). The tax incentive is a factor for investment, especially in some sectors that do not generate income at the time of commencement of the business.

Table 7: Which is the major obstacle for investors in Ethiopia?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Customs and tax related problems	40	35.1	35.1	35.1
	High cost of doing a business	2	1.8	1.8	36.8
	Infrastructure problems	20	17.5	17.5	54.4
	Investment climate	3	2.6	2.6	57.0
	Government bureaucracy	32	28.1	28.1	85.1
	Lack of market	9	7.9	7.9	93.0
	Others	8	7.0	7.0	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

There are many factors which any investors want to know before they decide to invest in foreign country. 35.1% of the respondents clearly noted that customs and tax related problems are the main obstacle to do a business in Ethiopia. To export and import, the time that will take still much even when we compare to other sub Saharan countries. To solve these problems, ERCA and the Ethiopian government are working to modernize the current IT system which the country now exercises with the help of foreign donors. The country also applying to WTO to be a member. To meet the requirements of WTO, the government try to do major amendments that are very helpful not only to full the requirement, to decrease the cost of customers and to facilitate the service delivery by cutting some unacceptable and meaningless procedures.

1.8% of the respondents respond that High cost of doing their business is the major obstacle. 17.5% of them argued that infrastructure is the main problem to invest in Ethiopia. The total investment climate assumed as a problem by 2.6% of the respondents. Bureaucracy in different governmental organizations is the major tackle to invest in Ethiopia and it get 28.1% of the respondents. They states that most of the government services have problems at the ground level. Lack of market and other problems assumes as a major problems by getting 7.9% and 7% respectively.

There are also problems stated by respondents regarding land management office, ministry of industry, ministry of trade, NBE regarding the issue of hard currency to import raw materials and other necessary equipment for the sake of the company production purposes.

Table 8: Did FDI is better than local investment?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	102	89.5	89.5	89.5
	No	12	10.5	10.5	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

Foreign direct investment has a power to boost the local investment climate. Now a days international company wants to work abroad because of different reasons. 89.5% of the respondents argued that FDI is better than local investment.

The benefits of FDI extend well beyond attracting needed capital. Foreign investment also confers technical know-how, managerial and organizational skills, and access to foreign markets. Furthermore, FDI has a significant potential to transform economies through innovation, enhancing productivity, and creating better-paying and more stable jobs in host countries, in sectors attracting FDI as well as in the supportive industries (Arnold, Javorcik, and Mattoo 2011; Bijsterbosch and Kolasa 2009; Echandi, Krajcovicova, and Qiang 2015; Rizvi and Nishat 2009; WEF 2013). Importantly, foreign investors are becoming increasingly prominent players in delivering global public goods, addressing climate change, improving labor conditions, setting global industry standards, and delivering infrastructure to local communities. It brings foreign technology and frontier knowledge that, if successfully absorbed by local firms, can improve their productivity directly. FDI can also increase competition among firms in the local market by leading to a reallocation of resources away from less productive to more productive firms, thereby increasing aggregate productivity over the long run.

The remaining respondent with 10.5% states that foreign direct investment is no better than local investment which is owned by the local citizens.

Table 9: Which factors do you think that will drive investors to invest other than incentives?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Market size	35	30.7	30.7	30.7
	Cost of labor	42	36.8	36.8	67.5
	competition	12	10.5	10.5	78.1
	Others	25	21.9	21.9	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

In this study market size, cost of labor, competition and other factors are the alternatives given. From the alternatives presented most of the respondent's i.e. 36.8% has chosen cost of labor as the major force that attracts investment in Ethiopia. 30.7% select market size and 10.5 & 21.9% accounted for competition &other factors respectively.

Many studies proved that domestic market size is an important determinant of foreign direct investment. (Shamsuddin, 1994; Asiedu, 2006) Usually it is proxied by GDP and per capita GDP. According to Dunning (1998) and Caves (1996) market size found mostly influential in attracting market seeking FDI mode. Market seeking FDIs are aimed at serving local and regional market. Large markets help multinational enterprises to benefit from economies scale in producing large amount. (Cleeve, 2008)

Country's factor endowment is commonly understood as the amount of land, labor, capital, and entrepreneurship that a country possesses and can exploit for different sectors. The Rybczynski theorem (1955) explained that increasing the level of the labor supply will lead to raise production of the good which uses that factor intensively. Foreign investors try to benefit from cheap labor especially where production is labor intensive (Ali &Guo (2005)). In addition to cheap labor, the out-put labor ratio (labor productivity) also determines the inflow of FDI.

In the UNCTAD report regarding innovation & investment it listed out the determinant factors in Ethiopia some of the are unique geographical location, comparatively safe & less corrupted business environment, having a capital city that hosts head quarter of many national & international organizations and a bring a country that’s rich in culture and history can attract investors.

Table 10: Do you think poor investment climate and infrastructure can be supported by giving tax related incentives?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	28	24.6	24.6	24.6
	No	86	75.4	75.4	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

The question forward tries to assess the relationship between week investment climate and incentives relation to FDI. 75.4% of the respondents indicate that poor investment climate cannot be supported by tax incentives. According to different studies countries with weak investment climate incentive are not effective. The investment climate is a pre requisite for most investors whether they are domestic /foreign to invest in specific location.

James(2009) states “ In countries with weak investment climates—say, with extensive red tape on accessing land, starting a business, or exporting and importing—lowering the effective tax rate has limited impact on foreign direct investment (FDI). Morisset and Pirnia (2001) support this conclusion, stating that “incentives will generally neither make up for serious deficiencies in the investment environment nor generate the desired externalities.

The remaining 24.6% of the respondents argued that poor investment climate can be supported by tax related incentives.

Table 11: How did you rate the loan interest rate given by the Ethiopian government to foreign investors when we compare with other countries?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Very high	14	12.3	12.3	12.3
	High	28	24.6	24.6	36.8
	Medium	49	43.0	43.0	79.8
	Low	20	17.5	17.5	97.4
	Very low	3	2.6	2.6	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

12.3% of the respondents say that the loan interest rate given by the country is very high. 24.6% suggests it is high and 43% responds the rate is medium. 17.5 And 2.6% argued the rate given has low and very low return rate respectively.

The rate of return of an investment approached by literature through a real interest rate as a representative of the cost of capital is a possible determinant of private investment. The perceived negative relationship between interest rates and private investment is a long debated issue which pulls in a number of prior studies. Neo-classical theory Greene and Vilanueva (1991) suggests that, as high interest rates discourage investment by raising user cost of capital, private investment is negatively related to interest rate. Here, its worth to make two distinctions: the interest rate would have a negative impact in the level of private investment made by domestic agents if the investment is financed in the local credit market. However, an increment in interest rate could have a positive effect in the capital flow from abroad, like it usually happens in emergent markets.

Table 12: Did you think there are alternatives other than tax incentives to attract FDI for developing countries like Ethiopia?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	44	38.6	38.6	38.6
	No	70	61.4	61.4	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

Most developing countries uses tax incentives to attract foreign direct investments. 38.6% of the respondents say there are options other than giving tax incentives to attract FDI by: making the bureaucracy simple in government organizations, expanding infrastructure, creating attractive investment and trade environment, delivering loan service with reasonable interest rate, making the country stable in politics, paying attention to build bilateral agreements with other countries to allow the free movement of exported goods, decreasing the time taken to export and import.

The remaining 61.6% suggests that there is no option other than tax incentives in developing countries like Ethiopia. Because the others factors that are used to attract FDI like infrastructure are not in better potion so as to use as a mechanisms.

Table 13: Effect of better Infrastructure on investment

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly dis-agree	1	.9	.9	.9
	Dis-agree	7	6.1	6.1	7.0
	Neutral	23	20.2	20.2	27.2
	Agree	47	41.2	41.2	68.4
	Strongly agree	36	31.6	31.6	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

An efficient legal infrastructure reduces institutional uncertainties for foreign investors, facilitates establishment and enforcement of contracts and various other ways reduces the transaction cost of doing business. A well-developed financial infrastructure and capital market is also important for foreign investors because it facilitates access to local capital market. The better developed financial and capital market encourages business to set up operations, as they can access complementary local finance more easily and face lower transaction cost for local financial services such as the payment system.

0.9% of the respondents strongly dis-agree on infrastructure have effect, 6.1% dis-agree, 20.2% of them are neutral, 41.2 and 31.6% of the responses shows infrastructure's role on attracting foreign direct investment is vital by putting their answer agree and strongly agree respectively.

