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INDRA GANDHI NATIONAL OPEN UNIVERSITY SCHOOL  
OF SOCIAL SCIENCE FACULTY OF ECONOMICS

Determinants of Domestic Private Investment  
In Amhara National Regional State

By  
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Addis Ababa, Ethiopia  
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## DETERMINANTS OF DOMESTIC PRIVATE INVESTMENT IN AMHARA NATIONAL REGIONAL STATE

Project Work Submitted to the Indira Gandhi National Open University, in partial fulfillment of the requirements for the award of the Degree-Masters of Arts (Economics). I hereby declare that this work has been done by me and has not been submitted elsewhere.

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## CERTIFICATE

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I certify that the project work entitled “**Determinants of Domestic Private Investment in Amhara Region, Ethiopia**” submitted by Alemtsehay Sinor Tegegne is her own work, and has been done under my supervision. Hence, it is recommended that this project be placed before the examiner for evaluation.

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## ABSTRACT

Private investment in the Amhara National Regional State in real terms, as well as a ratio to Gross Domestic Product (GDP) has been falling in some periods of 2003-2010. Viewed against the background of growing evidence of a link between investment and economic growth, an inconsistent and downward trend in the region's private investment is a matter of concern. The question of what determines private investment behavior in the region, therefore, becomes an important issue. Several studies in developing countries emphasize the importance of macroeconomic policy in explaining variations in investment, and in particular, for identifying the macroeconomic determinants of private investment.

The paper examines the macroeconomic determinants of private investment in the Amhara region by means of a regression analysis. For econometric analysis, the data used for the study is mainly secondary data collected from different regional government organizations. The model used for econometric regression is an eclectic version of flexible accelerator model designed to capture some of the key determinants of private investment behavior. Econometric results of the study support the existence of a short-run dynamic adjustment and the long run equilibrium relationship between these macroeconomic variables and private investment level. Public investment, bank credit to the private sector and the real interest rates affect private investment level in the short run, while GDP growth and real exchange rate affect private investment in the long run.

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## IS AND ABBREVIATIONS

ANRS	Amhara National Regional State
BoFED	Bureau of Finance and Economic Development
GDP	Gross Domestic Product
GDI	Gross Domestic Investment
PI	Private Investment
EIA	Ethiopian Investment Agency
IAE	Investment Authority of Ethiopia
FDRE	Federal Democratic Republic of Ethiopia

# CHAPTER ONE

## INTRODUCTION

### 1.1. Background of the Study

Economic growth is the primary objectives of any nation in the world. This truth is accepted almost with controversy. To raise income, well-being and economic capabilities of the people everywhere is the most crucial task facing us today. Aid is disbursed every year; investments are undertaken; policies are framed and elaborated; plans are hatched so as to achieve this goal at least a step to close it.

Ethiopia as part of the world is facing the problem of promoting economic growth. Over the past four and five years, it has experienced periods of rapid economic growth as measured by gross domestic product. Over the same period, problems of unemployment, higher inflation, and income inequality remained intractable.

Economic growth, which is being highly desired, can be achieved through capital accumulation, foreign aid, grants and loans. Among the factors which promote economic growth, capital accumulation is the most important one which is brought by real investment. By entering a new business; by expanding current business or by replacing worn out capital investment creates a market demand for capital goods. These goods add to the stock of capital in a county, and endow it in the future, with an even larger capacity for production so an economy grows. It is the fact that investment is the most important factor which promotes economic growth. But, its spatial distribution is uneven across different areas of Ethiopia. It flows where infrastructures are available; and in addition, it has been flowing towards areas where labor, land and the proceeds of marginal efficiency of capital are higher. (BoFED 2006)

Investment not only provides finance, but also technical, personal, new technology, research and innovations in products and techniques of production. It helps in raising productivity; and hence, real wage of local labors, and the investment project is labor intensive. It also provides larger employment opportunities; and creates effective demand for investment goods and increasing the production of goods and services that promotes economic growth.

Although Ethiopia is endowed with immense and untapped natural resources; and it is listed among countries which have low status of investment. Even the investment flow shows some

ution for the economic growth of the county. This is due to  
g habit; low level of education; etc.

Amhara National Regional State as part of Ethiopia witnesses the same problems like that of the country. The region has different opportunities for the expansion of investment activities. For instance, conducive climate, available land, abundant natural resources like water, dependable market, etc. So having these potentials of investment, it is possible to improve the investment situation in the region by addressing the problems that faces it. This brings better employment opportunity, raising real wage of the local workers, creating effective demand for investment goods, services and equitable distribution of income. (ANRS Investment Agency, 2009).

The main objective of this study is to investigate the determinants of domestic private investment in the Amhara National Regional State. The study will also shed light on the determinants of economic growth, and provide invaluable feedback for the design and implementation of stabilization policies.

The Amhara National Regional State is located 9° 20' to 14° 0' North and 36° 20' to 40° 20' East in Ethiopia's North Western part with a total area of 161,829.4 square kilo meter. The region has 10 Administrative zones, 166 urban urban and rural woredas (districts) and other 263 towns. The region's population is estimated to 17.2 million according to the census of 2009 which accounts 25.5% of the country's total population; and the region makes up 15% of the country's total area. The crude fertility rate in the region is 39.5 per 100 people; and the average number of children a woman can bear during her reproductive life time is about 5.1 children. This shows that extended family weakens saving and investment as consumption expenditure rockets. (BoFED, 2009).

The Amhara National Regional State has huge resource base and large investment opportunities with its vast unutilized land, favorable topography, eye-catching natural and man-made tourist attractions, availability of inviting resources for doing productive business, and the hardworking reputation of its people make the region quite attractive to the investors. Besides, the region also has a huge arable land (about 6,726,676 hectares) of which 1.2 million hectares with high development potential; and 570,000 hectares of arable land is suitable for irrigation. However, out of the total irrigable land, 11,400 hectares of land is currently used for irrigated agriculture. This covers about 2% of the total potential available rural land, and 0.4% of the total urban land (ANRS investment Agency, 2007).

exploitable mineral resources such as, opal, gold, coal, iron and beryllium, etc; and it has varied construction materials. About a third (1/3) of the country's livestock potential accounts to the region. All these potentials and others tend to attract diversified agribusiness activities and other investment opportunities in varied economic sectors.

Gross domestic product measures the total value of all goods and services produced in the region. According to the Bureau of Finance and Economic Development estimation (BoFED, 2009), the regional gross domestic product (RGDP) in the region grew on the average rate of 5.2% in the year of 2009. The performance of the GDP is highly affected by the natural and human-made hazards which the GDP growth rate fluctuated in the last ten years (2000 to 2009). According to the recent 5 years plan, the region contributes 36% in terms of area coverage, and 31% in production of the country. However, productivity per hectare has been found declining or remained relatively static. This indicates that investment in technology transformation is very low or in-consistent.

In the context of the Amhara National Regional State, private domestic investment includes: investment in manufacturing, agriculture, industry, construction, hotel and tourism and service sectors. Despite the aforementioned diverse development investment potential, private investment trends in the Amhara National Regional State in the past has not been impressive. This has made successive regional governments put in place several policies to promote private investment, which include, adapting and issuing of new investment policy and investment code. However, various governments including the Amhara National Regional State have sought to encourage empirical investigation in to the main determinants of domestic private investment. Thus, the poor response of the private investment created in the region.

## **1.2. Statement of the Problem**

Private investment is key to long term economic growth (Khan and Reinhart, 1990: 21), and Devarajan, Easterly and Pack (2001: 82). However, the level of private investment, in the region is not only low; but also shows downward trend for some periods during 2003-2010. Declining investment ratios and levels are a problem. Firstly because investment matters for growth; and secondly, because low investment increases vulnerability in the economy (Mlambo and Oshikoya, 2001: 16). A key challenge facing the Amhara region is to come up with policies that would help raise private investment in order to stimulate and sustain economic growth. With a view to

conclusions and implications for the Amhara region, it is  
of private investment.

Investment is the main indicator in the process of economic growth and development of any nation. Different investment activities around different economic sectors are the vital means for development.

As it is already known; being rich and having accumulated capital are not sufficient condition for economic development. Those resources should be activated in a way that they can add value and get utilized extensively and intensively. These activities require the involvement of private economic units in an extended way with huge and varied outputs. However, in many developing countries including Ethiopia, different policy implementation and macro-economic adjustment measures do not improve private investment in a remarkable degree.

Many problems contribute for the declining of private investment in the Amhara Regional State. Absence of accurate and up-to-date data on resource potential; absence of information about feasible project ideas; lack of well organized promotional service strategy and promotion skill gap are major problems still prevailing, among many others. This shows that many factors have hindered the regional investment development activities, negatively affecting the national domestic private investment at large.

Hence, this study aims to identify and analyze the major factors or determinants of private investment activities in the Amhara Regional state.

Therefore the paper tries to answer the following research questions

- What are the determinants of private investment?
- Which of these factors contributed to the slow growth of private investment in the economy?
- What policies, if any, have been undertaken to encourage private investment in the Amhara region?

### **1.3. Significance of the Study**

The region has been facing different problems such as: drought, the high population growth etc. to meet the fast development of investment needs. Most of these drawbacks/problems of investment are undetermined. As to the knowledge of the research, no study has yet looked, specifically, into

in the Amhara region. This study, therefore, intends to shed determinants of private investment in Amhara region. It is of private investment, which would be of great use in the formulation of possible policy intervention to help stimulate and sustain private investment and economic growth of the region and the nation at large. The output of the study is expected to benefit the private investors in identifying the potential intervention areas of the region. The findings of the study would also help researchers and academicians as spring board and source of data/ literature for undertaking further researches.

### 1.4. Objective of the Study

The main objective of the study is to investigate the major determinants affecting the expansion of private investment activities, and their impact on the economic growth and development in the Amhara National Regional State.

The specific objectives of the study include:

- To overview the basic potentials of the region;
- To identify major problems affecting the intervention and performance of the private investment in the region;
- To identify different investment opportunities and policy options to encourage investment and;
- To show the significance of different variables affecting private investment;

### 1.5. Hypotheses

The empirical literature on private investment behavior in developing countries seems to have focused on testing several hypotheses advanced to explain variations in private investment (Oshikoya, 1994: 578). The hypotheses to be tested in this study are that macroeconomic factors help explain variations in the level of private investment; and that these effects can be categorized into short-term and long-term effects. Specifically, the relationship between private investment and the seven identified variables: public investment, domestic credit to the private sector, real interest rate, inflation, trade, real exchange rate, and real GDP growth are hypothesized.

