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10 The Impact of Foreign Direct Investment on Sustainable Economic Growth: A Focus on the Textile and Apparel Industries in Ethiopia

Abstract: There is considerable disagreement regarding FDI and economic growth. Some studies have indicated the positive impact of FDI on economic growth, while others say it has retarding effects. The third group argues that the effect of FDI depends on the country's absorptive capacity. This article studies the impact of FDI on sustainable economic growth in Ethiopia. Primary data was collected by interviewing 26 managers in six industrial parks. The data on sectoral (textiles and apparel) and total FDI inflows were collected from secondary sources. Regression held on EViews 12 and descriptive statistics were employed for data analysis. The result revealed a positive and stronger relationship between sectoral FDI and GDP as compared to total FDI and GDP. This implies that the sectoral FDI inflows are promising for supporting the country's economic development. However, sustainable economic growth depends on domestic enterprises' participation.

Keywords: foreign direct investment, sustainable economic growth, Ethiopia, textile and apparel

Introduction

The impact of the volatility of foreign direct investment (FDI) on sustainable economic growth, particularly in countries merely relying on FDI, has gained research interest. A growing number of foreign direct investments has been flowing into Ethiopia as a result of its export-promoting policy (EIC, 2017) that offers support to companies exporting priority items such as textiles and leather (Staritz & Whitfield, 2017). The inter-

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est and commitment of the government of Ethiopia in attracting foreign apparel businesses appear promising.

Ethiopia's textile and apparel sector has witnessed a surge in export-led growth and ranks amongst countries like China and Bangladesh in terms of industrial output and sourcing destination. High-volume garments are sourced from Ethiopia by apparel buyers (USITC, 2018; Achim et al., 2015). According to Achim et al. (2015)'s survey, Bangladesh was predicted to be at the top of the list of future sourcing destinations, while Ethiopia was seventh on the list. Large international companies are also drawn to Ethiopia because of comparative advantages such as low labour costs, cheap and affordable energy, proximity to important markets and duty-free and quota-free access to EU and US markets for Ethiopian manufacturers under the Everything But Arms (EBA) and African Growth and Opportunity Act (AGOA) programmes, respectively. The government of Ethiopia hopes to attain textile exports worth US$30 billion by 2025 and increase the GDP of the country, household income, foreign currency and employment in the country by establishing industrial parks (IPs) for investors throughout the country (Khurana, 2018). However, the recent trend of FDI inflows to Africa is falling. East Africa, which was the fastest-growing region in Africa, received only US$7.8 billion in FDI in 2019, a 9% decline from 2018. Ethiopia received US$2.5 billion FDI in 2019, a 24% and 39% drop from 2018 and 2016 respectively. The FDI inflows to Ethiopia were extremely hit by political tension and the global pandemic (UNCTAD, 2020).

Thus, the vision faced a realistic challenge, a fall in FDI that has a direct impact on economic contraction. Ethiopia has accomplished little in terms of structural economic change, despite the industrial policy, government engagement and impressive economic growth in recent times. Companies claimed to provide better working conditions, accelerate industrialisation and contribute to economic growth, but they created another dimension of challenges to the market by abandoning the country due to political instability, keeping unpaid huge debt (Staritz & Whitfield, 2017) borrowed from Development Bank of Ethiopia (DBE).

Unless the attraction of investment is balanced by developing the existing and new domestic capacity, merely focusing on FDI is not a viable way to create competitive industries and maintain sustainable economic growth (Gebreeyesus, 2013). The drop in economic growth in recent times has led us to question whether it is related to the volatility of FDI or the monopolistic nature of FDI.

Using empirical evidence, this paper discusses the impacts of merely relying on FDI for sustainable economic development. The remainder of the paper is organised as follows. Section 2 presents the literature review of previous studies. Section 3 outlines the method of data collection and analysis. Section 4 presents the main results and discussions. Section 5 concludes and provides suggestions.

Literature Review

Ethiopia's industrial development strategy (IDS), which was introduced in 2002, aimed at creating a conducive environment for industrial development by providing several supporting services to investors engaged in light labour-intensive textile and apparel sectors, aspiring to increase export and employment (Weldesilassie et al., 2017; Yost & Shields, 2017). Among the various policy instruments, developing countries are mostly implementing FDI to realise their development plan. As Staritz and Whitfield (2017) pointed out, following the first development plan, which only encouraged local apparel investment and resulted in modest exports, the Ethiopian government broadened the scope of its development policy in the second and third phases. The government has been building several IPs that aimed to attract large textile and apparel foreign investors, lift exports and facilitate linkages between domestic and foreign firms to enable learning and competence building among local firms.

There is a promising contribution from the sector to economic growth. The contribution of the textile and apparel industry to GDP was around US$1 million (1.35%) until the mid-2000s, US$12 million (1.9%) in 2010, US$117 million (2.6%) in 2014 and around US$93 million in 2018 (Staritz et al., 2016; Yost and Shields, 2017). However, Staritz et al. (2016) and Staritz and Whitfield (2017) argue that compared to the agricultural share to the aggregate growth, the contribution of manufacturing, specifically the textile and apparel sector, was insignificant and unnoticeable in the international apparel export market. In fact, in the long run, the sector can provide sustainable economic development if appropriate policies and institutions are established (Dumludag, 2009; Keane, & te Velde, 2008).