Table 14: Political stability have a great role on FDI

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Dis-agree	3	2.6	2.6	2.6
	Neutral	21	18.4	18.4	21.1
	Agree	44	38.6	38.6	59.6
	Strongly agree	46	40.4	40.4	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

The economic process of a country and in particular the inflow of FDI into a country can be disrupted by unsettled, implicit or explicit, internal or external political disputes and crises. Without stable political conditions, whatever the economic environment may be, a county's effort to create a more hospitable environment for oversea investors cannot be fruitful. Political instabilities can delay FDI until the storm weathers away or diverts away for good.

From the respondents 2.6% dis-agree, 18.4% neutral and 38.6% agree on the issue that political stability have a vital role to attract FDI. The remaining and much of them with 40.4% argued it is one of the main determinants that use to gain the interest of foreign investors.

Table 15: Financial support can attract FDI

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly dis-agree	3	2.6	2.6	2.6
	Dis-agree	17	14.9	14.9	17.5
	Neutral	38	33.3	33.3	50.9
	Agree	30	26.3	26.3	77.2
	Strongly agree	26	22.8	22.8	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

From the answer from respondents 2.6% strongly dis agree, 14.9% dis agree, 33.3 neutral, 26.3% agree and the remaining 22.8% strongly agree on that financial support has a great role on attracting foreign investment in Ethiopia.

The government of Ethiopia gives priority to manufacturing and agro-processing to support them financially. Development bank of Ethiopia is a well-known governmental institution which is responsible for this kind of support.

Table 16: Duty free privilege has good effect on investment in Ethiopia

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Dis-agree	3	2.6	2.6	2.6
	Neutral	17	14.9	14.9	17.5
	Agree	58	50.9	50.9	68.4
	Strongly agree	36	31.6	31.6	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

Governments need to perform various functions in the field of political, social and economic activities to maximize social and economic welfare. In order to perform these duties and functions governments require large amount of resources called public revenues. Public revenue consists of taxes, revenue from administrative activities like fines, fees, gifts and grants. However, taxes are the first and foremost important sources of public revenue which are central to the current economic growth and development agenda. The importance of taxation as a veritable tool of economic growth and development depends on a proper tax system which has the capacity to generate revenue through tax. While fulfilling the revenue function, taxes also have a pervasive influence on economic decisions of individuals and businesses, and on social equity. (SADC, 2004)

Ethiopia also uses taxes as revenue which is laid on import including local types of taxes. 2.6% of respondents dis agree on duty free incentives have a good effect to attract FDI, 14.9% are neutral and majority of them which account 50.9% agree on the good effect of it. The remaining 31.6% strongly agreed.

Table 17: Market size can attract FDI?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Dis-agree	11	9.6	9.6	9.6
	Agree	67	58.8	58.8	68.4
	Strongly agree	36	31.6	31.6	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

Market seeking companies have the objective to produce and sell the final out put in the host countries market. In undertaking investment of this kind, investors consider the feasibility of reducing costs (in comparison with cost of servicing the market as an export destination) and the potential growth in the size of the host country's home market in the long run. The growth in the host country's market depends on the general economic outlook in its economy. These types of FDI have several challenges and uncertainties that are paramount to the investment decision. In particular in the pace at which the new market will develop the ability of the firm to speed up this process and what share of the market the firm will be able to capture in the long run. For reason many firms prefer to explore by exporting before making actual investment.

From the respondents 9.6% dis-agree, 58.8% agreed and the remaining 31.6% strongly agree that the market size of the host country can attract foreign direct investment.

Table 18: Inflation rate can affect FDI?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Dis-agree	5	4.4	4.4	4.4
	Neutral	31	27.2	27.2	31.6
	Agree	57	50.0	50.0	81.6
	Strongly agree	21	18.4	18.4	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

The inflation variable is significant with the expected sign. The implication is that at higher level of inflation investors are enabling to invest because they fear that their assets are losing value. This finding implies that if there is stable price level in the country investors are interested to invest.4.4% of the respondents dis agree, 27.2% are neutral, 50% of them agree and the remaining 18.4% strongly agree that inflation rate in host country can affect foreign direct investment.

Table 19: Fair wage of employees can attract FDI?

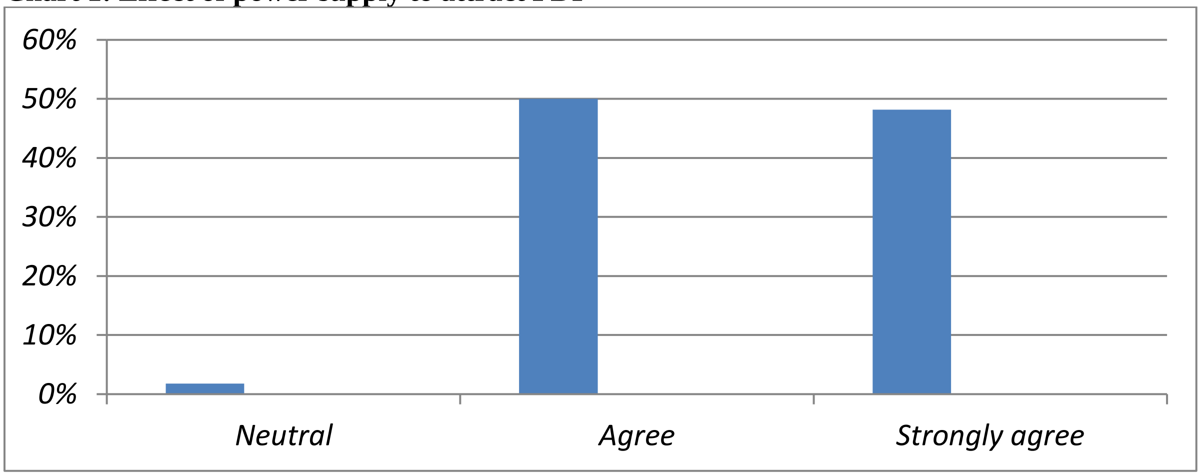
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly dis-agree	2	1.8	1.8	1.8
	Dis-agree	16	14.0	14.0	15.8
	Neutral	27	23.7	23.7	39.5
	Agree	41	36.0	36.0	75.4
	Strongly agree	28	24.6	24.6	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

Ethiopia's labor law, which regulates worker-employer relations, is in line with international conventions. With over 43 million workers, Ethiopia has the second largest labor force in Africa (World Bank, 2014). Ethiopia's minimum wage is among the lowest in Africa, with only 5 countries - Burundi, Uganda, Egypt, Gambia and Malawi - having lower minimum wages (ILO, 2010/11). Generally, private sector monthly salaries for university graduates range from USD 150 to USD 200, while construction sector monthly wages range from USD 60 for daily laborers to USD 300 for a foreman.

From the result 1.8% strongly dis-agree, 14% dis-agree, 23.7% neutral, 36% agree and 24.6% strongly agree on that the fair wage prayed to Ethiopian employees can attract the foreign investors to invest in the country.

Chart 1: Effect of power supply to attract FDI



Source: Questionnaire of the study

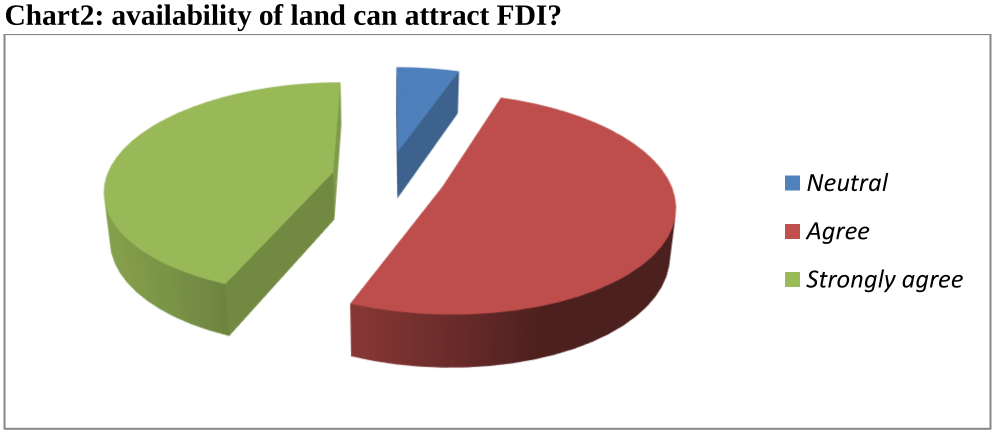
Ethiopia has enormous potential for hydropower and geothermal energy generation. Several studies have so far been carried out to estimate Ethiopia's energy potential and to develop short, medium and long-term investment plans for the power sector.