## Study

This study focuses particularly on assessing the determinants of private domestic investment in the Amahra Regional State in eight years period ranging from 2003 to 2010.

The effectiveness of every study greatly depends on the availability of resources with conducive environment. In conducting the study, however, there were a lot of limiting factors that the researcher face it. In this respect therefore, unavailability of accurate and full data, the absence of fund from any organization, the respondents shared much time to return the response of the questionnaire, the high bureaucracy in each and every sector were the burden the researcher bore to carry up on the collection of the data. Moreover, utilizing more disaggregated data seeking to explore sectoral private investment may arrive at different results.

### **1.7. Organization/ Structure of the Thesis**

The study is organized into six chapters. Chapter one deals with the introduction. Chapter two provides some economic background information on the regional economy. Chapter two reviews the relevant literature; while the research methodology is discussed in chapter three. The study results and presentation is discussed under chapter four; while chapter five presents the conclusions and policy implications based on the study findings.



## CHAPTER TWO

# L REGIONAL STATE ECONOMY

### 2.1. Demographic Situation

In economic analysis demographic analysis takes great concern as population is considered a source of important factor of production, like labor and entrepreneurship. As a factor of production, population growth could contribute to economic growth, but as consumption units, population could put pressure on the economy. The population of the Amhara National Regional State is estimated to be 19.6 million in 2007 with annual growth rate of 2.76 percent. The crude fertility rate in the region is 39.5 per 100 people; and the average number of children a woman can bear during her reproductive time is about 5.1 children (BOFED, 2008). This shows that increased/larger family size weakens saving and investment as consumption expenditure increases. The number of the region's population accounts to about 25.5% of the total population of the country. While geographically the size of the region accounts only 15% of the country. Out of the total regional population, about 88.6% reside in rural areas with uneven distribution and with weak infrastructure; but most of them engaged, mainly in small holder agricultural activities.

According to BOFED (2006), 43.49% of the population is under age 14; and only 3.53% are with the age greater than 65. This suggests the increasing societal dependency ratio (raised to 88.74, a high socio-economic burden).

### 2.2. Macro-Economic Situation

Gross domestic product measures the total value of all goods and services produced in the region. According to BoFED (2006), GDP in the region grew on the average rate of 5.2% in the year of 2005. The performance of the GDP is highly affected by natural and human-made hazards affecting the GDP growth rate to fluctuates during the last ten years (2000 to 2009), particularly during Ethio - Eritrea war and during the recurring years of drought. The real GDP had reached 19.4 billion Birr in 2009 from the amount of 10.6 Billion Birr in 1996. The performance of the economy was relatively weak in the years of 2000-2007 due to low implementation of private investment. Per capita income of the region varies from 721.2 to 812.1 Birr during the last 10 years (2000-2009) with an average growth rate of 19 %. The highest per capita income was in the year 2001 with growth rate of 5.15% (which declined to 7.05) in the following year with per capita income of 764.9 Birr.



### nd per capita income

Details	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Total regional domestic product in billion Birr	10.5	11.5	10.4	11.3	12.3	13.3	13.5	12.9	14.6	15.2
Total population	14.56	15	15.4	15.9	16.3	16.8	17.2	17.7	18.2	18.7
Per capita	712.2	765	670	714	751	793	787	733	801	812
GDP growth rate (%)	7.47	8.36	1.93	3.76	4.63	5.28	4.71	3.6	4.52	4.48
Per capita growth rate	4.24	5.15	-1.05	0.77	1.65	2.29	1.85	0.72	1.64	1.61

Source: - ANRS BoFED (2010)

When we come to the structural transformation of the economy, the share of agriculture declined from 67.40% in 2000 to 60.93 in 2009. In contrast, the shares of industry and service sectors grew from 19.50% and 13.02 % in 2000 to 21.13% and 17.77% in 2009, respectively. The gross domestic value of the agriculture sector increased from 7.8 Billion Birr in 2000 to 11.85 Billion in 2009; and the value of the industry and service sectors increased from 2.2 billion and 1.5 billion in 2000 to 4.1 billion and 3.41 billion in 2009, respectively.

Table 2: Real gross domestic product and the share of GDP by component sectors (capital in billion Birr)

Sector	Year									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Agriculture	7.1	7.8	6.4	7.2	7.1	7.8	7.9	6.3	9.99	11.85
Industry	2.1	2.2	2.4	2.4	3.3	3.4	3.2	3.6	3.83	4.1
Service	1.4	1.5	1.6	1.7	1.9	2.1	2.4	3.00	3.37	3.45
Total GDP	10.6	11.5	10.6	11.3	12.3	13.3	13.5	12.9	17.5	19.4
Per capita income	721.2	764.9	670.4	713.5	750.9	792.7	786.6	732.5	801.3	812.1

Source: BoFED (2010)

Table 3: The structural GDP share of sectors (capital in billion Birr)

Sector	Year									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Agriculture	67.4	67.66	61.62	63.45	58.03	58.6	58.22	48.68	55.65	67.91
Industry	19.5	18.94	23.02	21.43	26.59	25.69	24.02	27.78	22.99	22.91
Service	13.09	13.41	15.37	15.12	15.38	15.71	17.76	23.54	21.36	19.18

Source: BoFED (2010), macro-economic development in ANRS.

will be the dominant economic sector which accounts to about 40% of the total employment, about 88% of the region's population. According to (BoFED 2004 ó 2008) data the Amhara region contributes 36% of the total national and 31% of the total agricultural area coverage production of the country. However, productivity per hectare has been found declining or relatively static. This suggests that investment in technology and transformation has been very low or inconsistent.

### 2.3. Economic Growth

One instrument to measure economic growth is GDP. Accordingly, the economic growth rate was fluctuating in last year decade. It was increasing from 7.75% in 2000 to 10.94% in 2001, but slumped down to 4.71% and 3.56% in the years 2006 and 2007, respectively, though on average showing grow to rate of 5.2%

Table 4: Growth rate of component economic activities by sectors

Economic Activity by sectors	Years									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Agriculture	8.3	9.0	-0.8	2.4	1.7	3.0	2.7	-0.5		
Industry	3.8	4.9	6.5	5.3	10.5	9.6	7.3	7.8		
Service	9.1	10.5	8.1	8.0	8.4	8.8	9.6	11.6		
Total	7.47	8.36	1.93	3.76	4.63	5.28	4.7	3.6	4.52	4.48

Source: BoFED (2010)

On the basis of analyzed data in table 4 above, it can be concluded that the growth rate of the agricultural sector showed a decline by an average of 1.4% from 2002 to 2007, whereas, the industry and service sectors increased by an average of 6.96%, 9.26%, respectively. On the other hand, the annual growth rate in per capita income fluctuated due to the fluctuating economic growth performance. Economic growth of the Amhara Region fluctuated from -1.05 to 5.15 in the years 2000-2009 with an annual average per capita growth rate of 1.9% per annum. Though the region experienced unstable economic growth, the growth rate of GDP is higher than the growth rate of population by 2.87%.

### 2.4. Resources and Investment Potential

#### 2.4.1. Resources endowment

The Amhara National Regional State is one of the most resourcefull regions of the nation. The varied altitude range of the region creates varied climate and ecological zones with a choice of resources for

on covers about 15% from the total area of the country and According to the information from the investment agency of of the nation's underground water resource in addition to the big lakes like Tana, Ardibo, Haik, Zengena; and big rivers like Abay, Tekeze, Awash, Denakil, etc. With their many tributaries. It is to be remembered that Ethiopia is traditionally known as the ÷water tower of Africa. Besides, the region has a huge arable land with estimated size of 6,726,676 hectares, among which 1.2 million hectares is with high agricultural potential and, 570,000 hectares of arable land is suitable for irrigation. But, out of this irrigated land potential only 11,400 (2%) hectares is currently used for irrigated agriculture. (ANRS investment Agency, 2007)

According to BoFED (2008), in terms of agricultural and related resources, the region constitutes about 1/3 (33%) of the nation's livestock population (including 10,512,770 cattle, 5,320,330 sheep, 470 camels, 1,465,020 asses, 105,510 mules, and 973,460 beehives) which contributes 22% to the nation's agricultural outputs and 12.5% of the GDP. In addition, the region producer, supplies in current backward situation, about 1/3 (5,198,449 tons in 2007) of the nation's crop production which includes cereals, pulses, spices, fruits and vegetables. Besides, the nation big resources of fish belongs to the region with the annual fish catch from lake Tana estimated to be 15,000 tons of 20 different species and 10,000 tons from other rivers with 22 different species. In addition, the region has a huge potential for floriculture development where 1.2 million hectares of land is well suited for the production of cut flowers

Furthermore, the region has considerable potential of forestry and forest products. About 870,600 and 1.5 million hectares of land are available, respectively for the development of forestry and fruit trees. Together with this, the region is known for its incense and gum natural forest resources with the estimated annual yields of 205,167 tones, and 1,678 tons respectively. On the other hand, the region's resources in the area of tourism is tremendous. That is, the region is one of the richest areas in the country in terms of tourist attraction with natural geography, wild life and historical places. Particularly, the region is situated at the heart of the historic route of Ethiopia, the Rock Hewn churches of Lalibela, Palaces of the part Ethiopian emperors in Gondar, the Semein mountain national park, which have been listed among the world is heritage sites by UNESCO, together with endemic wild animals, water bodies and falls, tradition murals, historical churches and antiquity sites.

On the other hand, throughout the region, there are abundant exploitable mineral resources, including: opal, gold, coal, limestone, lignite, gypsum, gemstone, silica, sulfur, benthonic, mineral waters, etc. Other mineral resources as basalt, river sand, red Ash, and Imbrute found with unlimited amount. According to BoFED (2009), the region has an estimated population of about 19.2 million, out of

ve people (15-64 years of age). This abundant and relatively resource. According to BoFED's survey results about 77.8% on has high amount of natural resources; and 72% of these professionals also confirm that these opportunities have not been exploited and about 52% of them also state that the involvement of private investors is low.