FDI is considered to be an integral component of an open and competitive international economic system and a significant growth mechanism (Polat & Payaslıoğlu, 2016; Kenneth et al., 2019; Kurtishi-Kastrati, 2013). Along with the advantages linked to FDI, developing countries, emerging economies and countries in transition have liberalised their FDI system and pursued the best policies to attract investment (OECD, 2002; Anandakumar, 2012). Despite the growing interest in FDI inflows, there is considerable disagreement regarding FDI and sustainable economic growth. While some studies have indicated the positive impact of FDI on economic growth (Aghion & Howitt, 1990; Magnus & Ari, 2001; Romer, 1986; 1990), other studies reported otherwise (Fan, 2002). The third group of studies argues that the effect of FDI on a host country's economy depends on the country's absorptive capacity in terms of its human capacity, level of development and financial development (Alfaro et al., 2004; Beugelsdijk et al., 2008; Borensztein et al., 1998; Lensink & Hermes, 2004; Masron et al., 2012; Ucal et al., 2010).

As per the pro-FDI theorist (Lipsey, 2002), sustained economic growth requires the productivity of labour and capital. In this category, positive externalities and spillover effects are essential to develop and maintain a competitive advantage in the global economy. Whereas the anti-FDI group (Bornschier & Chase-Dunn, 1985; Fan,

2002; Denisia, 2010) state that FDI will retard the economic growth, Rand and Tarp (2002) observed that FDI inflows are quite volatile, which supports this theory. They found no general link between FDI and output in their analysis. Researchers Falki (2009) and Levine and Carkovic (2002) studied the relationship between FDI and economic growth of Pakistan and 72 countries, respectively. Their studies showed that the exogenous component of FDI doesn't have a strong beneficial impact on economic growth. Albuquerque (2003) argues that FDI is less volatile compared to other financial investments. However, volatility in other factors affects FDI. Kiyota and Urata (2004) reported that large volatility in real exchange rates discourages FDI, while the depreciation of the host country's currency attracts it. Jensen (2008) found that democratic regimes favour FDI due to reduced political risks. The lower the level of the political risk, the higher the FDI inflows (Meyer & Habanabakize, 2018). Lensink and Merrissey (2006) found that volatility has a negative effect on economic growth. On the other hand, lower and more variable growth rates in uncertain economies might be less attractive for foreign investors.

As stated by Dunning (2014), FDI takes place in the framework of oligopolistic firm structures. Based on Hymer (1960), foreign firms are seen as having an advantage over local ones. The theory of internationalization characterizes foreign firms as seeking to mitigate transaction costs (Coase, 1937), tackle market risk and uncertainty, exert control and bargaining power, maximize profits, and ensure favourable transfer pricing (Buckley and Casson, 1976; Hymer, 1960). Kojima (1973) argues that FDI can be beneficial to both partners if FDI originates from a "comparatively disadvantaged" marginal industry at home. The host country can acquire a comparative advantage in the same industry, whereas the foreign firm can produce goods at a lower cost than at home and import and export the goods back to home and third countries markets respectively.

FDI crowds out domestic investments (Borensztein et al., 1998) by creating a monopolistic (Vissi, 1995) economic environment, either by increasing the demand for money and in turn impacting interest rates (Dang & Tran, 2020) or investing huge currency which increases the overall money flow (Perez et al., 2012) of the host country. The increase in capital flow inflates the price of inputs for domestic investors. As a result of this effect, domestic investors are forced to borrow money from financial institutions at high interest rates. These companies are crowded out if they are unable to repay their debts or compete. However, FDI can be quite heterogeneous (Head & Ries, 2003) as well, and it may vary with the mode of entry (Svensson, 1998) into the foreign market. Foreign investors may enter a market with different modes of FDI, compatible with their balances of costs and benefits. Based on the study of Alfaro et al. (2010), foreign investors can also "crowd in" domestic firms. In their work, they considered a small open economy characterised by two layers of industries both at the microeconomic and macroeconomic level and found that FDI has a positive impact in all three conditions: keeping constant the presence of FDI, increasing the

share of FDI and when goods produced by domestic firms and multinational companies (MNCs) are substitutes rather than complements.

Despite the argument, FDI inevitably improves the integration of the host country into the global economy and fosters growth (Ucal et al., 2010). FDI is seen as a key driver of economic growth and development (Alfaro et al., 2010). However, the overly credulous approach to the benefits of FDI is an indication of the host country's vulnerability instead of its resilience to both the volatile and monopolistic nature of FDI (Hausmann & Fernandez-Arias, 2000). Countries borrow money through FDI. However, public debt is a risk when total FDI inflows are higher. Rather than always pursuing too much FDI, countries need to focus on building coherent legal frameworks, investment protections, an appropriate investment environment (Wang, 2009) and the functioning of businesses to advance in economic growth through the export market (Albuquerque, 2003).

FDI can back the host country's enterprise development through linkages with suppliers. This is possible when the hosting country put joint-venture requirements into place or promoted linkages with domestic firms to support domestic industrial build-up (Kenneth et al., 2019). This kind of investment policy helps to maximize positive spillovers and human capital from the activities of foreign affiliates (UNCTAD, 2018). However, when domestic enterprises have neither bargaining power nor government assistance, MNCs may choose to form a fully owned firm (Karabay, 2010).

For local firms, the simplest means to learn from the global production networks and global value chains (GVCs), and create national companies, which can participate in the outflow investment and export, is learning by doing with foreign firms. Based on the work of Keane and Velde (2008) to realise and sustain learning by doing and knowledge spillovers, the hosting country's government has the responsibility to set policies that build sustainable links between local and foreign firms. In such a learning process, the hosting country can increase the skill level of the labour, which helps to improve the productivity and standard of the manufacturing processes. These contribute to the country's manufacturing competitiveness as well as the development of a long-term economy.