The country's hydropower potential is estimated at 45,000 MW and the potential for generating electricity from geothermal is about 5,000 MW. The country is also endowed with enormous potentials of other renewable energy sources like solar and wind, particularly in rural areas. Despite such huge resources, the country has so far managed to utilize merely 2000 MW of its power generating potential and only about 33 percent of the population has access to electricity. Since the formulation of the last comprehensive power system expansion master plan, the fundamental and unprecedented structural change that have taken place in the economy are now finding their driving force in the power sector. Currently, Ethiopia has around 2000 MW of installed power generating capacity, out of which 1,980 MW (99%) is generated from hydropower plants. The remaining12 MW (0.6%) and 8 MW (0.4%) comes from thermal and geothermal sources respectively. According to the five year Growth and Transformation Plan (GTP), the country's installed electricity generating capacity is expected to reach 10,000 MW by the end of 2014/15 from the current level of 2000 MW. In the same year, the electricity coverage of the country will be 75 percent. (Ethiopian investment guide-2015)

In addition, the Grand Ethiopian Renaissance Dam is an under-construction gravity dam on the Blue Nile River in Ethiopia. The dam will be the largest hydroelectric power plant in Africa when completed. There are also many hydroelectric power projects that can meet the power demand of large manufacturing in the country. The availability of power supply is the main requirement for foreign investors because all activities of their project at host country is based on it.

As shown on the graph, 1.8% of the respondents are neutral, 50% agree and the remaining 48.2% strongly agree about power supply of the country have a good opportunity to attract FDI.

Chart2: availability of land can attract FDI?



Source: Questionnaire of the study

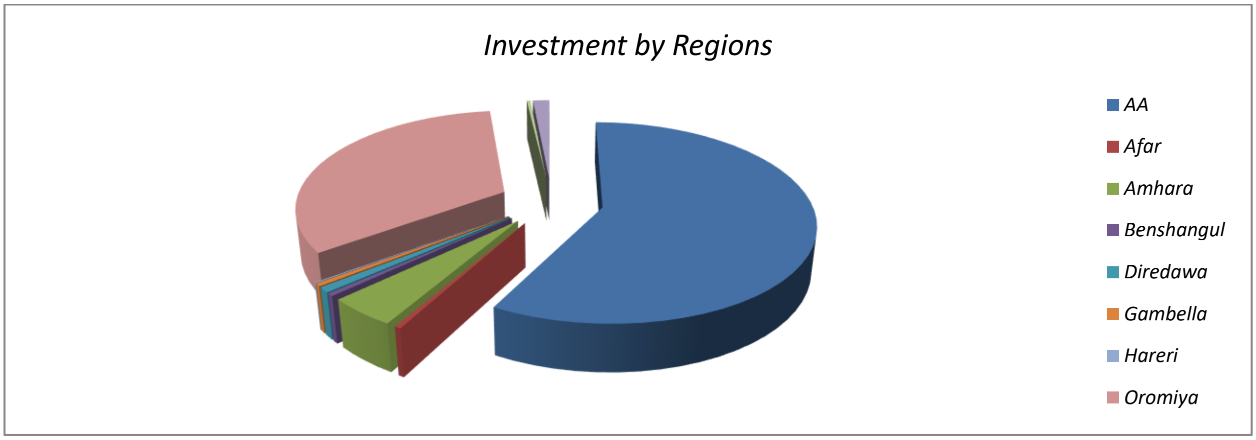
Ethiopia is the 27th largest country in the world by land size with the total area of 1.14 million square kilometer. From this 513,000 square kilometer land is arable. The topography and geographical location, it is suitable for the production of some of the world's most coveted food crops - cereals, pulses, oil seeds, a wide range of fruits and vegetables, coffee, tobacco, sugar cane, tea and spices, among others.

Investment commission and regional investment agencies gives more attentions to give the needed land area to FDI. In addition to this shades are built by both government and private investors to decrease the time of investors. Building Industry Park also gets a big concern by the government. There are more than ten industry parks build by the country and most of them starts operation. Eastern industry zone which is built by a Chinese investor and Huajian now it's working to finish its own park, are among the private parks.

From the respondents 5.3% are neutral, 50.9 agree and 43.9% strongly agreed that the availability of land in host country has a great role to attract foreign investors into the country. Some investors described their reaction when I was at investment commission to collect questionnaires that the land management offices especially at regional states are not as much as enough to get the service. The rules are very different in each region and they amend and put unnecessary requirements every time. For example they ask a bank deposit to get land for investment.

Related to Tax Authority and Investment Bodies

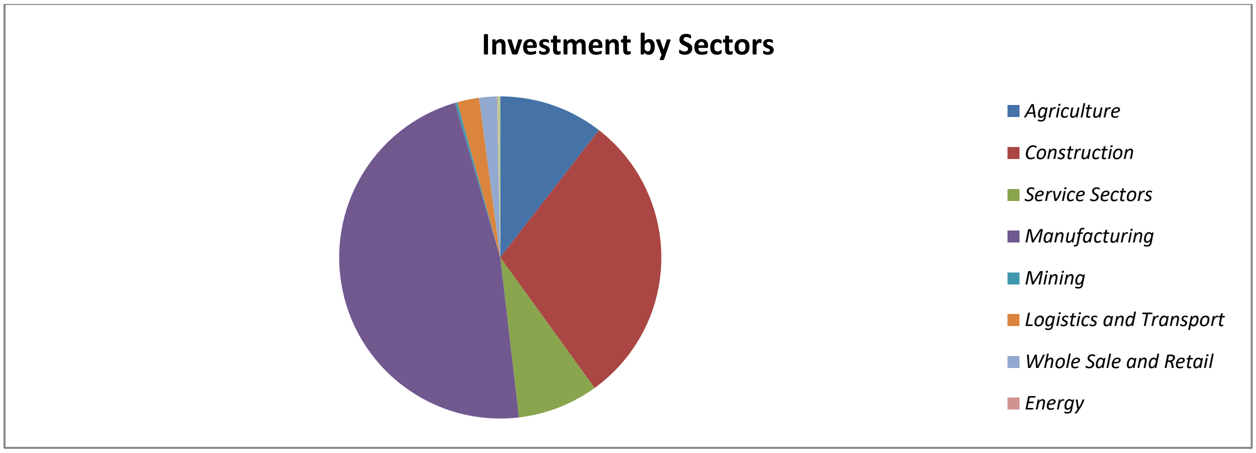
Chart 3: Investment by regions



Source: EIC

As shown from the above chart most of the investors are working in the capital, Addis Ababa. Oromiya region attracts much FDI next to Addis Ababa. This is mainly because of infrastructure, resources and markets attract them to concentrate on the two regions.