#### **2.4.2. Investment opportunities**

The region has huge potentials in natural and human resources, it undoubtedly could have numerous investment opportunities, in the area of agriculture, industry, mining and social services. The economy of the region, similar to that of the nation, is based on agriculture. The suitable and varied climatic conditions, the availability of ample arable land and water resources make it favorable for agricultural production such as: for crops, livestock, fish, honey, flower, fruits, vegetables production and for the developments of forests. A wide presence of agricultural resources and products paves the way to wide access to the realization of manufacturing industries, such as: processing of cereals, pulses, species; processing of coffee and sugar cane; processing of fruits, vegetables and honey; processing of fish, milk, and meat; processing of forest products; and processing of any other agricultural products.

The resources in the area of agriculture further creates an investment area of rendering services in the processing of field including: polishing, harvesting, threshing, etc. and commercial farming, (including: rental of agricultural machinery, veterinary facilities and plant protection services, installation of irrigation systems, supply of other inputs and outputs, etc). The modest agricultural base in the region lets way to the establishment of small, medium and large scale enterprises, such as: food complex industries, breweries, soft drinks, etc.; fat and oil processing industries; textile factories; leather processing industries; pulp industries; electrical goods and components; production industries; medical and surgical equipment production industries; fertilizers and chemical industries; building material production (like: cement, glass, ceramics); coal production industries; real estate; high tech metallurgy; and manufacturing of utensils.

On the other hand, different mining activities, such as: exploitation and extraction of coal, gold, opal and other precious metals; and extraction and manufacturing of precious construction goods, etc. could be the other main development opportunities. In addition, the huge water, solar, wind, mineral, and biomass resources are important and promising areas of investment generation. These could be mini and small hydro plants, biogas plants, solar energy and energy related technology, and devices production supply, etc. Due to the supply and demand gap, energy generation could be

far one of the richest in the country in possessing attractive endemic wild life and historical attraction, it could be and is, investment opportunities in hotels and restaurants, lodges, tour operation, museums need to be available to a large extent. Concerning education, the existing gross enrolment ratio of elementary education is 83.9%, the pupil teacher ratio 58.1; and the average distance to school is about 3.33 kilo meters. As regards health facilities, one doctor serves for 230,391 people; and one nurse serves for 9692 people (BoFED, 2006). All these show that, there is a gap between demand (basic needs) and supply or service production. So, investors could have a vast area of intervention, such as, in the establishment of health and educational institutions, training of education professionals and health personals, etc. With the current fast increasing in population, the demand for residential houses, trade centers, infrastructures, demand for other basic facilities is increasing alarmingly. So, participation in the construction of residential houses by real estate; renting of construction materials; equipment, training of person are among the main profitable investment opportunities.

### **2.4.3. Measures to improve investment climate**

Government can play a vital role in augmenting comparative advantage and decide to put more emphasis on economic diversification through adopting appropriate fiscal and monetary reforms to, among others, encourage private investment. The role of government is particularly important in areas, such as: maintaining economic and political stability, enacting investment regulatory frameworks, developing infrastructure and human capital (through educating people), creating a liberalized and competitive economic environment. These factors may influence private investment through their impact on investment risk and uncertainty (Tefferi Mequanint 2000:13).

Some government policies that influence /encourage private investment include incentive system and the legal climate for businesses. Incentives can be provided for investors through tax reduction, giving license and subsidies to attract more investors. Generally, lower tax rates attract higher level of investment. So incentives are viewed as effective in attracting investment, specially the export oriented and large scale investments. The legal and regulatory framework governing private business activities are determinant factors for attracting investment; and they need to be stable, transparent and reliable. As it is noted by Fias (1998), firstly, the rule of the game must be reasonably stable. Secondly, the judicial system must be able to enforce law and contracts effectively and honestly; and thirdly, the government should have a climate that is free of bureaucratic interference and arbitrary decision.



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ures to boost private investment in the 1970s, initiating to the private sector through organizations, such as: Amhara Development Bank, Construction Bank etc. The main objective is to establish and develop commercially viable businesses through provision of financial assistance to investors with commercially viable projects. Other policies included interest rate policy which was intended to ensure that private savings are increased; appropriate investment decisions made; financial incentive provided to investors; and reducing bureaucracy involved in securing of foreign exchange for importation of goods and the realignment of the national tax system. The latter includes change of direction in the tax policy as income taxes were reduced to levels that are low by international standards. (BoFED, 2008)

The completion of major infrastructure projects in the early 1980s also contributed to an environment conducive to private sector investment (BoFED 2006). Among the investment promotion incentives, the provision of land was taken as one the area of investment promotion. The investment proclamation no. 31/ 1995 provides for the use of rural land for investment in the Amhara region. This indicates that land is given on priority bases to projects falling in the category of activities identified on the top priority in the region or those considered having high social return. Those activities which affect the rights of the peasantry and peasant holdings and those that require land which are designated for the development of natural resources, religious sites or public services are not to be granted for the investment operation. The size of land holding to be granted for investment depends on the nature of the project and the amount of capital assigned for it. Land is given on a lease contract terms for a period more than thirty years. The lease rate for the land made to vary from Zone to Zone according to the distance from all weather roads and the existing development level within the zones. The rate discriminates in favour of remote and under developed zones and which again differ within the zone. The intention of such policy is to attract investments to less developed areas within the region. In terms of investment types, those investments which are believed to contribute to the environmental protection and public services are given land on free of charge. The proclamation also gives the right of holding upon requests for the above mentioned purpose by fulfilling the requirement on the part of the private investor, land will be given/transferred/ to the investor within fifteen days from the signing of the contract. (Investment Agency, 2008)

In addition, the government has established the Investment Authority in recognition of the importance of private investment in the creation of employment, economic diversification and



Authority mainly focuses on export development and the manufacturing sector. As a primary government contact include, among others: to promote the establishment of manufacturing enterprises for export and import substitution; to promote the establishment of joint ventures between local citizens and foreign investors; and to identify market outlets for locally manufactured goods. (ANRS investment Agency, 2007)

Despite government's efforts and commitment in attracting investment, some of the schemes that were initiated to promote investment have not been able to achieve the intended objectives. Mainly due to policy implementation problems, such as; rate of land lease variation, bureaucratic procedures, etc.

## 2.5. Trends in Investment in the Amhara Region

The military government (Derg, 1966) came to power there were significant changes in the economic system observed, including the termination of the feudal production relation, which was a widely recognized impediment to economic development in Ethiopia. This definitely was a relief to the majority of the rural poor due to the proclamation of rural land to the tiller. Large number of private businesses and properties were nationalized (proclamation No. 26/1975). However, Proclamation No - 76/1975 issued at the same time restricting private sector operation to a few lines of activities and imposed capital ceilings on them. Only individual businesses were allowed (without branches); and private businesses could possibly be organized themselves in the form of partnership and the membership restricted to 5 persons. Joint ventures were allowed by the proclamation No- 235/1983; but it only gave the right for the government and foreign investors, with the major share of the government. However, only few joint ventures were realized over the years. A total of six joint ventures were organized, out of which two were liquidated (Melaku Tefera, 1989).

Recognizing the overall crisis of the economy and the world situation in the late 1980s coupled with the intensified internal instability forced the military government to change its policy direction, announcing a "Mixed Economic Policy" in 1989. The change of the policy direction, however, did not do more than the proclamation due to the short life of the Derg in power. On the other hand, public investment to GDP had an increasing trend particularly during the time of the intensification of the establishment of the state - owned enterprises, except during the last three years. Presumably, the deceleration of public investment after 1989 was due to the effect of the

Policy changes were made after the present government took the central elements were: the greater scope it gave to the private economy; and the emphasis it placed on Federalism (TGE, 1991).

In order to materialize the intention of putting the private sector a leading sector in the economy, Proclamation No.15/1992 was promulgated in May 1992. The same proclamation was a complete departure from the previous regimes' special investment decree No.17/1990, and a joint venture special decree No.11/1989. The new promulgated investment proclamation has created good investment environment particularly for domestic investors, which allows the participation of private investors in air transport, electricity production and distribution, Banking and Insurance.

After exercising proclamation No15/1992 for about four years, a new proclamation No. 37/1996 was promulgated in July 1996 to amend some weak points of the previous proclamation. The proclamation No. 37/1996 gave more emphasis on the clarity of some ambiguities prevailed in the first one. With regard to organizing an institution to implement the investment policy and for providing incentives, Investment Office of Ethiopia which then was renamed "Investment Authority of Ethiopia (IAE)" was established. The authority was accountable for Investment Board, which chaired by Prime Minister. The responsibility of Investment Authority of Ethiopia (IAE) established included: processing investment application (i.e., issue investment certificates and grant investment incentives) as per the proclamation provided. The IAE has been responsible for investors with and above capital of Birr 250,000 (for domestic investors) and USD 500,000 or equivalent for foreign investors<sup>1</sup>. If any investors do not feel happy by the decision of IAE, they can appeal to the Investment Board. The decision of the Board is the final. A great progress has been made with respect to the institutional arrangement when compared to the previous regime.

Previously, the investors were used to go to the respective line ministries depending on the type of investments to get temporary license. After the temporary license the investors should go to Investment Agency for acquisition of investment incentives. Currently, however, the investor goes only to IAE to get both investment certificate and incentives. There are two types of investment rules in Ethiopia. These are the Federal Investment Policy and the Regional States Investment Regulations. The Federal Investment policy under the proclamation no. 37/1996 aimed at improving the living standard of the people of Ethiopia by bringing sustainable economic and social development (FDRE, 1996a). It was aimed at accelerating economic development, putting the





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efficient utilization of natural resources. This then, gets and thus, create a wide employment opportunity.

This perhaps indicates that generous investment incentives through investment policy alone in the form of tax holidays and others are not enough to influence the inflow of private investors to the target regions. Here, though the other main factors supposed to influence investment distribution is beyond this study, factors perceived to be influenced are infrastructure, investment implementation procedures (beaucracies), capable human resource in the respective regions, and the certainty of policy environment presumably determining factors.

Other things noteworthy to mention is, like other regions the Amhara National Regional State formulated investment regulations based on the Federal Investment Policy in terms of its content. The region is significantly different from the regions in terms of its investment opportunity. However, these different sectoral compositions and opportunities should be specifically reflected in different regional states investment regulations. The sectoral priorities of one region may differ from the other regional priority. For instance, regions with high livestock potential should be able to give more emphasis to promote livestock development; while other regions having high potential in tourism should give due emphasis in promoting such priority sector. Different Regional States have developed institutional structures to implement their respective investment policies and have provided some rules and regulations regarding the use and management of rural and urban land including for investment purposes.