MNCs help to increase industrial efficiency and improve resource allocation in host countries and influence the local suppliers of intermediate products to become more efficient with delivery speed, quality and reliability of the products to meet the high standards of the overseas companies (Lipsey & Sjöholm, 2010). However, when MNCs possess and control new technologies, then it becomes challenging to imitate for the local firms (Alfaro et al., 2004; Wang, 2009) and contributes to unemployment in the host country. In developing countries such as Ethiopia, the competition from foreign firms may not allow the existing and new domestic firms to put pressure on and enter the market respectively due to intensive capital from the other side. As mentioned by Geda and Meskel (2009), the negative effects may also arise in a factor market where foreign investors increase demand for scarce resources such as skilled labor and domestic credit, and hence raise production costs for local firms.

The experience of FDI varies from country to country (Karabay, 2010). Countries like India, Indonesia, Korea, Turkey, Thailand, Singapore, Ireland, Japan and Taiwan are known for their pro-FDI policy, with certain restrictions, and the linkage with domestic firm requirements has been strictly imposed. These restrictions allowed them to accumulate technological capabilities more rapidly; however, Germany, UK and France imposed performance requirements. The Special Economic Zones (SEZs) of China helped the creation of linkages between firms in the SEZs and others. In each stage, there is learning to adapt technology and give a chance to local investors to participate in the system through different techniques and supportive institutions.

Ethiopia mainly targeted the attraction of foreign firms by constructing IPs in different regions of the country, presenting fiscal and market incentives following the lesson learned from the first growth and transformation plan (Weldesilassie et al., 2017). The IPs are used as a strategic tool to catch up and sustain development through export growth, human capital development and technological learning.

Market incentives, such as preferential market access, play a central role in the global apparel trade. Among the broad range of possible incentives, financial and fiscal incentives are the ones most frequently employed. Developing countries often prefer fiscal instruments, such as tax holidays, concessionary tax rates, accelerated depreciation allowances, export incentives, duty drawbacks and exemptions, whereas developed countries mainly use financial incentives, including cash grants and interest-free or subsidized loans (Altenburg et al., 2020). This study has highlighted (Table 10.1) some incentive schemes in five countries: Bangladesh, China, India, Kenya and Ethiopia in special industrial and economic zones; however, the participation of local firms under AGOA and EBA packages is limited due to various reasons outlined by the work of Gebre-Egzlabher (2007). Based on USITC's (2018) report, Ethiopia's apparel export to the U.S. reached US$37.0 million in 2016 compared to US$1.9 million in 2010. The country's total AGOA utilisation rate is 96.0% next to Kenya which is 98.0% (ITC, 2018).

Table 10.1: Incentive schemes of Bangladesh, China, India, Kenya and Ethiopia [authors' compilation].

	Bangladesh	China	India	Kenya	Ethiopia
Infrastructure and OSS services	Yes	Yes	Yes		Yes
Tax Exemption for the first two years 100%	Yes	Yes	Yes		Yes
Borrowings			Yes		Yes
Duty-free import of materials	Yes		Yes		Yes
Duty-free import and export of raw materials and finished goods	Yes		Yes		Yes
Relief from double taxation	Yes		Yes		Yes

Table 10.1 (continued)

	Bangladesh	China	India	Kenya	Ethiopia
Exemption from dividend tax	Yes		Yes	Yes	
GSP facility available	Yes				
Accelerated depreciation on machinery or plant allowed	Yes				
Remittance of royalty, technical, and consultancy fees allowed	Yes			Yes	Yes
The price for m2 of land is $1.25 to $2.20, while the price of shed per m2 is $1.60 to $ 2.75.	Yes				Similar
Corporate tax of <15%		Yes	Yes	Yes	Yes
100% exemption of customs duties and other taxes on imports to capital goods					Yes
Spare parts up to 15% total import capital goods, exempted, from payment of customs duties					Yes
60–80 years of land lease right at a promotional rate					Yes
Up to five years personal income tax exemption for expatriate employees of industrial parks					

Much empirical evidence on the relationship between FDI and economic growth is generic, and the results are mixed. Questioning that the mixed results might be aroused from using total FDI, Wang (2009) studied the heterogeneous effects of sectoral FDI inflows on the host country's economic growth considering 10 Asian economies. The results showed that FDI in different sectors had different impacts on the host country's economic growth. Wang et al. (2010) also found that the impact of FDI inflows on Chinese exports was stronger for the traditional labour-intensive goods such as textiles and clothing than for capital and technology-intensive goods. Among manufacturing industries, Masron et al. (2012) reported that industries with high FDI inflows tend to enjoy positive spillover effects.

Foreign investors compare the economic policy uncertainty of the hosting country with the home country before making FDI investment decisions in a particular country (Canh et al., 2020). In the case of Ethiopia, this paper tries to demonstrate the impact of FDI's volatility on sustainable economic growth, and how the economy was merely dependent on foreign investors, considering political instability.

Methodology

This chapter reviewed relevant literature and analysed empirical evidence on industrialization, policy and strategy documents, proclamations, and annual reports to understand the impact of FDI inflows on economic sustainability focusing on a specific manufacturing sector (textile and apparel) in Ethiopia.