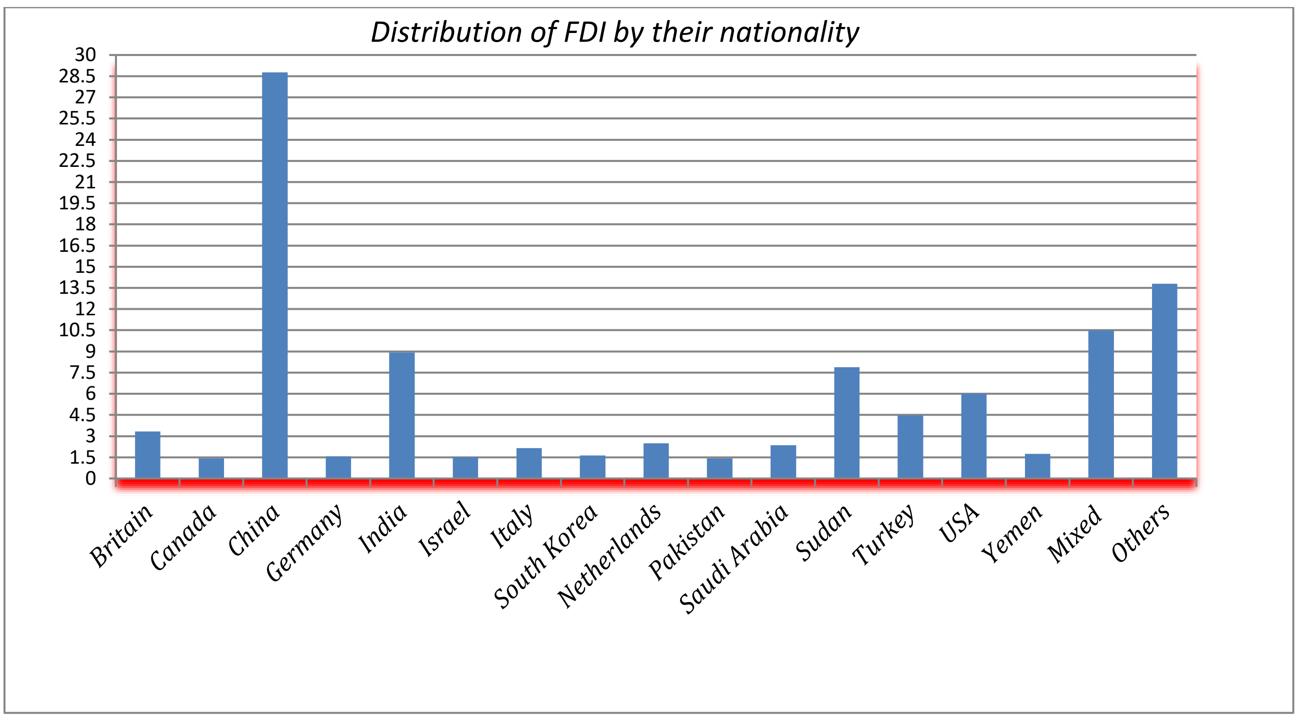
Chart 4: Investment by sectors



Source: EIC

When we see the investment sectors, most foreign investors are engaged in manufacturing. The government also gives special concern and support to this sector. Construction sectors follow manufacturing sector in number.

Chart 5: Distribution of FDI by origin



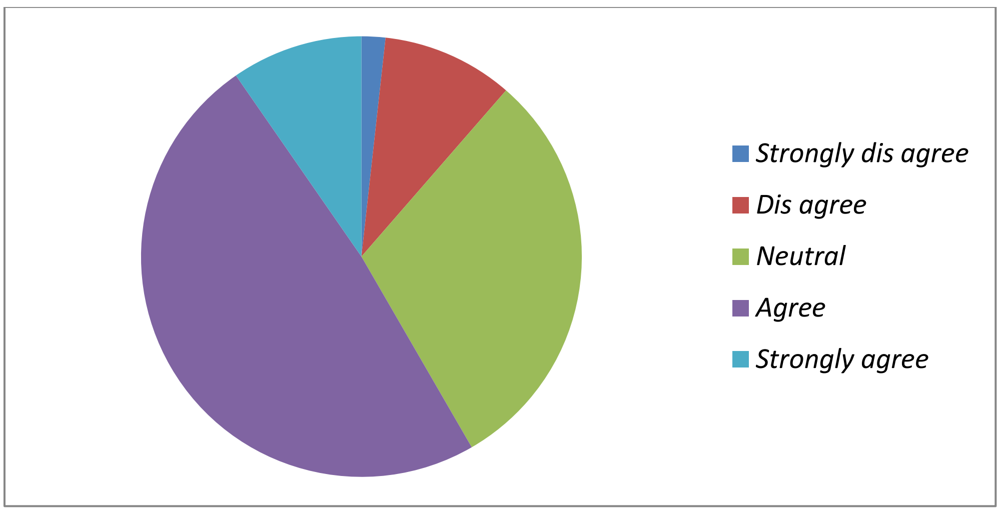
Source: EIC

When we see from the above chart, Chinese investors took the lion share in Ethiopian economy. U.S.A, Turkey, India and Sudan highly involved in the country. According to UNCTAD 2017, Ethiopia was by far the most dynamic and largest FDI recipient (accounting for almost half of the total inflows of LLDCs in Africa), thanks to improvements in infrastructure and advances in industrialization. Inflows to Ethiopia have been rising constantly since 2012, even when FDI declined in many other LLDCs.

Ethiopia attracted new FDI in manufacturing, which could create opportunities for local SMEs to link to global supply chains. Although China was one of the major sources of FDI, foreign investors from other economies have started investing more in Ethiopia's agro-processing, hotels and resorts, as well as in its manufacturing activities.

Ethiopia has focused on garment and leather production. Chinese investors also dominate announced green field projects in 2016 (Appendix 2). Estimated capital spending by Chinese MNEs skyrocketed from an annual average of $2 billion in 2013–2015 to over $14 billion in 2016.

Chart 6: Tax authority and Investment bodies have a enough and skilled man power



Source: Questionnaire of the study

It's well-known that all tax related incentives services are given especially by the tax authority and investment offices. 1.8% of the respondents strongly dis agree, 9.6 of the dis agree, 30.3% are neutral, 48.7% agree and 9.6 strongly agree on that both offices have enough and skilled manpower.

Table 20: Did they give Fair and fast service?

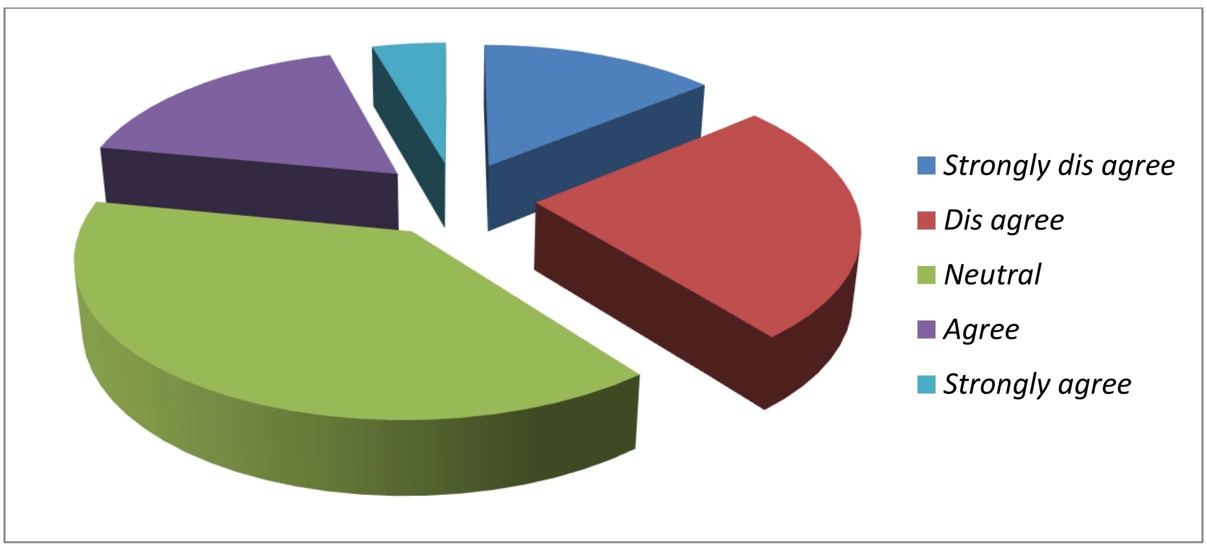
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Dis-agree	53	46.5	46.5	46.5
	Neutral	8	7.0	7.0	53.5
	Agree	20	17.5	17.5	71.1
	Strongly agree	33	28.9	28.9	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

Before assessing tax incentives it's a must to have an overview about the country tax system and also due to the fact that tax system design is also closely linked to domestic and international investment decisions the researcher has raised question on the tax system in Ethiopia.

According to (William B. Barker, 2007)" emerging economies do not have a model to rely on that demonstrates the efficient use of their tax systems to provide the critical ingredients for development, including increasing and retaining investment and at the same time increasing tax revenue. 46.5% dis agree7% neutral, 17.5% agree and 28.9% strongly agreed on the issue that both government organizations gives fair and fast services to investors.

Chart7: Did the government monitor the privileges given?



Source: Questionnaire of the study

There must be monitoring work to evaluate whether the investors are uses their privileges only for the given investment business. The data that collected from customs and investment officers by interview shows that this work is not properly done by customs, investment and other government concerned bodies. 14% of the respondents expressed by dis agree strongly, 25.4% disagree on the work is done properly. 38.6% are neutral, 17.5 agree and the remaining 4.4% strongly agree on the organizations are monitoring those privileges.