The Amhara Regional State is, geographically, the second largest region of the country and relatively wide in land coverage and natural resource endowments. The region has ten administrative zones which vary relatively in their levels of development. The region has established investment promotion bodies in hierarchical order, that include: the Amhara Investment Bureau accountable to the Investment Board, Zonal and District Committees. The Regional Investment Bureau is responsible for the day-to-day activities of investment through Zonal and District Investment Committee in the region.

The performance and distribution of investment, however, does not confirm the intention provided by the proclamation. The participation and distribution of the private investors in different zones of the region is far from the intention of the regional government. The main reason for such variation is due to the established administrative procedures; some ambiguity on the regulation of investment incentive by the bottom executing groups; and unclarit of the rural land

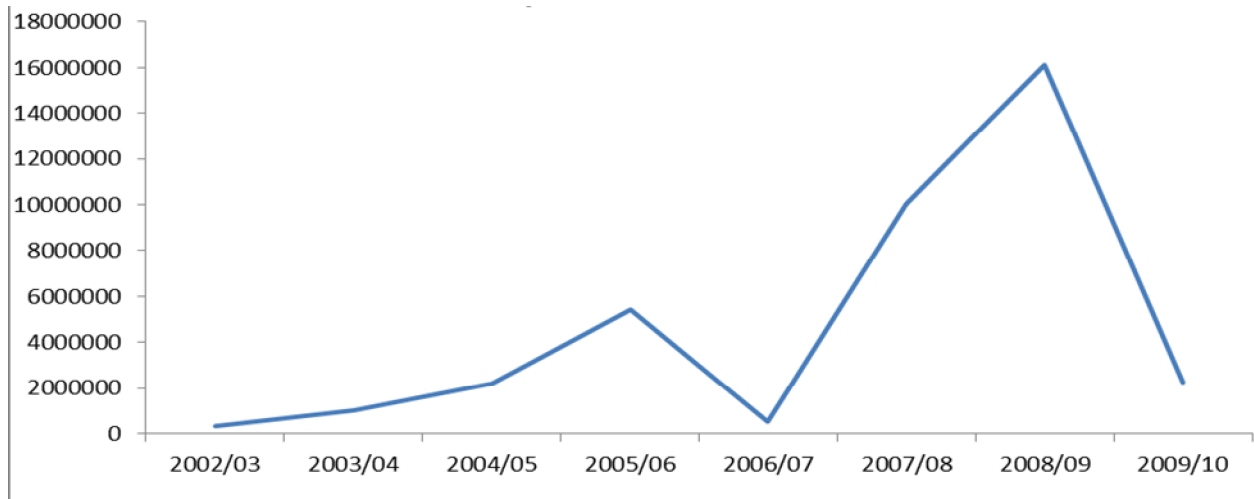
of investment in the region, there is a clear bias towards the highest numbers of investment projects distributed to states that generous investment incentives through investment policy alone in the form of tax holidays and others are not enough to influence the inflow of private investment in the region. Other main factors that could influence private investment include: availability of infrastructure, investment implementation procedures, capable skilled human resource and the certainty of policy environment as determining factors.

The investment regulation formulated by the region is adapted from the Federal Investment Policy. The investment opportunities of the Amhara Region are different from other regions in Ethiopia, which largely determine private investment in the region. These different sectoral compositions, opportunities and the sectoral priorities of the region are also different from the other regional priorities; and this is reflected in the investment regulation of the region. More emphasis was given to promote agro processing and tourism related investment as the region is more endowed with agricultural and tourism resource. More importantly, the Amhara National Regional State also developed institutional structures to implement investment policy and have provided some rules and regulations regarding the rural and urban land for investment purposes.

It is worthwhile to examine the trends of investment in the economy so that some insights into its link with economic performance (Shafik, 1992:270). Private investment can be measured in two ways. One is to measure investment in terms of ratios to GDP, which gives an indication of investment growth in relation to the economy, because real GDP relates to the general level of economic activity in the country. However, this method has a number of shortcomings, especially if the economy being studied is started from a low base, and grew over time. The other method is to measure investment in levels, in real terms. This method helps to overcome the shortcomings inherent in the former method, Nonetheless, both methodologies are used in this section to analyze trends in investment.

According to BOFED (2009), there is a practice in reporting depreciation in to the national account; and hence the investment figures reported in this study depict the net investment. Figure1below shows the trends of net private investment in the Amhara Region from 2002 to 2010. Domestic investment (private and public) has been declining and has never recovered to reach its 2006 and early 2008 highly peaks.

**Figure 1: Trend of private investment in the Amhara region (2002/03-2010)**



### 2.5.1. Performance of Private Investment

Available evidence (BoFED, 2008), indicates that the response of the private sector to the economic reform made for the region is not satisfactory. Despite the various measures taken and gradual amendments made on the investment proclamation that has been undertaken to further encourage the private sector, the supply response of the private sector is far from the satisfactory level expected in the region. The case is more serious when it comes to materialization of licensed projects. Different literatures have forwarded different suggestions evidencing more of qualitative reasons with little empirical or quantitative reasonings contributing factors among the suggested impediments can be seen into two aspects. Firstly, from investors view point, investors in the region in particular and in the country in general had been marginalized from economic activities for many years, so that they have the impression that if the newly changed investment environment is that much credible to sustain. In addition, the irreversibility of investment behavior which entails, that any investors rationally think that postponing (waiting) investment activities till the uncertainty are removed. Secondly, the institutional, infrastructural and resource constraints are the outstanding obstacle that slowed down the pace of real rate of investment in the Amhara region.

sector is low, the figures regarding the intended/ planned  
compressive, since the number of newly licensed investment  
y.

**Table 5: Summary of approved investment projects (1995 - 2009)**

Development Sector	No. of projects	Investment capital (in :000ø Birr)	Employment
Agriculture	1024	5870398.96	280796
Industry	566	27561501.63	266
Construction	311	3423830.62	35246
Hotel (tourist)	478	2150082.71	28078
Trade	66	306322.57	3344
Transport	7	60228.5	514
Social service	153	13664579.69	8179
Minig and energy			
Total	2605	53,036,944.68	356,423.00

Source: ANRS Investment Agency Statistics Bulletin (2010)

According to ANRSø Investment Agency (2009), a total of 2,605 Investment projects with a planned/registered capital of Birr 53 billion and 356,423 job creation had been licensed in the Amhara region from 1995 to 2009. The sectoral distribution of these licensed investment projects is: 39% agricultural projects; 21.72% industry; 11.93% construction; 18.34% hotel and tourism; 5.87% social service; 2.53% trade; 0.26% transport, and with no investment project for mining and energy sector.

As it is clearly indicated in table 5 above the investment capital of the region in agriculture, industry, construction, hotel and tourism, trade, transport and social service sectors accounts for 11.06 %, 51.96%, 6.45%, 4.05%, 0.5%, 0.11%, and 25.76%, respectively. As shown in table 6, Out of the total licensed projects, about Birr 1,677,029 with Billion Birr capital have commenced Operation, 1,934,182 with estimated capital of Birr Billion are in their implementation phase (under construction). The rest, which is about 4,983,571.5 with billion birr capital projects are not in any activity. The financial sources of projects have revealed that about 7,230,140.50 billion birr

The remaining balanced Birr 4,368,214.20 billion (37.66%) is  
 projects are 361(11 from primary, 150 from secondary and

**Table 6: The status of approved investment projects in ANRS (July, 2007)**

Development Sector	Approved			Implementation stage			Operation stage		
	No of projects	Investment capital in :0000birr	Employments	No. of projects	Investment capital in :0000birr	Employments	No of projects	Investment capital in :0000birr	Employments
Agriculture	705	5065550	178209	32	329411.5	37500	288	474437.6	65046
Industry	487	26787706	258984	44	538090.5	4444	35	235705.5	3143
Construction	202	2867864	28676	54	405413	2963	55	150553.8	3607
Hotel	280	1270963	17317	113	621196.6	7277	85	257929.1	13484
Trade	50	232524.8	2553	7	28133	220	9	456641	571
Transport	6	35087.7	514				1	25140	
Social service	109	13576020	6033	8	11937.6	238	36	76622.39	1908
Minig and energy									
Total	1839	49835715	492286	258	1934182	52642	509	1677029	87759

**Source:** ANRS Investment Agency (2007)

Beginning the promulgation of Investment Proclamation No. 15/1992, investment projects whose licenses were terminated (either cancelled by investment agency or returned by investors themselves) reached a total of 90 projects (38 from primary, 32 from secondary, and 20 from tertiary sectors) . Since 1992/93, those projects which were approved; but, that did not yet start any project activity, categorized by the Authority as inactive projects reached a total of 361 in this number (11 from primary, 150 from secondary and 200 from tertiary).

Among the total of 5368 investment projects which got licenses from July 1992 to January 2010, 5144 projects are owned by domestic investors; while the remaining 205 projects are either wholly owned by foreign investors or on joint venture arrangements. In terms of total investment capital position, the amount of domestic owned projects reached 35,989.73 billion Birr, while the capital of foreign owned approved projects reached 10,201.14 billion Birr.

## CHAPTER THREE

# LITERATURE REVIEW

Economic growth is a primary objective of the majority of the world's nations. To bring this economic growth dealing with investment is among the many crucial issues. As a result, this literature review chapter covers the economy of the case study region in Ethiopia, the theoretical and empirical issues of domestic private investment determinants.

The review section of the case study region focuses on the concept of investment, the functional relationship between the determinants of private investment while the empirical review part consists of the empirical analysis of private investment determinants.

### **3.1. Conceptual framework**

#### **3.1.1. The Concept of investment**

Different scholars define investment differently. Investment is the sacrifice of current benefits or rewards to pursue an activity with expectation of greater future benefits or rewards. It is a mechanism to increase the economy's production capabilities and generate economic growth. (Encyclonomic WEB.pedia). The most noted activity pursued is the production of capital goods. (webbeconomics.com) (<http://WWW: web economics>), Investment is an asset or item purchased with the hope that it will generate income in the future. It could be a physical property or a financial item as bonds, stocks, etc. (Dictionary of economics). Mankew (2000) defines it as a spending devoted to increase or maintain the stock of capital as factories, offices, etc used in the process of production. On the other hand, the Britannia Book Encyclopedia (1998) defines investment as the process of exchanging income during one period of time for an asset that is expected to produce earning in the future periods.