The data were collected from both primary and secondary sources. The primary data were collected using interviews with the Ethiopian investment commission's one-stop-service coordinator director (EICOSSCD), IPs one-stop-service support centre (IPOSSSC) and textile and apparel companies in the IPs. The secondary sources are the national bank of Ethiopia (NBE), the world bank (WB), the international monetary fund (IMF), the United Nations conference on trade and development (UNCTAD) and the Ethiopian textile industry development institute (ETIDI).

Accordingly, among the 26 IPs, field surveys were conducted with a total of 26 face-to-face interviews (two with EICOSSCDs, six with IPOSSSC coordinators and 18 with companies' managers) based on their operational status. Among the existing IPs, six Ips (Addis Ababa Bole Lemi I, Adama, Hawassa, Kombolcha, Mekele and Eastern Ips) were selected using purposive sampling on the basis of their active role in the economy and operational circumstances. EICOSSCDs and IPOSSSC coordinators were interviewed about investment policies and key performance indicators (export performances, firm linkages, employment), and the interview with the company managers focused on firm ownership, export destination, raw material sources and employment.

Tables and figures are used to describe the status of the IPs, firm's ownership, firm's country-specific ownership, market orientation, export destination and textile and apparel trade value. Annual import-export trade values of 14 sets of textile and apparel items were aggregated over the period 1998 to 2018, both for the world and the markets. Then, the annual import-export of all commodity trade values for the same period was aggregated. Finally, the annual trade value of textile and apparel share as a percentage (Figure 10.3) was calculated, for import-export trades both for the USA and world market. The annual import-export trade values of 14 sets of textile and apparel items were used to investigate the trade balance (Figure 10.4) between import and export trade of textile and apparel goods for the period of 19 years between 2000 to 2018, for the world market.

To examine the correlation (Table 10.6) between FDI inflows and economic growth and measure the impact of FDI volatility on GDP (Table 10.7), an autoregressive conditional heteroscedasticity (ARCH) model was performed for a dataset between 2000 to 2019 both for total and sectoral FDI inflows and their corresponding import and export.

Textile and Apparel Sector's Ownership in Ethiopia

Ethiopia has 221 textile and apparel companies, with 118 locally-owned and 103 foreign-owned companies, respectively (Table 10.2). Among the 103 foreign firms, 63 (61%) textile and apparel firms operating in the IPs originate from 15 countries. Chinese firms take the leading number of FDIs, followed by Indian, Turkish and Italian firms. Despite an integrated value chain approach and industrialisation targets, there is no single operational domestic firm in the IPs whether as a supplier or any other form of activities (Table 10.3). Unless there is learning in each stage to adapt technology and management skills, and build market chains, when large international companies renounce the IPs (such as AYKA Addis Textile Sc), the resource becomes unworkable, resulting in a sustainability dilemma. To mitigate such a risk, the hosting countries should encourage the establishment of local firms in the IPs and set policies that build sustainable links between the local and foreign firms (Keane & Velde, 2008).

Table 10.2: Active textile and apparel firm ownership.

Ownership	Total firms	Business type		Inside IPs	Sectors			
		Private	Share		Textile	Apparel	Integrated	Other
Ethio-china	2	2			1		1	
Pakistan	3	3			1	1	1	
Chinese	48	48		33	24	21	3	
Hong Kong	2	2		2		2		
India	13	13		9	2	10	1	
Bangladesh	2	1	1	1		1	1	
South Korea	4	4		3		4		
Taiwan	2	2		2		2		
Indonesia	2	2		2		2		
Sri Lanka	2	2		2		2		
Israel	1	1				1		
Turkey	9	9		1	3	3	3	
Italy	4	4		1	1	3		
Netherlandss	2	2		2		2		
Belgium	1	1		1		1		
France	1	1		1		1		
Britain	1	1		1		1		
USA	2	2		2		2		
Canada	1	1						1
Peru	1	1				1		
Foreign Total	103	102	1	63	32	60	10	1
Ethiopian Total	118	115	3		26	72	15	5
Total	**221**	**217**	**4**	**63**	**58**	**132**	**25**	**6**

Among the 63 companies operating in the IPs, the textile and apparel sector had a share of 44.44% and 47.62%, respectively. However, from a total of 221 firms in the country, the share of textiles, apparel, integrated textiles and others is 26.24%, 59.73%, 11.31% and 2.72% respectively. This shows that the apparel sector is more dominant than the textile sector, which can result in raw material shortage. This is consistent with the problem reported by the work of Bedane and Egziabher (2019). Almost all businesses are privately owned, which does not bode well for the spillover effect. However, domestic firms must also be proactive to learn from foreign firms through different techniques instead of relying on government efforts.

Industry Parks

There are 26 IPs in Ethiopia; 11 private and 15 Public. However, most IPs were not fully operational and are dominated by privately-owned foreign companies. As of now, the function of government institutions in facilitating, enhancing and measuring the linkage between foreign and domestic enterprises has been difficult to discern. Constructing IPs in different regions or places without reviewing existing performance appears to be a systematic technique for balancing and urbanising regional developments, which may or may not be appropriate from a business perspective.

Market Destinations

The main market destinations (Table 10.5) for exporters from the IPs are the USA and EU. Figure 10.1 presents the total number of exports from the IPs to the partner countries. USA, Germany, Sudan, Italy, United Kingdom, Canada, Turkey, China and France are the top export destinations of Ethiopian apparel exports. From EU countries, Germany takes a large share of apparel exports. Compared to 2014/15 apparel exports to EU countries, the US market has taken the largest share of Ethiopian apparel exports. However, most exporters are foreign firms through their previous market connections. Unless the required competitive capability is acquired through linkage, it will be challenging to utilise AGOA and EBA opportunities for domestic firms.