Table 21: Ethiopia gives more incentives than other African countries?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly dis-agree	42	36.8	36.8	36.8
	Dis-agree	32	28.1	28.1	64.9
	Neutral	9	7.9	7.9	72.8
	Agree	17	14.9	14.9	87.7
	Strongly agree	14	12.3	12.3	100.0
	Total	114	100.0	100.0	

Source: Questionnaire of the study

Table 22: Investment Tax Incentives in Selected Developing Countries

Country	Investment Tax Credit	Accel. Deprec'n	Sectoral incentives	Export incentives	Regional incentives	Loss carry forward	Yrs Tax holidays	CT rate
Botswana	None*	Mining+ cap all.	Yes	Duty exemptions	No	5**	None	25%
Egypt	None	5-20%	Yes	Yes	Yes	5	5-20	40%(32)
Ethiopia	---	Yes	Yes	Yes	Yes	3-5	1-5	35%&
Ghana	None	5-20% pa	Yes	Yes; less CT in NTE	Yes (-25/-50%)	5	5-10	30-32.5%
Kenya	None	Yes	Limited	Yes	No	Unlimited	10	30-37.5
Lesotho	None	5-25% pa	Yes	Yes	No	Not avail.	None	15-35%
Mauritius	10% antipollution***	Yes	Yes	Extensive	No	Unlimited	0-10	15-25-35%
Nigeria	5-20%	No	Yes	Yes	No	4	3-5	30%
Rwanda	None$	5-50% pa	Yes	Yes	Yes	5	None	30%
Tanzania	None	25-100%	Yes	Yes	Yes	5	2-5@	30%
Uganda	None	5-20%	Yes	Yes	Yes	Unlimited	10	30%

Source: El-Samalouty (2000) and UNCTAD Investment Policy Review series.

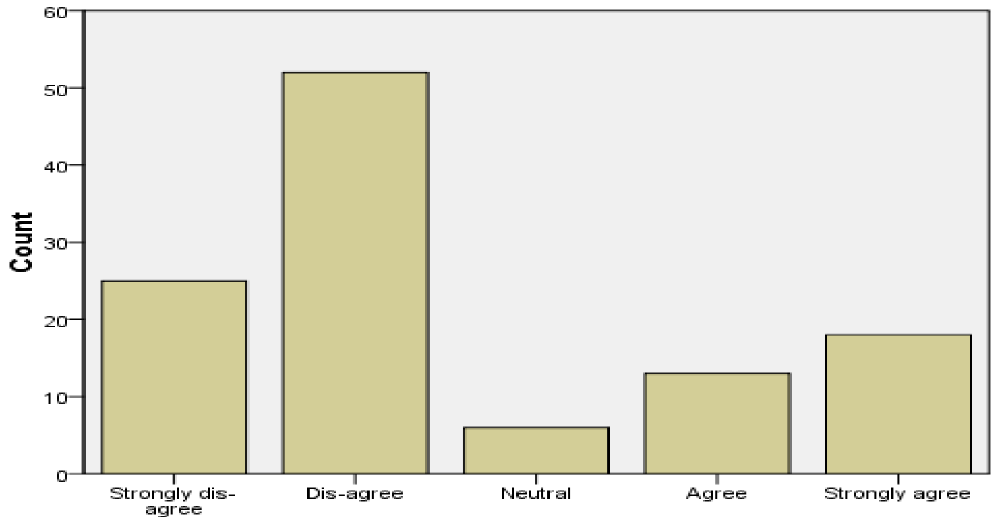
Note: * Minister can agree reduced tax rate or favorable treatment of expense deductions case-by case
****** Indefinite loss carry-forward for post-development expenditure in the mining sector.
*** Favorable capital allowances plus a 25% investment allowance on new premises, plant and Machinery and computer software available in the first year.

Table 20: lists the incentives that may be used for different purposes to achieve different objectives, with their advantages and drawbacks. Fiscal incentives differ in their approach (whether they are broadly-based or selective); their coverage of taxable parties; which taxes are used; and the appropriate tool or incentive. Tax incentives have different effects on economic behavior and efficiency. Policy-makers' choice of fiscal instruments from Table 3 depends on the structure of the economy, government objectives and on the activities, companies and investors that the government wish to promote. According to how they operate, different tax incentives can have different impacts on:

 New versus existing companies;
 New versus continuing investments;
 Short-term versus long-term investments; and
 Firms with existing sales revenues versus firms with future cash flows (e.g. start-ups, with longer-term projects).

From the respondents 36.8% strongly dis agree, 28.1% dis agree, 7.9% neutral, 14.9% agree, 12.3% strongly agree on the issue that Ethiopia gives more privileges than other African countries.

Chart 8: Ethiopia gives more incentives than other African countries?

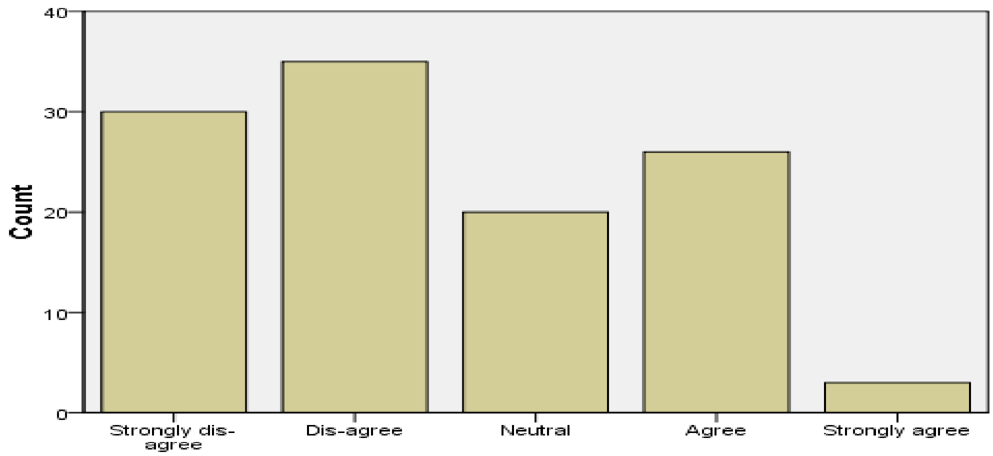


Source: Questionnaire of the study

From the response 21.9% strongly dis agree, 45.6% dis agree, 5.3% neutral, 11.4% agree and the remaining 15.8% strongly agree on the Ethiopian government grants more privileges to foreign investors than local citizens.

Based on the investment regulation number 270/2012, some economic activities are restricted to only for local citizens. Financial institutions like insurance and banks, telecommunication, electricity utility are also locked for foreign nationals.

Chart 9: Did necessary sectors privileged for incentives?



Source: Questionnaire of the study

Based on the council of ministers regulation number 270/2012, the areas of investment which are privileged to incentives are listed. The respondents listed some sectors which have no privileged but their economic importance is high. Such as:

- To invest at health sector like laboratory services, specialized clinics and hospital and at education related, the regulation states that there must be a land owned by the investors to get the privileges listed on it. But, it is difficult to get land at big cities like Addis Ababa.
- Cleaning services have no privileges. The number of high buildings in many cities of the country is increasing and they need sophisticated technology and skilled manpower to operate the wok.

As shown on the above graph 26.3% strongly dis agree, 30.7% dis agree all necessary sectors are granted privileges. 17.5% are neutral and the reaming 22.8 and 2.6% expressed all necessary economic sectors are privileged by putting their votes on agree and strongly agree respectively.

Outputs from SPSS

Bootstrap Specifications

Sampling Method	Simple
Number of Samples	114
Confidence Interval Level	95.0%
Confidence Interval Type	Percentile

Descriptive Statistics

		Statistic	Bootstrap[a]			
			Bias	Std. Error	95% Confidence Interval	
					Lower	Upper
Infrastructure	Mean	3.96	.00	.08	3.80	4.13
	Std. Deviation	.921	.002	.061	.827	1.075
	N	114	0	0	114	114
Political stability	Mean	4.17	-.01	.08	3.98	4.35
	Std. Deviation	.819	-.001	.048	.725	.911
	N	114	0	0	114	114
Market size	Mean	4.12	.01	.08	3.95	4.28
	Std. Deviation	.832	-.013	.073	.653	.951
	N	114	0	0	114	114

a. Unless otherwise noted, bootstrap results are based on 114 bootstrap samples

Correlations

				Infrastructure	Political stability	Market size
Infrastructure	Pearson Correlation			1	.500**	.121
	Sig. (1-tailed)				.000	.100
	Sum of Squares and Cross-products			95.860	42.667	10.491
	Covariance			.848	.378	.093
	N			114	114	114
	Bootstrap[c]	Bias		0	-.005	-.023
		Std. Error		0	.080	.081
		95% Confidence Interval	Lower	1	.318	-.052
			Upper	1	.646	.283
Political stability	Pearson Correlation			.500**	1	.048
	Sig. (1-tailed)			.000		.308
	Sum of Squares and Cross-products			42.667	75.833	3.667
	Covariance			.378	.671	.032
	N			114	114	114
	Bootstrap[c]	Bias		-.005	0	-.013
		Std. Error		.080	0	.073
		95% Confidence Interval	Lower	.318	1	-.105
			Upper	.646	1	.189

Market size	Pearson Correlation			.121	.048	1
	Sig. (1-tailed)			.100	.308	
	Sum of Squares and Cross-products			10.491	3.667	78.281
	Covariance			.093	.032	.693
	N			114	114	114
	Bootstrap[c]	Bias		-.023	-.013	0
		Std. Error		.081	.073	0
		95% Confidence Interval	Lower	-.052	-.105	1
			Upper	.283	.189	1

**. Correlation is significant at the 0.01 level (1-tailed).

*. Correlation is significant at the 0.05 level (1-tailed).