Banock, Baxter and Davis (2006) in their dictionary of economics define investment as the sum of gross fixed capital formation and the physical change in stocks and work in progress. As a whole, the economic view of investment is related to the idea of expending future production possibilities by developing standard capital goods and other resources which make more productive with forgone of another alternative. Generally, all the above definitions provide almost the same fact. That is, expenditure of fund on either capital goods or financial assets (as bonds, stocks, etc) by foregoing current satisfaction achieved with consumption to pursue activities that are expected to



### 3.1.2. Private Investment

Theory of investment is one of the most crucial areas of concern, even though it is one of the least developed areas of economics. The existing theories of investment behavior are developed for industrialized countries which are quite different from the developing countries in their institutional features (Blejer and Khan 1984:379). Some

Keynes (1936) who first focused his attention on systematically questioning the revealing view on investment behavior, observed that interest rate does not equate savings and investment at all time and everywhere. He further pointed out that since any rational assessment of the return of investment was bound to be highly uncertain, the ñanimal spiritsö of private investors on the importance of human instincts in investment decision making would be the main driving force in investment decision (Seven and Solimano, 1992:97). In the 1950s and 1960s after Keynes, the accelerator principle becomes popular as theory of investment behavior. It postulated a linear relationship between investment and output. The accelerator principle tells as that investment depends on the rate of growth of income produced magnified in investment; and income falls, then to the absolute level of investment falls (Ibid).

However, the accelerator principle met some criticisms as it does not apply when the income is operating below full employment. If this is the case, investment will respond after income has been raising for some time, even though there will only be a lagged response.

### 3.1.3. Public Investment

It is, generally, acknowledged that public investment, *ceteris paribus*, was supportive of private sector investment through the creation and improvement in infrastructure, which was a necessary condition to economic development and growth (Devarajan, Easterly and Pack, 2001: 82). Improvements to national infrastructure continued to be a major concern for the government of Ethiopia. Public investment, as a ratio to GDP, reached its peak in 1982; thereafter declined and never recovered to reach the 1980's peak again. Public investment showed a promising trend from 1975 to 1982 only to decline thereafter. From 1988, public investment shows a trend similar to those of private investment in the same period, rising until 1990 and thereafter hovering around the 2000 Million. Furthermore, another classification could be made between domestic and foreign investments.

## Investment: Theory and Empirical Evidence

During the 1980s, there had been a shift in the focus of the governments of developing countries, from an emphasis on the public sector towards greater reliance on private enterprises. Relevant empirical literature and theoretical considerations reveal many macro-economic variables that affect private investment.

### 3.2.1. Theoretical Literature Review of the Determinant of Private Investment

The study of the determinants of private investment has been afforded extensive detail in formal investment models based on the experiences of developed countries. Chirinko (1993: 1875-1911) provides some insights into the different forms of some of these theoretical models. According to Ghura and Goodwin (2000:1821) there are four general approaches to modelling investment common in the existing investment literature. These broad categories include the flexible accelerator model, which they associated with Keynes (1936); the neoclassical model, associate with Jorgenson (1971); and Tobin's Q model, which is associated with Tobin (1969) and the expected profits model, which has a number of variants.

The basic notion behind the flexible accelerator model is that the larger the gap between the existing capital stock and the desired capital stock, the greater a firm's investment (Ghura and Goodwin, 2000: 1823). The hypothesis is that, firms plan to close a fraction of the gap between the desired capital stock  $K^*$ , and the actual capital stock  $K$ , in each period (Chirinko, 1993: 1875). Within the framework of the flexible accelerator model, output, internal funds, cost of external financing and other variables may be included as determinants of  $K^*$  (Chirinko, 1993:1875).

Chirinko (1993: 1878) argued that in the neoclassical approach, the desired or optimal capital stock is proportional to output and the user cost of capital (which in turn depends on the price of capital goods, the real rate of interest, the rate of depreciation and the tax structure). Therefore, an investment equation results from the gap between desired capital and the actual capital stock (Ibid). In the Tobin Q theory of investment, the ratio of the market value of the existing capital stock to its replacement cost (the Q ratio) is the main force driving investment (Chirinko, 1993: 1888; Ghura and Goodwin, 2000: 1823). That is to say, enterprises will be increased to invest if the increase in the market value of an additional unit exceeds the replacement cost.

There are theories hinging on profits or profits earned by business units and industries instead of outputs (Chirinko, 1993: 1891). This analysis of profit and investment relationship has several





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Investment is affected by current profits, the amount of retained profits, price and sales, which reflect the profits (Chirinko (1993: 1901)). The greater the gross profits, the greater will be the level of internally generated funds, and in turn the greater will be the rate of investment (Zebib and Muoghalu, 1998: 101).

In addition, there is the dis-equilibrium approach, which views investment as a function of both profitability and demand for output (Chirinko, 1993:1901). In this instance, investment decisions have two stages: the first being the decision to expand the level of productive capacity; while second is the decision about the capital intensity of the additional capacity (Serven and Solimano, 1992: 7). The first decision depends on the expected degree of capacity utilisation in the economy, which provides an indicator of demand conditions; while the second decision depends on relative prices such as the cost of capital and labour. The investment decision takes place in a setting in which firms may be facing current and expected future sales constraints. Therefore, investment depends both on profitability and on the prevailing sales constraints, which determine the rate of capacity utilization (Serven and Solimano, 1992: 7).

Also, Mlambo and Oshikoya (2001: 23) argued that, it can be deduced from modern theory of investment that the level of investment depends on:

$$I = I(\Delta\gamma, r, q, \mu) \dots \dots \dots (1)$$

where,  $\Delta\gamma$ , is the expectation of future market conditions;  $r$  is the financial constraints of the firm;  $q$  is the valuation of the firm in the stock market; and  $\mu$  is economic and political uncertainty.

It is clear from the discussion above that private investment depends on three broad categories of variables: Keynesian, neoclassical, and uncertainty variables. Variables that may be included in the Keynesian tradition include GDP growth, internal funds and capacity use, while the neoclassical determinants of private investment include Tobin's Q, real interest rate, user cost of capital and public investment (Mlambo and Oshikoya, 2001: 18). The uncertainty variables as referred to in Oshikoya (1994: 585) are the variability of the user-cost of capital, real exchange rate, inflation rate, and the debt/GDP ratio. The investment models have been widely applied using data from several developed countries as noted in Chirinko (1993: 1876). However, there are difficulties associated with testing the implications of these models for developing countries. Noted among others are the assumptions, upon which these models are based, like the existence of perfect capital

on, which are not satisfied in most developing countries (Goodwin, 2000: 1821; Mlambo and Oshikoya, 2001: 24).

The inadequacy of data in developing countries on capital stock also makes it difficult to observe the stock adjustment mechanism, upon which almost all investment theories are based (Mlambo and Oshikoya, 2001: 24). Likewise the study by Zebib and Muoghalu (1998: 100) makes an observation that, it is difficult to obtain empirically a production function, from which a functional form of the desired amount of capital could be derived under certain optimisation conditions. Furthermore, the observable interest rates in developing countries often do not reflect the scarcity of capital because capital markets are either small or not functioning (Wai and Wong, 1982: 21), rendering the application of cost of capital unrealistic. Because of the data limitations involved in empirical models of developing economies, especially for capital stock and appropriate measures of return on investment, some studies, such as Fry (1998: 12-13) have used the variants of the flexible accelerator model, where the speed of adjustment is influenced by a number of observable variables (Ghura and Goodwin, 2000: 1821). These observable variables may include public investment, credit to the private sector, inflation, the real exchange rate, trade, GDP growth and interest rates.

The next section discusses the empirical evidence relating to the effects of these variables on private investment in developing countries.

### **3.2.2. Empirical Evidence on the Determinants of Private Investment**

Different determinants alter private investment around the globe as different studies have identified. Steven, M. Fazzari (1993) studied macroeconomic determinants of private investment in America with a series date analysis of 1970-1990 which accounts 40 and 50 percent of all plant equipment spending. According to the same researcher, the most important determinant of investment is the strength of the economy. The direct impact of taxation and spending initiatives on overall economic activity is likely to have a greater effect on investment than the influences of taxes on the cost of capital. The higher the production income and employment, the higher the income of workers; which creates higher demand and sales, traditionally called multiplier effect. According to Oshikoya (1994), a study on the determinants of domestic private investment in Africa, GDP has a significant effect on investment. That is, private investment was discouraged by low economic growth in both low income and middle income countries between the years of 1979-1983. Roong Poshyananda, et al (2003); investigated the main determinant of investment cycle in



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result the most important determinant of investment seems to be return means higher marginal productivity, which leads to

The uncertainty determines investment aspiration to a large extent. Particularly, Africa's poor performance in investment growth seems to be due to high degree of uncertainty. This uncertainty extends from political instability to other variables as inflation, property rights, exchange rate, etc. (World Bank, 2003). In addition, many economists believe that macro-economic uncertainty has adverse effect in private investment. Oshikoya (1996), argued that the slow response of private investment to economic recovery particularly in low income countries reflects micro economic uncertainty.

As it is broadly believed now, the nature and structure of the market referred to as maturity largely determines investment. Market maturity refers sophisticated and sound financial structure, extensive information systems, well developed public infrastructure, stabilization of property rights, flexible market in both long and short run, nature of factor supply, etc. Infrastructure includes the sector of transport, water power, telecommunication which has a significant positive effect on economic output and growth. According to the study of Wei, Chin et al (2005), the main determinants of private investment in South Asian countries, particularly in Thailand and Malaysia, are sound financial and economic structures. These are taken as the main factors that cause investment and market collapse. Steven M. Fazzari (1993), in his study on American investment situation from 1970-1990, showed that financial condition plays a fundamental role in determining the course of private investment.