FDI Inflows

During the period from 2000 to 2019, the average evolution of FDI inflow as a percentage of GDP reached 2.94% (Figure 10.2). The net FDI inflows in 2016 was a record of 5.6 as a percentage of GDP. However, it has dropped since then, down to 2.6% in 2019.

Table 10.3: Active firm ownership by country in the industry parks.

Industry park	Ownership																
	China	India	South Korea	Taiwan	Netherlands	Ethiopia	Italy	USA	Hong Kong	Sri-Lanka	Indonesia	Belgium	Turkey	France	Bangladesh	Britain
Bole Lemi I	2	4	3	1												
Hawassa	4	3		1				1	2	2	2	1	1	1		1
Kombolcha	2						1	1								
Mekele		2													1	
Adama	1															
Eastern zone	24					2										
Total	33	9	3	2	2	0	1	2	2	2	2	1	1	1	1	1

Table 10.4: List of industry parks.

S/No.	Industry Park	Ownership	Status	Cluster	Location
1	Bole Lemi I	Public	Operational	Apparel, Textiles, Leather and leather products	Center
2	Bole Lemi II	Private	Under Construction	Apparel, Textiles, Leather and leather products	Center
3	Kilinto	Public	Under Construction	Pharmaceutical	Center
4	Hawassa	Public	Operational	Textile and garment	South
5	Dire Dawa	Public	Ready	Mixed	East
6	CCECC Dire Dawa	Private	Under construction	Mixed	East
7	Kombolcha	Public	Operational	Textile and Apparel Leather and leather products	North
8	Mekele	Public	Operational	Textile and Apparel	North
9	Adama	Public	Operational	Textile and Apparel	Southeast
10	Jimma	Private	Ready	Agro-processing	West
11	Bahir Dar	Public	Ready	Textile and Apparel	North
12	George Shoe	Private	Operational	Leather and leather products	Southeast
13	Eastern zone	Private	Operational	Mixed	Southeast
14	Huajian	Private	Operational	Apparel, Textiles, Leather and leather products	Southeast
15	Debre-Birhan	Public	Operational	Textile, Garment and Agro-processing	North
16	Arerti	Public	Under construction	Building material, home appliances, and furniture	Northeast
17	CCECC Arerti	Private	Operational	Construction material and home appliance	Northeast
18	Ayesha	Private	–	–	East
19	Vogue	Private	Operational	Textile and garment	North
20	DBL Group	Private	Operational	Textile and garment	North
21	Velocity	Private	Operational	Textile and garment	North
22	Airline & logistics park	Public	Planning stage	Transportation	Center
23	Addis industrial village	Public			Center

Table 10.4 (continued)

S/No.	Industry Park	Ownership	Status	Cluster	Location
24	Bure	Public	Ready	Agro-processing	North
25	Bulbula	Public	Under construction	Agro-processing	Southwest
26	Yirgalem	Public	Ready	Agro-processing	South

Table 10.5: Market destination of firms operating in IPs.

Industry Park	Number of companies	Market destination	Type of privilege
Adama	1	USA and Australia	AGOA
		Hong Kong	EBA
		Europe	
Bole Lemi	9	USA, Canada	AGOA
	9	EU /Germany, France, Italy, Poland Romania	EBA
	8	ASIA /China, Sri Lanka, India, Singapore	COMESA
	3	Kenya, Djibouti, South Africa	
	1	United Arab Emirates	
	1	Pakistan	
	1	Malaysia	
	1	Taiwan	
	1	Local	
Eastern	5	USA	AGOA
	2	EU	EBA
	1	Brazil	COMESA
	6	Kenya, Tanzania, Uganda, Sudan, Zambia	
	1	Turkey	
	1	Saudi Arabia	
	2	China, Sri-Lanka	
	17	Local	
Kombolcha	2	USA	AGOA
	2	EU	EBA
	1	East ASIA	
Hawassa	17	USA, Canada	AGOA
	9	EU	EBA
	3	ASIA	COMESA
	2	Egypt, Kenya	
	2	Malaysia	
Mekele		USA	AGOA
		EU	EBA