Unless otherwise noted, bootstrap results are based on 114 bootstrap samples

The final step is conducted is generating the correlation matrix and checking whether the variables do not correlate too highly or too lowly with other variables (Field, 2009). If variables correlate too highly (r > 0.8 or r < -.8), "it becomes impossible to determine the unique contribution to a factor of the variables that are highly correlated." (Field, 2009). If a variable correlates lowly with many other variables (-0.3 < r < 0.3), the variable probably does not measure the same underlying construct as the other variables. Both the highly and lowly correlating items should be eliminated. As can be seen in the above table, none of the questionnaire items correlates too highly with other items, but some correlate too lowly with several other items. That does not necessarily mean that the items should be eliminated: the variables with which they do not correlate enough could constitute another factor. There is one objective test to determine whether the items do not correlate too lowly: Bartlett's test. However, that test tests a very extreme case of non-correlation: all items of the questionnaire do not correlate with any other item.

Bootstrap for One-Sample Test

	Mean Difference	Bootstrap[a]				
		Bias	Std. Error	Sig. (2-tailed)	95% Confidence Interval	
					Lower	Upper
Sex	1.219	.003	.039	.009	1.148	1.291
Age	2.711	.003	.081	.009	2.553	2.870
Tax incentives can stimulate FDI	1.132	-.001	.032	.009	1.069	1.194
Work experience	2.789	-.003	.125	.009	2.553	3.043
Area of investment	3.281	-.021	.143	.009	2.939	3.521
Tax incentives well communicated	1.965	-.004	.071	.009	1.813	2.099
Did you get those incentives as per	1.596	.001	.048	.009	1.490	1.693
Which is major determinants	1.368	-.001	.045	.009	1.271	1.456

Impact of tax incentives	1.956	.010	.090	.009	1.805	2.151
Major obstacles	3.456	.005	.223	.009	2.912	3.856
FDI better than local	1.105	.001	.028	.009	1.053	1.167
Factors other than incentives	2.237	-.018	.093	.009	2.061	2.431
Poor investment supported by incentives	1.754	-.011	.040	.009	1.649	1.825
Loan interest rate	2.737	-.006	.100	.009	2.540	2.949
Is there alternatives	1.614	.002	.046	.009	1.525	1.711
Infrastructure	3.965	-.005	.090	.009	3.759	4.113
Political stability	4.167	-.006	.080	.009	3.998	4.334
Financial support	3.518	.007	.095	.009	3.331	3.719
Duty free	4.114	-.001	.069	.009	3.972	4.256
Market size	4.123	.000	.083	.009	3.921	4.308
inflation rate	3.825	-.005	.067	.009	3.683	3.959
Fair wage	3.675	.017	.095	.009	3.525	3.913
Power supply	4.465	.006	.051	.009	4.367	4.605
Land	4.386	.000	.054	.009	4.296	4.501
Human resource	3.789	-.004	.083	.009	3.622	3.966
skill	**3.307**	**-.006**	**.072**	**.009**	**3.166**	**3.430**

a. Unless otherwise noted, bootstrap results are based on 114 bootstrap samples

Cronbach's Alpha	N of Items
.662	44

Scale Statistics

Mean	Variance	Std. Deviation	N of Items
95.89	70.403	8.391	34

Cranach's is the most common measure of internal consistency (reliability). It is 0.662 which is above the acceptance level of 0.6.

CHAPTER FIVE

5. SUMMARY, CONCLUSION AND RECOMENDATIONS

5.1 Summary

Major Findings from Interview

- The incentives are given to any investors who wants to invest in the country can attract to do a business.
- Other than the given incentives, the bureaucracy in different governmental organization is the main problem that affects the whole investment activity. And the services are not supported by IT infrastructure. All such services have a great problem at the ground level. Some government employee is not ethically fit to their positions.
- The government lacks power to enforce the regulations and proclamation of investment. The privileges are given and prohibited without clear justification. The rules and regulations are not clearly defined.
- Customs and tax related problems have the power to affect investment. The time taken to import and export is one of the lowest in the world.
- The sartorial coordination between organizations that are attached with privileges services is very low. The decision from one office is not accepted by the other one. Example: ministry of industry and ERCA dis agree each other on the voucher and other export related incentives. Because of this the service delivered to investors are got delayed. The national input output coefficient is not applied until and because of this the reconciliation process takes four months averagely.
- To get land for investment, it's very difficult especially in big cities like Addis Ababa and it has a very long process with different performance across many regional states.
- One stop service lonely done by the federal investment commission. But other regional and city administration investment agencies didn't apply the same business. So because of this it's difficult to get other government services at the same point, especially to get utilities like water and electric power.
- Government should pay attention to build bilateral agreements with other countries to allow the free movement of exported goods
- There are many sectors that are not open to foreign investors
- Now a day it is very difficult to get hard currency for the purpose of importing capital goods and raw materials for the investment.

Major Findings from ERCA and Investment Employees

- The controlling system regarding the given incentives is not done properly. The country loses much revenue each year which is equivalent to the revenue collected amount. But on the regulation of investment commission and ERCA, the power of controlling and supervising the incentives that are given to investors is given to them. Investment commission has the structure unlike ERCA. The government also didn't act on the issue for a long time still.

- The loan evaluation of development bank of Ethiopia has a great problem. Some companies go outside after consuming the privileges given to them without paying their loan interest. The capital asset that they leave when they go out is not as much as enough to replace their bank debt and tax related payment.
- Some investors come with foreign workers which the work can be done by the local people, so they affect the job opportunity that can goes to local citizens.
- Some of the machineries that are imported from abroad are used hic can cost by absorbing the country's hard currency.

5.2 Conclusion

The paper also used questionnaires and secondary data to access tax incentives and FDI. In the data analysis, part the researcher found data's that illustrate the condition that based on these the researcher draw conclusion.

- From the data's from EIA Investment has shown remarkable growth status. The volume and capital of in domestic, foreign and public investments are indicating encouraging numbers, this growth in investment plays vital role in creating employment opportunities, technological transfer and to adjust the counties trade balance.
- Promoting the country's overall investment potential to the outside world by using different Medias is not as much as enough. The work mainly done by using the embassies of the country.
- Most of the respondents agree that they didn't get the incentives that are granted at the time of promotion. It is difficult and complex the way to get those incentives at the ground level.
- Customs and tax related problems, infrastructure problem and government bureaucracy are the majors obstacles for investors. Customs rules and regulations are not matched with the international practices. It's also difficult to get water supply, electric power easily. In those areas the difficulty level is more complex.
- Foreign direct investment is better than local investment which can bring new technology, capital and innovations, can gives a job opportunity to local citizens. Skill also can transfer from the foreigners to local peoples. The country can also get foreign currency if they are focused on the export business.
- Based on the respondents, market size of the country and cost of labor can attract FDI other than the privileges given to them.

- Most of the respondents agree that developing countries like Ethiopia have no option other than giving tax incentives. It is because that they have no good infrastructure, there are also different problems what the investment environment did not want within.
- Political stability of the country has a great role to attract FDI. Security in different areas especially in Africa is the major problem for investors. Even the last for year's chaos in the country affect the overall activities of many investors.
- Financial support especially for manufacturing and agro-processing is another factor that can attract foreign investors in to the country.
- Power supply is the major problems for many countries in the world. Investors focused on this because the machineries need to operate with acceptable cost. Ethiopia gives focus to enlarge the supply of electric power not only the country's consumption rater for export purposes. Foreign investors attracted by the availability power in the host country.
- Even the country prepares shades in different industry parks, the availability of lands in different regions are not as per the demand for investment. The bureaucracy to get land is so difficult; corruption is also the main problem which affects the service delivery in many regions including Addis Ababa and Dire Dawa.
- Most respondents agree that the human resource at the customs and different investment offices are not equivalent both in skills and in number to serve the customers. The services also not as such supported by IT infrastructure. Because of this it is difficult to get those services as per the time standard.
- Monitoring and controlling of the privileges given is not properly done by both investment commissions and ERCA. It's difficult to know whether the investors are using their incentives only for the intended purposes. The only monitoring work that ERCA tries to do is that related to vehicles by using the information from the third part by paying for the given information. But it is not enough when we compare the given incentives.
- Most developing countries including Ethiopia give different types of incentives to attract FDI. When we compare the incentives given by the Ethiopian government with other African countries, it's not higher according to the respondents.
- There are restrictions on the incentives and all necessary investment areas are not included for the privileges.