Though Fazzari (1993), in his study on American investment showed that interest rate and cost of capital play a very uncertain role in the determination of investment when compared to the strength and form of financial conditions growth of sales, other empirical studies indicate that cost of capital plays a role in investment. According to Poshyanada et al (2003), the cost of capital which in turn depends on a number of factors, such as: the price of capital goods, the real interest rate in which firms can borrow to finance their investment project. According to Michal Brzozowski (2005), higher user cost and infirmly puts a break on both investment in physical capital and innovation activity. This study on Polish manufacturing industries from 1994-2004 further showed that high interest rates and high taxes alter investment in physical capital and innovation intensity.

and their application to developing countries has made it countries to concentrate on identifying variables that may several hypotheses advanced to explain variations in private investment in these economies (Greene and Villanueva, 1991: 39; Oshikoya, 1994: 583; Mlambo and Oshikoya, 2001: 29). In particular, the list of variables identified in the literature has tended to include macroeconomic factors and policies.

### **3.2.2.1. Macroeconomic determinants of private investment**

#### **i. Policy-related factors**

At the theoretical level, the impact of public investment on private investment activity is ambiguous. On the one hand, public investment on social and physical infrastructure by raising private and social rate of return can boost private investment. Most of the developing countries have a large component of public investment concentrated on infrastructure projects, which may be complementary to private investment (Oshikoya, 1994: 576 - 77). Oshikoya (1994:584) reports that evidence of complementarity between public and private investment has been found by studies such as Blejar and Khan (1984), and Aschauer (1989). However, increases in public investment may also crowd-out private investment if the additional government borrowing raises domestic interest rates and the future tax burden (Ghura and Goodwin, 2000: 1822). Previous studies by Shafik (1992:274) and Rossiter (2002: 66) found a negative effect of public investment on private investment. This study will address this empirical question in the context of the Amhara National Regional State.

#### **ii. Financial factors**

Changes in the volume of bank credit to the private sector are suggested to have a positive impact on private investment activities in developing countries (Oshikoya 1994: 584; Ndikumana, 2000:382). The basic idea is that, some business agents are unable to get financing directly from the credit market. Hence, these agents are strongly dependent on bank credit (Lounging and Rush, 1995: 517), which has remained the most important source of investment financing for private enterprises in developing countries (Oshikoya, 1994: 584). Additionally, this is based on the argument that availability of loanable funds may affect the investment decisions irrespective of the cost of capital (Chirinko, 1993:1899). A positive coefficient is expected in this study.

The direct impact of credit availability on private investment is also confirmed in studies by Wai and Wong (1982:28); Greene and Villanueva (1991: 52) and Ndikumana (2000:383). Since there is

it variable in the literature, we also expect the sign of its

Theoretically, interest rate should be a crucial variable (Shafik, 1992:275). The sign of the real interest rate is an empirical issue and depends on whether the data supports the McKinnon-Shaw hypothesis or the neoclassical view (Ndikumana, 2000:383). The neoclassical view is that real interest rates are expected to affect private investment negatively since higher interest rates raise the user cost of capital, and therefore, reduce investment (Ndikumana, 2000: 382). On the other hand, the McKinnon-Shaw hypothesis states that interest rates affect private investment positively (Agrawal, 2001: 9). However, the insignificant effect of interest rates on investment has been a common and often problematic finding in many empirical works (e.g., Shafik, 1992: 274. Greene and Villanueva (1991: 55) in their study, found that a higher inflation rate had a negative effect on private investment for 23 African developing countries. This empirical question will be addressed by the study, (researcher) in the context of the Amhara region.

### **iii. Interest Rate**

A change in interest rate has a huge influence on the amount of capital stock. A higher interest rate increases the cost of borrowing used to finance investment expenditures. If the cost of borrowing increases, the business sector is less likely to undertake expenditures on capital goods. Lower interest rate works in the opposite manner. That is, the lower the interest rate, the greater number of investment opportunities that could be profitable because of low cost of capital and the more likely the investment will increase (Vaish, 1995).

The effect of the real exchange rate on private investment can be considered in two ways: the demand side, and the supply side (Serven, 2002: 2). On the supply side, the effect of exchange rate is ambiguous. On the one hand, real depreciation of the currency raises the cost of imported capital goods since large component of investment goods are imported by developing countries (Ghura and Goodwin, 2000: 1822); and depreciation lowers private investment in the non-tradable goods sector. On the other hand, devaluation of the real exchange rate by raising the profitability of the tradable goods sector would be expected to stimulate private investment in that sector, as suggested by Froot and Stein (1991: 1214). On the demand side, the effect of the exchange rate is clear (Serven, 2002: 3). The main demand side effects are a reduction in private sector real wealth and expenditure, due to the impact of the rise in the overall price level on the real value of private sector financial assets (Ghura and Goodwin, 2000: 1822). For these reasons, real devaluation decreases domestic demand, and when the firms face sales binding constraints, the slump in

ce firms to reduce investment spending (Froot and Stein, 1993). This study provides an empirical answer to the question raised in the context of the paper.

Trade flows, external debt, and black market activities also affect the rate of investment in developing countries (Fielding, 1997:132). Empirical evidence shows that, among the many measures of openness, the measure of trade (imports and exports) appears to have the most consistent relationship with investment (Ndikumana, 2000: 384). The volume of trade positively affects domestic investment both through exports and imports (Fielding 1997:132). We also expect a positive relationship between the trade variable and private investment level.

#### **iv. Taxes**

A tax law affects investors to accumulate their capital. Different types of investments are taxed differently. However, corporate tax is the main which affects investment. Mankiw (2000), explains policy makers change the tax laws in order to shift the investment function and influence aggregate demand. According to J. Corrado and D. Jordan (1998) taxes are among many important considerations; and investors need to develop investment strategies with favorable tax treatment. This is because different taxes leveled from individual to corporate level affect firms and private investment in the region.

#### **v. General macroeconomic variables**

A number of studies have been identified factors that affect private investment in developing countries. Ouattara's study (2005: 19) undertaken on the determinants of investment in Senegal shows that public investment, real income, and foreign aid flows affect private investment positively; whilst the impact of credit to private sector and terms of trade is negative. Oshikoya (1994: 573-596) carried out an empirical analysis of macroeconomic determinants of domestic private investment in selected African countries with some characteristics similar to that of Ethiopia. The countries that were included in the sample are: Morocco, Mauritius, Tunisia and Cameroon taken as middle-income countries; and Malawi, Tanzania, Kenya and Zimbabwe from the low-income countries. According to the researcher's results of the study, the macroeconomic variables affect private investment in the sample developing countries differently, depending on whether a country is from a low income or middle income category (Oshikoya, 1994: 593).





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and an analysis of the macroeconomic factors that potentially, taken as a developing country in a short, medium and long run. The study confirm that real exchange rate, terms of trade, growth in output and public investment affect private investment significantly.

Based on the basis of above evidence, it appears to be clear that variations in private investment depend on the variables, GDP growth, interest rates, public investment, real exchange rates, inflation, availability of credit to the private sector, and changes in trade.

It is important for policy makers to be able to assess how private investment responds to policy changes. This can be determined by establishing how private investment in the country is decided, by analyzing the variables that systematically affect it. As noted in Oshikoya (1994:590), a formal framework for studying private investment in developing countries was developed by Blejer and Khan (1984b). Oshikoya (1994:590) referred to this framework as an extension of previous works in the theoretical literature on investment that yielded a well-defined class of models of the flexible accelerator type. Jorgenson's arguments (1971), associate with Oshikoya (1994: 590), Blejer and Khan (1984b) focused on the role of government policy derived an explicit functional relationship between the principal policy instruments and private capital formation. Oshikoya (1994:591) lists two principal conclusions that emerged from Blejer and Khan's (1984b) test of formal model for 24 developing countries. The first was the possibility of identifying well-behaved empirical function for private investment in developing countries. The second major conclusion was the establishment of a direct empirical link between government policy variables and private capital formation.

Wai and Wong (1982: 23) incorporated features of the neoclassical model into investment models for developing countries. Their approach took into account the relevant data problems and structural features that caused a gap between the modern theory of investment and the models that were specified for developing countries.

Another strand of investment theories (Serven, 2002:15), have focused on uncertainty and investment irreversibility as factors that can be seriously harmful to investment decisions. Available literature on Investment relating to the analysis of uncertainty links has shown that, if investment is costly or impossible to reverse, investors need to have an incentive to postpone their commitments and wait for new information in order to avoid costly mistakes (Serven, 2002:22).



## CHAPTER FOUR

# RESEARCH METHODOLOGY

### 4.1. Type and source of data

Data for the study was collected from primary and secondary sources. In the case of primary sources, the data was collected mainly through questionnaire based interviews. Direct interview method of data collection is preferred because many respondents in most cases failed to respond to mail questionnaires in the expected time. The personal interview using questionnaires was applied to overcome the resistance of the respondents; and also to obtain supplementary information using interviewers own skill. In such case, both open and closed ended questions were used. The secondary data sources were obtained from the offices of the Amahra Investment Promotion Agency, Bahir Dar city administration, Bureau of trade and transport, Bureau of industry and Urnad and urban development, Central statistical Authority, National Bank of Ethiopia and Ethiopian Economic Associations and Bureau finance and Economic Development

### 4.2. Data collection method and procedures

The researcher selected 15 experts from different governmental organizations to conduct key informant interview; and 85 private sample investors were also selected based on stratified sampling techniques to gather investor's opinion. The stratification was based on size of investment in the region. However, the sectors where the investors are involved were chosen through judgmental or purposive sampling. These exercises help the researcher as an opportunity to learn from the investors themselves in what they face as a challenge in the entry, operation and expansion of private investment.

### 4.3. Method of data analysis

#### 4.3.1. Descriptive method

In this study, descriptive analysis was undertaken based on the identified and tabulated information from the questionnaire. That is, firstly, data from the questionnaire was entered in to SPSS Version 20 and generated descriptive variables. Besides, the fifteen year time series data (1995 to 2009) were analyzed critically to ascertain whether the factors identified are determinants of domestic private investment in the region.

The model of private investment applied to the Amhara region is an eclectic version of flexible accelerator model designed to capture some of the key determinants in developing countries. Empirical studies on private investment determinants have been undertaken to capture some of the specific features of private investment in developing countries. In this paper, the basic accelerator model is modified to support the view that the effects of resource constraints are significantly determining private investment behavior in the region.

There is a growing perception that constraints with respect to credit and foreign exchange reserves affect both the direction and speed of adjustment of actual stock of capital accumulation to desired capital stock. The data covers a wide range of macroeconomic variables that include GDP growth, inflation, bank credit to the private sector, fiscal variables, exchange rates and trade variables. The data used in this study is annual data obtained from different sources. The sample is for the period 1995 - 2009 years. This period was selected, specifically, because this is the period for which data was available for the selected variables.