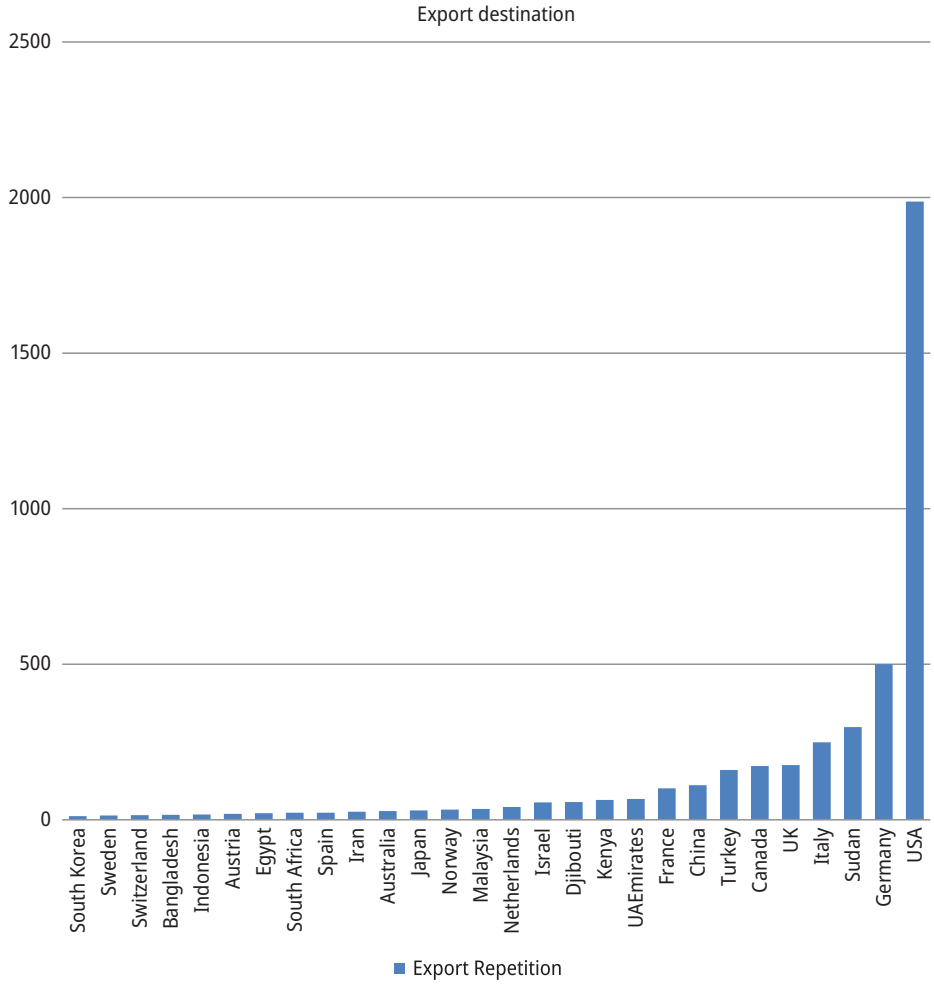

Figure 10.1: Export destination by volume (Source: unpublished data from EIC).

Different reasons can be stated, with the main reason being the volatility behaviour of the FDI. FDI inflows are mainly affected by uncertainty (Paul & Feliciano-Cestero, 2021). This argument can be backed by the data in Figures 10.2 and 10.5. The drop in FDI inflows and aggregate economy in 2008 might be connected to the post-impact of the 2005 election and world financial crisis, as it damaged the world economies, whereas, the drop in FDI inflows and aggregate economy in 2017, 2018 and 2019 were due to internal and external political pressures (UNCTAD, 2020). If the investment was comprehensive with local investors, the GDP should have been remained elastic.

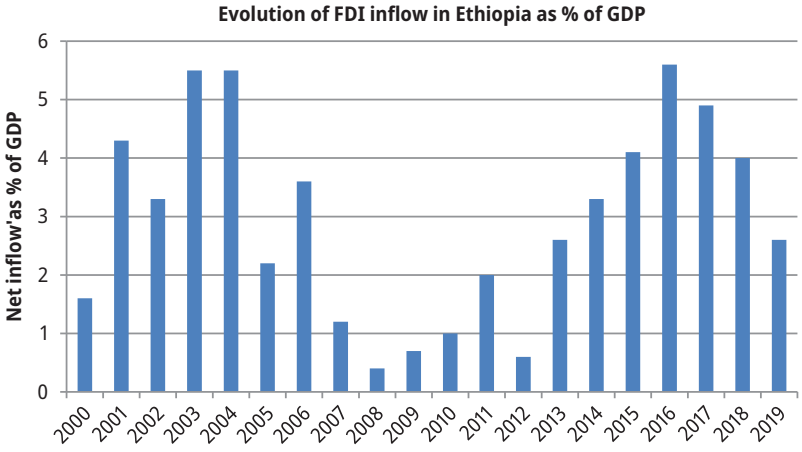

Figure 10.2: Net FDI inflow as a % of GDP.

Import-export Trade

Figures 10.3 and 10.4 demonstrate the import-export trade and trade balance of the textile and apparel manufacturing sectors in Ethiopia since 1998. Within these 20 years, there is a wide deficit. As can be seen in Figure 10.4, the percentage of USA export trade is higher than the world export trade, which is consistent with the market destination described in Figure 10.1. The preferential market access to the USA has played the main role in the success of the export. The Ethiopian domestic market and manufacturing industries are identified by high imports of apparel and textiles (Figure 10.3), both for domestic and export use respectively.

The Relationship Between FDI and Sustainable Economic Growth

Figure 10.5 shows the GDP growth by sector following FDI inflows. The industry sector that consists of manufacturing took the priority of FDI as it is expected to provide export opportunities and generate foreign currency. After 2002 the agricultural absolute growth is declining whereas the industry absolute growth is increasing drastically, which is backed mainly by the manufacturing sector, such as the textile and apparel industries. The average growth rate between 2000 and 2019 shows 8.8% per annum. This achievement was reached through the construction of big infrastructures, service facilities and incentives.