5.3 Recommendation

This paper studied the assessment of tax incentives and Foreign Direct Investment (FDI) in Ethiopia. FDI affects economic growth of developing countries positively through transfer of capital, know-how, and technology. It increases activity not only in FDI beneficiary firms but also the effect can spread to other firms in the country and sectors through technology spillover, human and capital formation and increasing competition, thus raising productivity for the whole economy.

- The Ethiopian government must promote the country's potential investment opportunities not only through the embassies of the country in different countries in the world. The promotion must address via mass media which have many viewers like BBC, CNN, ALJEZIRA and different sport channels to increase the total awareness of the country and the investment climate that are favorable to foreign direct investors.
- Investment board and other regulatory bodies must clearly defined which capital goods, construction material and vehicles are privileged to incentives to decrease and avoid the complain of investors that comes when they are forced to pay duty and taxes at the arrival of the shipment.
- The government must work to design simple and transparent tax system based on the international standard to facilitate the services and to decrease corruption at the tax systems.
- There must be a change by cutting the unnecessary bureaucracy in different government organizations. Transparency must be improved and controlling how the employees are serving customers must get higher focus by the government.
- Different studies indicate the labor cost of Ethiopia is very low. The citizens must get enough and marketable salaries from the hirers.
- In addition to giving different types of privileges to FDI, the government must increase the ongoing work of enhancing, developing and creating infrastructures in the country to make investments simple.
- Political commitment to develop suitable environment for investment, creating supportive rules and regulations related to investment and make adjustments when there is necessary in Ethiopia is in good position. The government gives attentions to things related to investment. Even investment board is leading by the prime minister of the country which is the higher political power of the country. This is a good opportunity for investors to access all their difficulties to the board and to get immediate solutions.
- The country's financial institutions must upgrade themselves so as to compensate the damage that comes from insured investment projects in the country. Political stability of the country is the major determinants of investments. When there is losses and damages because of the instability, they must get enough compensation as per. The government must give attentions to such types of incidents.
- To increase the power supply of the country, the Ethiopian government works different mega projects that can meet the demand of the country. This must be appreciated and it has a great effect on attracting FDI. But the bureaucracy to get this utility must me checked and transparency must be implemented.
- Private industry parks owners and the industry park corporation facilitates the investment climate by building shades for FDI and local investors. It helps the investors to begin production directly. But it is difficult to get land in other areas where there is no industry parks. The service in land management authorities in different regional states and city administrations is not as much as enough. The government should increase efficiency in the organization by putting clear rules and regulations to get land in those areas. The ethical behavior of the employees must be revised.
- The government should increase the number of employees and must build their skill in tax and investment related organizations so as to deliver a good service to investors and it must be supported by IT infra-structure.

- The investment regulations must be revised when needed and it must be clear to exercise at the ground level.
- One stop service must be applicable in regional investment organizations. The service is only done by federal investment commission.
- Monitoring and controlling the incentives that are given to investors must get concern by the government. Both regional and federal investment agencies and ERCA are simply silent on the issue. The amount forgone and the revenue collected each year have almost the same trend (see Appendix 3&4).the country loses huge amount of income to increase the investment and to gain benefits from that. If there is no control and monitoring activity, it increases the cost of investment generally. The rules and regulations must also protect abuses from the sectors by putting reasonable penalties.
- The government must see other developing countries experience especially sub Saharan African countries to adjust the rules related to investments so as to attract more FDI than them.
- The government should give focus for bilateral agreement with other countries that can help the free movement of investment products and services without duty and taxes.
- There must be an adjustment on the areas that are not favored to foreign investors. Sectors must be open to FDI.

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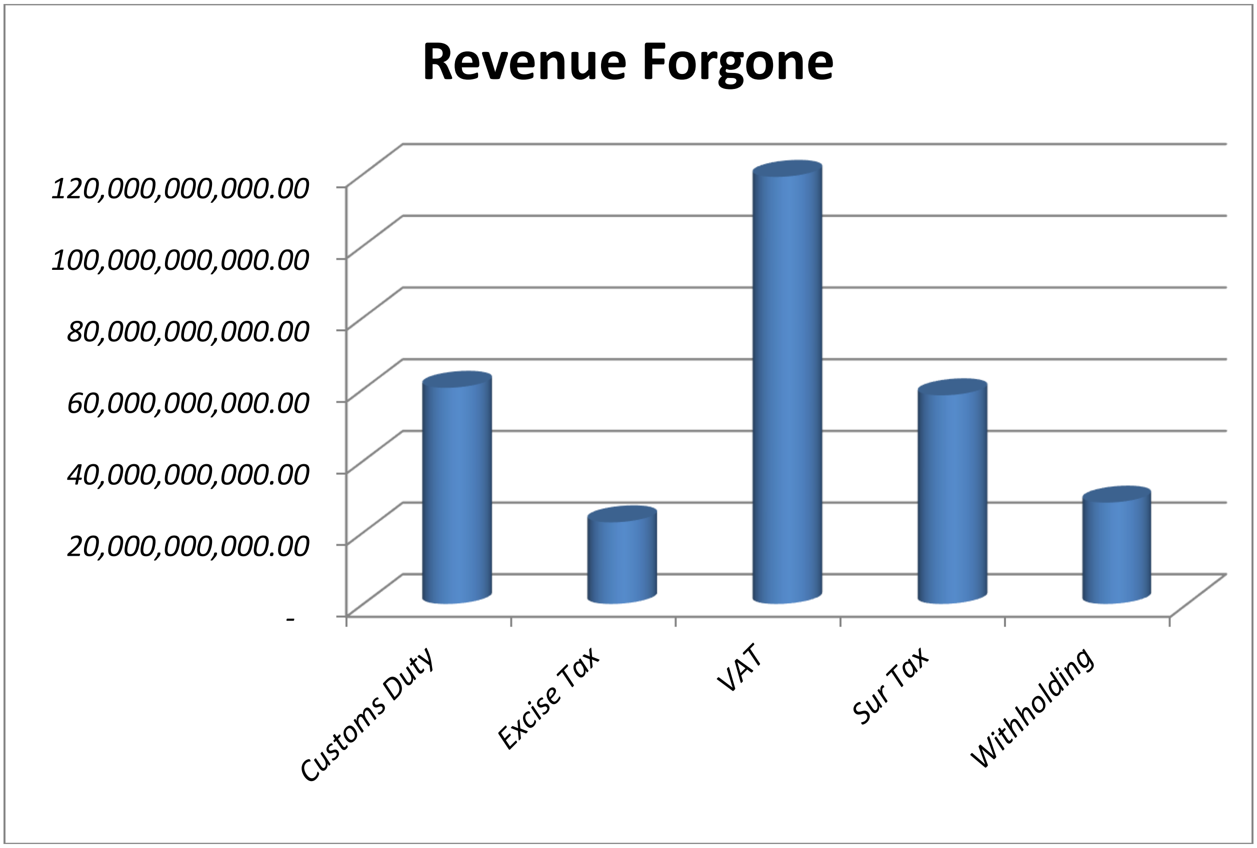
Appendix- 1- 10 Largest Greenfield projects announced in 2016

Host economy	Industry segment	Parent company	Home economy	Estimated capital expenditure (Millions of dollars)
Mozambique	Pipeline transportation of natural gas	China National Petroleum	China	4 000
Ethiopia	Pesticide, fertilizers and other agricultural chemicals	Office Cherifiendes Phosphates	Morocco	3 700
Bangladesh	Fossil fuel electric power	TenagaNasional	Malaysia	2 500
Myanmar	Fossil fuel electric power	Union Resources & Engineering	China	2 431
Myanmar	Fossil fuel electric power	APR Energy	United States	2 431
Cambodia	Industrial building construction	Tianrui Group	China	2 000
Bangladesh	Fossil fuel electric power	China General Technology Group	China	1 560
Myanmar	Wireless telecommunication carriers	Viettel	Viet Nam	1 500
Bangladesh	Natural, liquefied and compressed gas	Reliance ADA	India	1 048
United Republic of Tanzania	Fossil fuel electric power	KOYO Corporation	Japan	1 000

Source: ©UNCTAD, based on information from the Financial Times Ltd, FDI Markets

When we see the largest Greenfield projects that are announced in 2016, Ethiopia started pesticide, fertilizers and other agricultural chemicals factory which has a capital of 3700 million dollar. The project is owned by Morocco citizens. This shows that Ethiopia is one of the countries that can attract FDI.