In the long-run steadystate, private sector desired capital stock ( $kt^*$ ) is assumed to be proportional to expected output ( $Yt^e$ ) (1)  $Kt^* = a (Yt^e)$ . Because of the difficulty in identifying theoretically the correct specification and obtaining the necessary and reliable data in the Amhara region, this paper does not attempt to build and estimate a full - scale structural model of private investment in the region. Due to this fact, rather it is more of exploratory data analysis. Nevertheless the findings of this analysis may give supportive idea for those who try to build a full - scale fundamental relationship between private investment and macroeconomic variables which can be used to develop appropriate model of investment behaviour. Macroeconomic variables assumed to influence the gap between actual investment to desired investment included in the empirical analysis are: (1) real per capita GDP growth rate; (2) public investment; (3) real credit availability to private sector; (4) real foreign exchange reserve availability to private sector; (5) real exchange rate, (6) consumer price index; and (7) government budget deficit and dummy variables to capture structural change. Therefore, private investment is a function of the following macroeconomic variables:

$I_p = f(RRPGR, Pb/GDP, Cr/GDP, fra/GDP, Ex, CPI, (gdb / GDP)-1, D)$ . Where

$I_p$  = the ratio of private sector investment to GDP

$Cr/GDP$  = real credit available to private sector to real GDP ratio.

$fra/GDP$  = the percentage change of foreign reserve availability to private sector to GDP,

$E$  = the percentage change of real exchange rate.

$CPI$  = the percentage change in consumer price index.

$gdb/GDP (-1)$  = lagged ratio of government budget deficit to GDP.

$D$  = Dummy variable to capture structural change ( $D= 0$  for the period 2003 - 2010, and

$D= 1$  for the remaining period).

#### 4.3.2.2. Data Exploration

To avoid non-stationary and spurious results, analysing the nature of each variable about their distribution (normal or skewed); and its trend (stationary or non-stationary) is the first task in econometric regression. To this affect, first, the ratio rather than the level is preferred for each variable. Believing that this does not avoid the spurious result, particularly due to serial correlation of macroeconomic variables, for most of the variables that are expected to suffer from non-stationary, real ratios or growth rates have been used. These variables are real per capita GDP growth rate, real foreign reserve and real exchange rates and real credit availability. All the variables were tested for normal distribution. It was found that all variables were almost normally distributed.

## CHAPTER FIVE

# PRESENTATION OF FINDINGS AND DISCUSSION

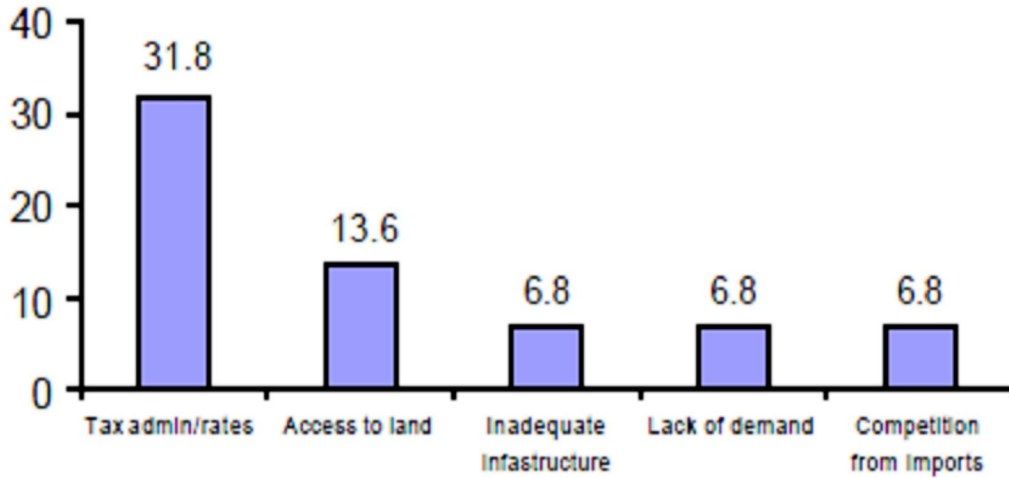
### 5.1. Analysis and Presentation of Findings

#### 5.1.1. Descriptive analysis

There are various factors contributing to the low level of private investment flow in the Amhara region. These impediments are accounted by both the government and investors side problems. On the government side, the major problems, include: shortage of land, inadequate infrastructure facilities, weakness of financial sectors, bureaucracy, etc. while among the many problems on the investors side to be cited, include rent seeking behavior which is found to be the most prominent problem that has been slowing down private investment in the region. This problem is found to have been decreasing the capacity of investors in implementing, preparation and management of their respective persists. This is due to the inability of project operation after license, securing land without proper plan, fencing land allocated for investors for a long period of time without starting the project entering in to investment activities without precise and accurate research. Failing to keep promise, they made to government properly start and run investment projects are also among many other problems.

As it is shown in Figure 2 below, tax administration/rates and access to land were identified/reported by 32 percent and 14 percent of sample investor's contacts, respectively as reflected/reported during the interview as the major obstacles in Amhara region.

by the sample investors in the Amhara region



It is clear that tax administration and access to land dominate the list of (single) primary obstacles identified by investors in the region. Insufficient domestic demand, business regulations, and access to credit are also reported as major problems.

**5.1.1.1. Access to Basic Physical Infrastructure (Telecommunications and Power)**

The importance of an efficient infrastructure in creating an environment suitable for private investment is unquestionable. It facilitates the production and distribution of goods and services as well as the flow of information. The poor state of infrastructure imposes high transaction and production costs on firms.

In the Amhara region, the existing infrastructural facilities such as roads, electricity, water, and communication service as well as the flow information are not adequate enough to attract private investment to the region. This hinders the flow of private investment. The region has one of the lowest road densities in Ethiopia and even in Sub-Saharan Africa standards (28 km/1000 km<sup>2</sup> compared with the average of 50 km/1000 km<sup>2</sup> for Sub-Saharan Africa); and only less than 20 percent of their and network is paved. This hampers economic development in general and efficiency of businesses in particular by making interregional economic activities very difficult. Availability and quality of other infrastructure services are also poor in the region. About 11 percent of the sample respondents identified access to infrastructure among the top three constraints, and 2 percent repeated as a primary impediment for business development.

structure services provided, the frequency of interruptions if considered. Power is one of the major bottlenecks almost everywhere in power and telecommunication services; and the waiting time it takes to get connected to these services once the application process was completed.

#### **5.1.1.2. Access to Credit**

The realization of planned investment by the sample respondents, therefore, partly depends on the ability of the financial system to provide them with affordable and efficient credit services. The business community in the region has consistently cited lack of access to credit as one of the major impediments to their business activities. Credit access constraint is reported by a good number of investors as among the three biggest obstacles to do business in the region. About 28 percent of the samples interviewed cited inadequate access to credit (and high collateral) requirements as the main problems. Some 21 percent of the sample investors reported the high cost of financing (bank interest rates and transaction costs of loans) as a very serious obstacle; and 16.2 percent of them reported it as a major obstacle to the operation and growth of their businesses.

However, it should be noted that the majority (about 58 percent of the cases) of the sample investors interviewed did not have long business relationships with their primary banks. Their business relationship did not exceed two years (in fact, it is far less for most of them). Considering that the amount of information lenders have about their borrowers and the established lender borrower relationship are crucial in lending decisions, it is not surprising that these investors have constrained access to credit. Access to credit is, generally, expected to vary across firms of different sizes. Some of the firms that reported inadequate credit access among their three major problems, 32 percent are small; and about 51 percent are medium sized investors.

#### **5.1.1.3. Access to land**

It is obvious that various investment activities require the acquisition of land for the establishment of different economic activities and future expansion site. Despite, in fact, land is a public property and is not easily attainable in the region. According to the existing land policies of Ethiopia, land is acquired on lease bases for manufacturing industry projects. On the basis of the existing legislation, individual private investors can acquire land only through the lease holding system, which restricts an individual right to sell and transfer land to the third party. This restrictive policy discourage private investors to participate in investment areas which require a long gestation

stors to concentrate on a short term investment projects like

The problem in the region is further exacerbated by the fact that, land acquiring takes a long period of time; and it is also tiresome owing to a weak and inefficient bureaucratic procedures. Moreover, the case of acquiring land is highly costly and makes the cost of doing business quite difficult and unencouraging.

#### **5.1.1.4. Lack of investment promotion capacity**

Investment promotion has to come occupy a prominent place in the strategies of investment attraction. Promotional efforts were highly cost effective, generation benefits. In amhara region, there is as such a clearly formulated investment promotion and advisory center as a separate entity. The ANRS investment promotion agency is a governmental institution responsible for investment licensing appraisal and advisory service at a regional level. The existing investment office in the Amhara region could not undertake effective investment promotion activities to attract private investors at a required pace. This is partly because of the limitation of finance, equipment and skilled human power.

#### **5.1.1.5. Bureaucratic Problem**

The bureaucratic procedures in most governmental offices of the region are also other bottlenecks to private investment. The tradition of huge socialist bureaucratic problems fill prevail in many governmental offices. The public offices don't have market orientation in providing their services, which creates unnecessary hurdles in the promotion of private investment.

Among the various problems are the difficulty in transfer of ownership to get access to credit from banks, complication in customs services in clearing imported items and absence of punctuality in clearing items and absence of punctuality in office hours in majority of the government offices are some of the points to be sited.

### **5.1.2. Econometrics results**

To examine more rigorously the various hypothesis out lined above, four equations for private investment rate were estimated for the region, using a time series data for the period 2003- 2010. Because of the violation of the assumption of orthogonal between the private investment ratio to GDP and real GDP growth rate, a preliminary test found that the two are highly correlated. One of the resolutions to such problem is either to drop or to transform the variable. Here, what was



with rate was used instead. Government budget deficit, the available at the end of the year, one year lagged value was credit available to private sector, real rate was employed instead of nominal rate. Every possible alternative was tried to avoid the problem of serial correlation. To capture the policy change since early 2000s, dummy variable was included in the specification coded zero for the period 2003 ó 2010, and one for the remaining period. This tests the difference in intercepts between the two periods. This however, does not mean the inclusion of dummy variable which can explain the effects and magnitudes on private sector since the policy change. The result of the estimated four equations using OLS were presented in Table 7 below.

