[Press Release]

A Joint Study on Ethiopia's FDI Policy, Performance and Challenges

ADDIS ABABA and TOKYO (January 27, 2022)—Today, a report on Ethiopia's FDI policy was officially released. It is the second joint study between the Policy Studies Institute (PSI), a policy think tank of the Ethiopian government, and the National Graduate Institute for Policy Studies (GRIPS), a national university in Japan, following the Ethiopia Productivity Report of February 2020.

The Ethiopia FDI Policy Report, whose work started in 2020, is a truly joint study between the two research institutions with shared planning, writing and editing. The project was co-funded by the Japan International Cooperation Agency (JICA) and PSI. Ethiopian and Japanese researchers worked attentively and effectually to produce this report despite restricted travel due to the global pandemic as well as political uncertainty and economic hardship in Ethiopia.

The principal authors from PSI are Dr. Mulu Gebreeyesus and Dr. Kiflu Gedefe Molla. Japanese contributors include Prof. Kenichi Ohno, Prof. Izumi Ohno and Ms. Sayoko Uesu from GRIPS, and Mr. Toru Homma, Senior Advisor on Private Sector Development of JICA.

The report addresses several issues that are long-term and structural for Ethiopia. They are problems that will remain even if the current difficulties are overcome. This report focuses more on these fundamental issues than how the present conflict and associated economic difficulties are to be solved (GRIPS published a shorter companion policy paper in 2021 that discusses, among others, strategies for a recovery from the current economic difficulty).

Ethiopia made great economic progress in the last two decades with energetic industrial policy and continued high growth. Nevertheless, structural transformation fell far short of plan targets. Manufacturing remains stagnant in volume, quality and productivity despite great policy effort expended. More recently, Ethiopia has faced slower growth and worsening macroeconomic imbalances due to accumulated debt, dismal export performance and excessive delays in the country's mega projects. The slowdown is experienced even before the nation reaches middle income. Ethiopia's policy regime needs revamping in light of these circumstances.

Over time, Ethiopia's FDI policy steadily improved and became more open and favorable to FDI. Various restrictions on FDI entry have been removed in steps. However, three important shortcomings remain in the current FDI policy.

First, policy goals are not clearly defined. This is because Ethiopian FDI policy has been formed cumulatively by a series of Proclamations and Regulations without a clear statement of where they are leading to. An explicit statement of goals, strategies, actions and the timeline of FDI policy is highly desirable.

Second, Ethiopia's FDI policy is more administrative than promotive. It is heavy on procedure and approval but quite weak in attracting high-quality foreign firms to Ethiopia and incentivizing them to work on domestic value creation. The current policy defines how investors should register technology transfer contracts and how these contracts are officially classified, but says little about the nation's aspiration to absorb technology, the type of technology which is most welcome, or how FDI is incentivized and how domestic firms are encouraged to teach and learn new technology. It is these latter provisions that are vital but currently missing.

Third, Ethiopia's FDI policy favors large labor-intensive operations, such as garment and footwear production, that employ many unskilled workers. This is appropriate for a latecomer country where job creation is a paramount national goal. But the nation should also strongly welcome bringers of high technology and new products from advanced nations. Such investors are usually smaller and more varied in their requirements on location, building design and supporting services than large apparel makers. To promote them, the minimum capital requirement imposed on FDI should be eased or abolished. More compact industrial space should be available (as amply supplied in Thailand, Vietnam, Indonesia, etc.) in addition to large, same-size sheds.

The key message of the report is that Ethiopia's FDI policy should become more selective and encouraging to those foreign firms that bring new or additional value to the national economy. It is a shift from quantity-based FDI to quality-based FDI. Here, quality refers to such actions as export generation, the transfer of technology and management knowledge, the introduction of products or processes new to Ethiopia, the upgrading of workers and engineers, the procurement of domestic inputs and services, and assisting domestic firms to actively participate in global value chains.

However, value creation should not be forced but encouraged by incentives and other favors with the final decision made voluntarily by each FDI firm. Government should not dictate foreign firms or they will leave Ethiopia for other host countries with fewer constraints.

Investment incentives must be selective, easy and not costly to administer, and hard to abuse. They should be conditional on the achievement of pre-set performance indicators such as employment, export, technical transfer, etc.. These criteria should be revised as circumstances and national targets change.

The report argues that Ethiopia still needs to create many jobs so it must welcome both "quantity" investors and "quality" investors. Large firms that hire many workers should be strongly promoted until the next industrial phase is reached and labor surplus disappears.

The capacity of planning and executing agencies, including EIC, MOI, IPDC, revenue and customs authorities and sectoral institutes, must be enhanced. Coordination among these organizations should be strengthened.

Ethiopia's business environment must be improved in a meaningful way. Without a conducive business environment, it is hardly possible to attract FDI, let alone "quality" FDI, even in the presence of a generous incentive system.

FDI inflows do not automatically improve the balance of payments or accelerate technology transfer. The trade balance is not immediately or visibly affected by FDI, a fact that is confirmed both theoretically and empirically in many countries. For technology absorption to happen, the host government and domestic businesses must actively create necessary conditions rather than passively waiting for it. Policy learning is required to know exactly how this can be done.

Ethiopia's industrial park management should be improved. Industrial parks are a real estate business with inevitable ups and downs. Ethiopia's state-run industrial parks must generate profits, improve competitiveness and prepare against unfavorable times. For this, six suggestions are offered: (i) diversify revenue sources; (ii) provide facilities and services strategically based on cost-benefit analysis; (iii) develop customer orientation in investor services and park operation; (iv) protect against negative shocks by building slowly; (v) accept FDI from all sectors; and (vi) offer diverse land and shed choices including small ones.

Comparative firm surveys in Ethiopia, Vietnam and Bangladesh reveal that Ethiopia is by far a latecomer in apparel export and there is much to be learned from advanced countries in apparel production. Management styles are different even between local and FDI firms operating in Ethiopia and locals can learn much from the management practices of foreign firms. The suspension of AGOA is a very serious problem and the facility should be restored as soon as possible with appropriate diplomatic actions and negotiation.

Ethiopia's light manufacturing is challenged by two unstoppable global trends: (i) the double requirement of product quality and ethical correctness in labor management and environmental protection, and (ii) Industry 4.0 that greatly transforms future manufacturing whose impacts on Ethiopia remain unclear. The report explores their implications for Ethiopia's industrialization.

The Ethiopia FDI Policy Report is available free of charge in hard copy. The soft copy is accessible through the websites of PSI and the GRIPS Development Forum. A companion paper, "FDI Policy for Enhanced Value Creation in Ethiopia: Situation Analysis and Policy Proposals" (GDF, 2020), is also downloadable from the GRIPS Development Forum website.

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