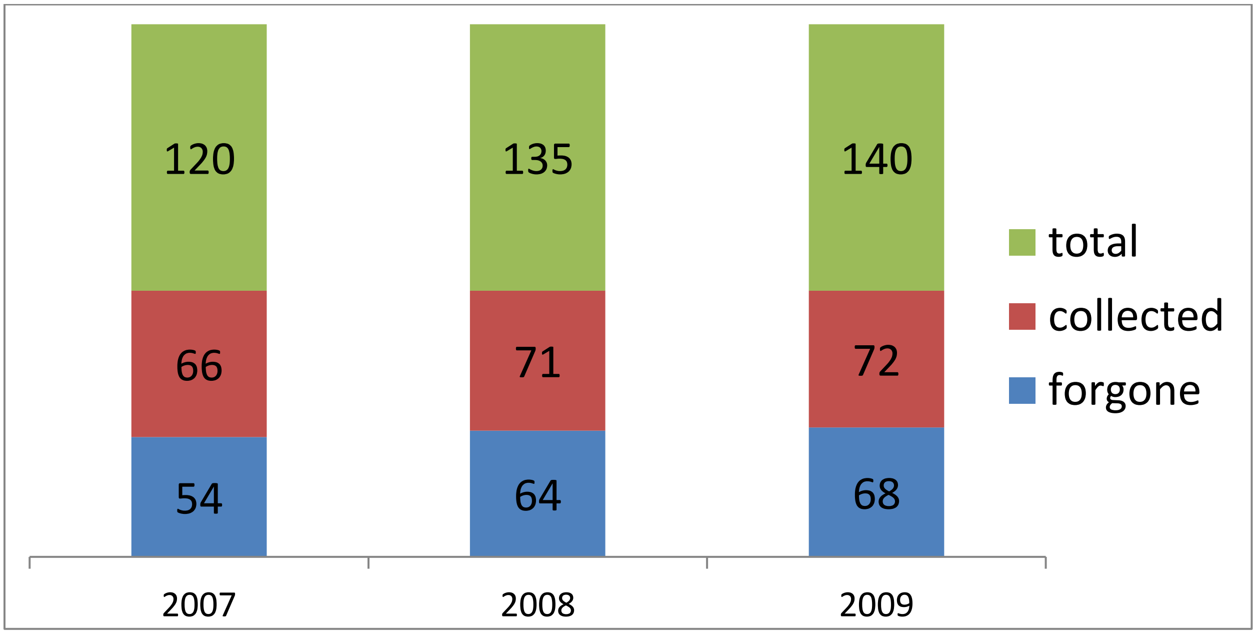
Appendix- 2 Revenue forgone for the last five years



Source: ERCA

As shown on the chart plotted above, the government of Ethiopia gives a huge amount of tax incentives for investor which is estimated more than 200 billion birr for the last five years. This figure shows us how much the government gives attention to increase the involvement of FDI in the country.

Appendix- 3 Revenue Collected and Forgone for three years



Source: ERCA

When we see the amount of taxes collected as revenue and forgone to encourage the participation of foreign direct investment, almost both of them i.e. revenue collected and forgone is almost equal. Ethiopia collects revenue from international trade and other inland taxes. These are the main revenue sources of the country. So the amount of taxes that is forgone to support investors is very huge to the country. If it is collected as revenue, the government can use this income to support the overall development of the country. The area must get enough attention in supporting, controlling and administrating the incentives given to investors.

A questionnaire to foreign investors who invest on different sectors in Ethiopia

I am Alemseged Awol, a prospective graduate of this year from St. Mary's University, Marketing Management department. To full fill the master's degree, I am conducting research paper on "the assessment of tax incentives and foreign direct investment (FDI) in Ethiopia". Your response is very helpful to accomplish this study. I want to assure that the information collected from you will be used for academic purpose only.

General description:

- ✓ No need of mention your name.
- ✓ You can answer by ticking on each box by using "√" or "**x**"
- ✓ You can give more than one answer if it's necessary.
- ✓ For more information ph. No. 0911080453, E-mail: alemseged1977@gmail.com

Part One: Personal Information

1. Sex male ☐ female ☐
2. Age 18-25 ☐ 26-35 ☐ 36-45 ☐ more than 45 ☐
3. How many years of experience do you have investing in Ethiopia?

   Less than 3 years ☐ 3 - 6 years ☐ 7- 10 years ☐

   11-15 years ☐ more than 15 Years ☐

Part two: Investment related questions

1. In which sector of investment you are involved?

   Manufacturing ☐ Agro-processing ☐ construction ☐

   Agriculture ☐ service sector ☐ others ☐
2. Tax incentives can stimulate the FDI to invest in Ethiopia?

   Yes ☐ No ☐
3. How do you rate the promotion regarding the Ethiopian investment opportunities/tax incentives to outside world?

   Highly☐Medium☐ Low ☐
4. Did you get those tax incentives that are promoted by the government when you come to work?

   Yes ☐ No ☐

5. Which one of the following factors are major determinant of investment in Ethiopia?

   Tax factors ☐ Non tax factors ☐

6. How do you rate the impact of tax incentives on your investment performance?

   Highly ☐ Medium ☐ Low ☐ No impact ☐

7. Which one of the following is the major obstacle for investors in Ethiopia?

   Customs and tax related problems ☐ Cost of doing a business ☐

   Infrastructure problems ☐ Investment climate ☐

   Government bureaucracy ☐

   If other ____

   ____

   ____

   ____

8. Did foreign direct investment (FDI) can give better opportunity to Ethiopia than local investors?

   Yes ☐ No ☐

9. If your answer for Q.No 8 is “Yes”, in what way the country can benefit?

   ____

   ____

   ____

10. Which factors do you think that will drive investors to invest other than incentives?

    Market size ☐ Cost of labor ☐

    Competition ☐ others ☐

11. Do you think poor investment climate and infrastructure can be supported by giving tax related incentives?

    Yes ☐ No ☐

12. How did you rate the loan interest rate given by the Ethiopian government to foreign investors when we compare with other African countries?

    Very High ☐ High ☐ Medium ☐ Low ☐ Very Low ☐

13. Did you think there are alternatives other than tax incentives to attract foreign direct investment (FDI) for developing countries like Ethiopia?

    Yes ☐ No ☐

14. If there is any alternative please specify

    ____

    ____

    ____

Part Three: Based on the given alternative choices please make a rank for your answers. The numbers on the top of table indicates the level of your answer.

1= strongly dis agree 2= dis agree3= neutral4= agree5= strongly agree

i. How do you rate the factors that have effects on investing in Ethiopia for foreign investors?

Ser. no.	Sentence	1	2	3	4	5
1.	Infrastructure					
2.	Political stability					
3.	Financial supports					
4.	Duty free incentives					
5.	Market size of the country					
6.	Inflation					
7.	Fair or little wage to employee					
8.	Power supply					
9.	Availability of land, buildings or shades					

ii. How do you see the structure of the tax authority and other investment related bodies?

Ser. no.	Sentence	1	2	3	4	5
1.	Have enough human resources					
2.	Employees have good skills and experience					
3.	The service delivered by them is fair and fast					
4.	The service is supported by ICT					
5.	Did they have monitor the privileges they give to investors					
6.	The law is well to protect illegality of the use of those incentives					

iii. About the duty free and tax holiday incentives

Ser.no.	Sentence	1	2	3	4	5
1.	Incentives delivered to FDI are good enough to promote investments					
2.	Ethiopia privileged more incentives than other African countries					
3.	There are more incentives to FDI than local investors					
4.	All necessary investment sectors are privileged to incentives					

iv. Can you describe negative effect of tax policy and incentives in the country?____

____

____

____

____

v. Can you describe positive effect of tax policy and incentives in the country?____

____

____

____

____

vi. In what way it is possible to solve the negative effet of incentives?____

____

____

____

vii. If there is any issues which didn't discussed on the above questionnaire, you can mention below.

____

____

____

____

I want to thank for your precious time!!!!