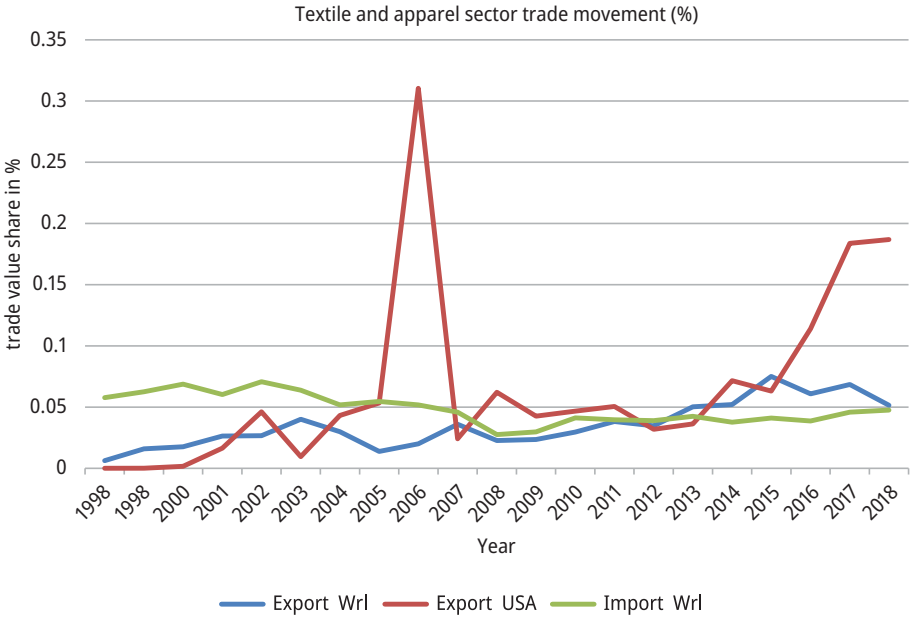

Figure 10.3: Textile and apparel import export trade.

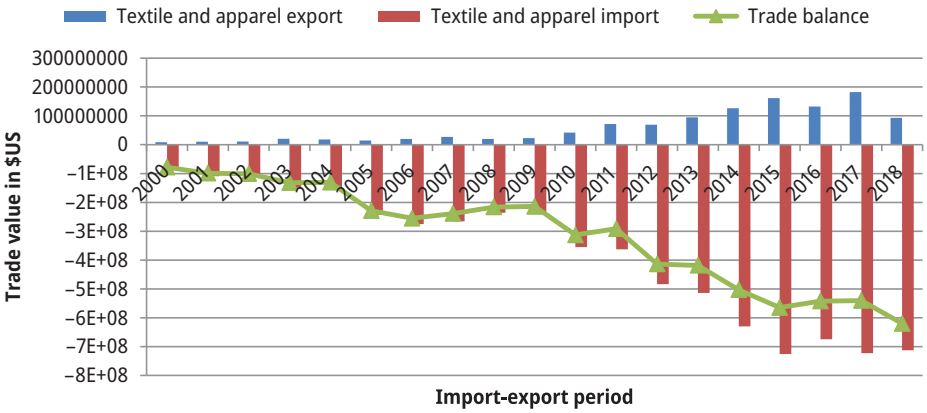

Figure 10.4: Textile and apparel trade balance.

The strength of correlation between GDP and both total FDI and sectoral FDI were found significant at p = 0.01 (Table 10.6). Compared to the effect seen in the total FDI inflows, the strength of correlation between sectoral FDI and export was found to be higher than that of sectoral FDI and imports. This is consistent with the findings of Wang et al. (2010), where the impact of inward FDI on Chinese exports was found to be stronger for labour-intensive goods such as textile and garment than for capital-

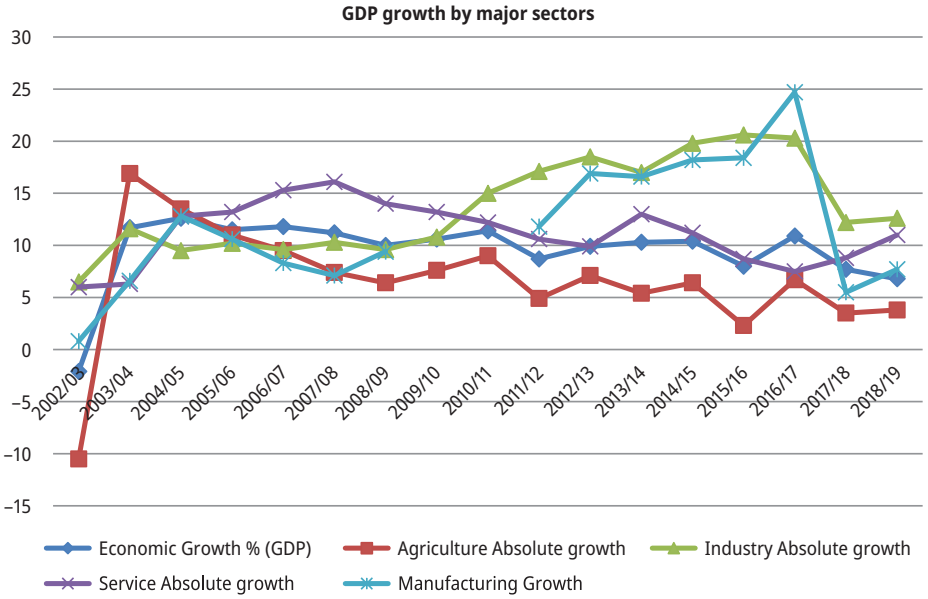

Figure 10.5: GDP growth by major sectors.

intensive goods. However, the strength of correlation between sectoral FDI and export was comparably lower than that of Malaysia (Masron et al., 2012).

Table 10.6: Correlations (trade value in $US).

	GDP	FDI inflows	Total EXPORT	Sectoral EXPORT	Sectoral FDIS	Total IMPORT	Sectoral IMPORTS
GDP	1.000000						
FDI inflows	0.897285	1.000000					
Total EXPORT	0.879486	0.734160	1.000000				
Sectoral EXPORT	0.902161	0.868332	0.923644	1.000000			
Sectoral FDI	0.897285	1.000000	0.734160	0.868332	1.000000		
Total IMPORT	0.944190	0.789303	0.936239	0.913767	0.789303	1.000000	
Sectoral IMPORT	0.965040	0.861671	0.935745	0.941365	0.861671	0.968756	1.000000

The Effect of Total FDI Inflows on Economic Growth

The total yearly FDI inflows ($US) were correlated with the total imports ($US) and exports ($US). The result shows that total FDI inflow is positively correlated with total imports as well as total exports, with a slightly higher strength in the former relationship. This is consistent with time-series data presented in Figures 10.2 and 10.4. The

type of firms operating in Ethiopia may explain the higher strength of the FDI-import trade correlation. As shown in Table 10.2, most firms are invested in the apparel industry, undertaking a cut-make-trim production that requires massive raw materials, specifically fabric. Basically, both domestic and foreign firms import fabric from abroad; however, most international corporations use their textile producers or worldwide supplier networks to import all of their inputs. Imports of textiles may have increased as a result of this. These findings align with those of Kurtishi-Kastrati (2013).

The objective is to develop a well-integrated industry and avoid import dependency. Hence, the government also focuses on identifying and building the capacity of existing textile mills and attracting new investors.

Moreover, the autoregressive conditional heteroscedasticity was performed to test the impact of total FDI inflows on GDP growth. The result, with an R squared value of 0.77, showed a significant positive effect (Table 10.7).

Table 10.7: Regression coefficients.

Dependent Variable: GDP
Method: ML ARCH – Normal distribution (BFGS / Marquardt steps)
Date: 07/07/21 Time: 20:00
Sample: 2000 2019
Included observations: 20
Failure to improve likelihood (non-zero gradients) after 68 iterations
Coefficient covariance computed using outer product of gradients
Presample variance: backcast (parameter = 0.7)
GARCH = C(3) + C(4)*RESID(−1)^2 + C(5)*GARCH(−1)

Variable	Coefficient	Std. Error	z-Statistic	Prob.
C	1.49E+10	3.27E+09	4.565192	0.0000
FDI	18.96643	2.314913	8.193148	0.0000
Variance Equation				
C	1.29E+20	2.81E+20	0.457910	0.6470
RESID(−1)^2	−0.451478	0.721764	−0.625520	0.5316
GARCH(−1)	0.618703	1.822061	0.339562	0.7342
R-squared	0.772613	Mean dependent var		3.80E+10
Adjusted R-squared	0.759980	S.D. dependent var		2.90E+10
S.E. of regression	1.42E+10	Akaike info criterion		49.86756
Sum squared resid	3.63E+21	Schwarz criterion		50.11649
Log likelihood	−493.6756	Hannan-Quinn criter.		49.91615
Durbin-Watson stat	0.661380			

The Effect of Sectoral FDI Inflows on Economic Growth

The result of autoregressive conditional heteroscedasticity, with an R squared value of 0.76, shows that there is a strong significance and positive relationship between the specific sector's FDI inflows and GDP (Table 10.8), which is consistent with the justification of Fauzel & Keesoonah, (2017). Hence, indirectly, the volatility of FDI has a strong impact on sustainable economic growth.

Table 10.8: Regression coefficients for sectoral level.

Dependent Variable: GDP
Method: ML ARCH – Normal distribution (BFGS / Marquardt steps)
Date: 07/07/21 Time: 20:08
Sample (adjusted): 2001 2019
Included observations: 19 after adjustments
Failure to improve likelihood (non-zero gradients) after 51 iterations
Coefficient covariance computed using outer product of gradients
Presample variance: backcast (parameter = 0.7)
GARCH = C(3) + C(4)*RESID(−1)^2 + C(5)*GARCH(−1)

Variable	Coefficient	Std. Error	z-Statistic	Prob.
C	1.52E+10	3.63E+09	4.177350	0.0000
FDIS	750.8883	99.58376	7.540268	0.0000
		Variance Equation		
C	1.33E+20	3.21E+20	0.412817	0.6797
RESID(−1)^2	−0.466215	0.693085	−0.672667	0.5012
GARCH(−1)	0.610110	1.895803	0.321821	0.7476
R-squared	0.764719	Mean dependent var		3.95E+10
Adjusted R-squared	0.750879	S.D. dependent var		2.89E+10
S.E. of regression	1.44E+10	Akaike info criterion		49.92324
Sum squared resid	3.53E+21	Schwarz criterion		50.17178
Log likelihood	−469.2708	Hannan-Quinn criter.		49.96531
Durbin-Watson stat	0.665651			

Conclusions

The results of the correlation and simple regression (ARCH model) study revealed that total FDIs and GDP, as well as sectoral (textile and apparel) FDIs and GDP, have a positive and significant relationship. For the selected analysis periods, the data showed significant variations. The majority of the findings show that economic growth fluctuates during periods of political unrest, resulting in foreign corporations leaving the country.

Despite the growing number of industries, industrial areas, availability of preferential market access, FDI inflows and government focus on the sector, domestic participation remains a risk for sustainable development. The government's strategy is mainly focused on attracting foreign investors. However, without domestic firms' participation, the sustainability of the industrialisation process, technology transfer, modern management and spillover effect, as well as sustainable economic growth, will be questionable.

Directly or indirectly, the variation in sustainable economic growth arises from the impact of depending solely on FDI inflows. Hence, the country's IPs policy needs a mechanism to measure the economic achievements and periodical transition of experimental learning. Not only foreign investors but also domestic firms require investment protection, transparent policy and predictable regulations.

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