The regression analysis results suggest that real per capita GDP growth rate and foreign exchange availability have exhibited expected positive sign and significant at 5% and 1% level, respectively. Public investment, real exchange rate, consumer price index, and budget deficit have exhibited negative sign, and except budget deficit, the three variables are significant at 1% for public investment, 5% for real exchange rate, and at 10% for consumer price index. The remaining variable (that is credit availability to private sector) is positive in sign, but insignificant magnitude. The equation was tested for multicollinearity using a tolerance value (i.e., 1-(R-squared)). A tolerance value of less than 0.2 is observed for some of the variables: real exchange rate, CPI and budget deficit. Hence, there is a need to avoid some of the variables step by step depending on the regression result. The basis for estimating the remaining equation is: (1) the presence of multicollinearity between some of the variables; (2) some of the variables such as real exchange rate, CPI and budget deficit which are proxy for the same Condition (macroeconomic instability / uncertainty); and (3) estimating each variables separately in different equation which enables us to identify its effect on the goodness of fit of the equation.

Variables which improve the predication power (R- square) of the equation will be added to the equation, where as those which resulted in the equation weak with prediction power will be dropped from the equation (Hamilton, pp,Year 72). With this background, four equations were estimated. In equation (1), all variables were included. As it was shown in Table 4 above except credit availability and budget deficit, the rest of the variables are significant at different levels. Real per capita GDP growth rate and foreign exchange availability positively and significantly affected private investment, while public investment, real exchange rate and CPI significantly influenced private investment in opposite direction over the regression period. In equation (2) two variables were excluded from the equation RER and (BDT/ GDP)-1. In this estimation

included in estimation are significant at 5% for RPGR, at 1% level; and except public investment, the remaining investment. When predication power was seen, it was less than the prediction power of equation (1). That is, it dropped from 0.91 (1) to 0.84 (2). But there was no problem of multicollinearity between variables as the analysis residuals indicated that, there is no serial correlation, the error terms are normally distributed. However, Durbin -Watson statistics that shows the existence of auto correlation exhibited a reduction from equation (1), that is from 1.81 to 1.57. Nevertheless, it does not tell us a series problem of autocorrelation. In order to see the effect of omitting RER from equation (2), equation (3) was estimated by including RER.

As it is shown in the estimation is Figure 2 below, the coefficient of RPGR, Cr/GDP are insignificant, with expected sign (i.e. positive sign). While the remaining variables are highly significant with opposite direction of influence on private investment, all are significant at 1% level. The other observation from estimation of equation (3) is predication power (as indicated by adjusted -  $R^2$ ) improved as well for Durbin - Vanton. To see if there is structural change over the period under study, equation four was estimated. In this equation, RER was excluded and (BDT/GDP) -1 used to see the effect of its omitting in equation (3). The coefficient of all variables included in the estimation are significant at different significant level except (BDT/GDP) -1 and their sign is consistent as the preceding equations. Dummy Variables are included in the equations to capture the structural change confirming that there was structural change (policy change) over the period, which has been substantiated by high significance level at 1%. In this equation, both the prediction power (adjusted - $R^2$ ) and Durbin - Waston statistics have shown an improvement over the preceding equations [see tables 5.1, equation (4)]. From the estimations made through equation (1) to (4) public investment over the estimation period showed that, in Ethiopia, it had substituted private investment rather to complement it. The estimation results on public investment in all four equations were against most of the argument for complementarily between public investment and private investment in developing countries. It is not surprising to get such results in the Ethiopian case, in the country where the government capital budget had been used to establish prastatals; and the government used to participate in the economy to the extent of production and distribution of consumer goods. These could have been purely produced and distributed by private sector for most of the period under study 2003-2010). The remaining years have been the period of a dramatic change in economic policy in general, and the role and magnitude of government in the economy in particular. Since it was found to be difficult, if not impossible, to estimate separately for the post - 1992

period and difficulty to get quarterly or six monthly data in the regression for the country. Thus, the seventeen years weighed the possible impact of the remaining years (2003 to 2010).

**Table 7: OLS estimation result for private investment functions**

Explanatory variables	Equation			
	1	2	3	4
RPGR	0.046 (2.22)**	0.054 (2.03)**	0.007 (0.56)	0.063 (2.40)**
PUB/GDP	-0.297 (-3.35)***	-0.254 (-2.26)**	-0.199 (-3.96)***	0.207 (-1.90)*
CR/GDP	3.775 (0.45)	17.717 (2.45)**	3.714 (0.76)	13.71 (1.88)*
(BDT/GDP)-1	-0.071 (-0.66)	-----	-----	-0.048 (4.83)***
D	-----	-----	-----	2.411 (4.83)***
C	6.844 (3.37)***	5.366 (3.030)***	4.296 (5.49)***	4.787 (2.90)**
ADJUSTED - R <sup>2</sup>	0.91	0.84	0.87	0.97
DW - statistic	1.81	1.57	1.87	1.89

The symbols \*\*\*, \*\*, and \* denote statistical significance at the 0.01, 0.05, and 0.10 levels.



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As it is clearly reflected in the descriptive analysis part of this paper, tax administration and access to land dominate the list of obstacles identified by investors in the region. Moreover, the limited availability and poor quality of infrastructure services which have been highly hampered by electricity and telephone services interruptions and waiting time to be connected were also the critical obstacles reflected by the investors. The insufficient domestic demand, business regulations, and access to credit constraints were reported by a good number of investors. These findings complement the econometrics results of the paper. As the analysis results in Table 7 above shows, except credit availability to private sector and budget deficit, which is a positive sign, but insignificant, the rest variables are significant at different levels.

Real per capita GDP growth rate and foreign exchange availability influence private investment positively and significantly. On the other hand, public investment, real exchange rate and CPI positively influence private investment in opposite direction over the regression period. The coefficients of all variables are statistically significant at different levels except (BDT/GDP) -1. There had also been series of policy changes over the period (1995-2009), which is substantiated by high significance level at 1%.

In conclusion, as it is emphasized in the theoretical and empirical literature, macroeconomic factors are the most important determinants of private investment, in a short run and long run perspectives. The variables that affect private investment are consistent with the hypothesized signs; and are also found to be statistically significant.

## CHAPTER SIX

# AND POLICY IMPLICATIONS

### 6.1. Conclusion

Investment plays an important role to the growth of a country. It is an increase in capital stock which is essential means for developing regions and for helping local people become prosperous. Properly investment paves the way for the development large scale of intervention by sectors, to increase specialization, promotes technological progress, and for creating employment opportunities for growing local labor force in a country or the regions.

As far as private investment in the Amhara region is concerned, it has been increasing since 1995. This is because the region has hospitable environment for various investment opportunities. However, in the years 1992 to 1995 E.C the participation of investors had been declining due to the country's economic depression and political problems experienced. But, since 1995 E.C, the investment flow in the Amhara region has been encouraging. The highest number of investors with increased capital was been recorded in 1998 and 1999 due to structural changes in region giving better services by investment promotion agency like quick approving and licensing of projects, good governance and others. This structural adjustment for giving better service, to investors was made in Feb. 1998 E.C.

Increasing investment flow to the region has a great contribution for the growth of the Amhara National Regional State in many aspects. Among others, increased contribution of investment in the region included creation of employment opportunities and helping in raising real wage of local labor. That is, increased investment not only provided employment opportunities, but also creates effective demand for investment goods and services that promotes the growth of the region. Even though the numbers of investment projects have been increasing, they are found by and large, at implementation and pre implementation phases. The investment projects which have already started operation are having less percent share of the total approved investment projects.

Despite its significant economic contributions, there are hindrances that constrained the flow of capital investment in the region at a desired rate and level. Some of the bottlenecks affecting investment flow in to the region include: land acquisition problem, in competent bureaucracy, lack of promotional capacity, lack of adequate infrastructure facilities and many others.

The study has investigated the determinants of private investment in the Amhara region over the period of 2003-2010, in the short run and long run perspectives. It employed the techniques of co-integration and

gle and Granger (1987), which provided mechanisms to deal with series data. The evidence in this study supports the view that determinants of private investment, in a short run and long run perspective. Applying the general to specific approach to error correction model, our statistical results suggested the existence of stable long run (co-integrating) relationships between macroeconomic variables (except trade variable) and private investment. The variables that affect private investment are consistent with the hypothesised signs and are also found to be statistically significant. In cases where there was ambiguity in the literature, our results have provided the empirical results.

## 6.2 Policy Implications

Based on the study finding the following are policy implications/suggestions provided for better future promotion and engagements and investment projects:

- i. The full and unrestricted participation of the private sector in all sectors in the Amhara region should be encouraged and supported so as to better mobilize adequate capital resources for investment purpose;
- ii. It would be essential for medium and small scale investors, if this sort of investment is encouraged, it might create a better environment for the adoption of appropriate technologies that enable the utilization of the region's large resource endowments, such as labor.
- iii. The Investment agency of ANRS and the concerned bodies should concentrate on resolving matters that hinder private investment and implement ways and strategies that would encourage both local and foreign investors. If local private investors are encouraged, and be actively involved in different sectors, this would help to attract more investment.
- iv. Better Infrastructural service facilities should be provided to attract more diversified investments. Most of the investment projects are concentrated in the center, Addis Ababa due to the existence of better infrastructural facilities. With improved better infrastructural facilities to investors in the Amhara region to investors, it would be possible to utilize the different opportunities..
- v. Most of the investment projects in Ethiopia are dependant upon loans from banks as their sources of finance. This is also observed in few on going projects in the Amhara region. Though removing the existing rigidity of the banking system for better access to credit facilities to investors would be very essential; and this should be in favor of the utilization of credit in the productive sectors of the economy like agriculture and industry.
- vi. Now a days, promotion plays a great role in attracting private investors. So, the investment promotion agency of ANRS, and particularly the office of the Amhara Region Trade and Small Scale Industry should have separate legal entity that promotes investment projects with sustainable capital inflow at desired level and rate for balanced regional development and growth.



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information system that enables to properly manage, support the

ment institution and land under residential development agency

should be prepared and made suitable for investment activities.

- ix. By identifying the comparative advantages of the region, it should be changed in to competitive form through better implementation of the working situation.
- x. Other constraints, including land acquesdier and management problems, incompetence bureaucracy, etc. have to be improved and services to investors by investment agency should be enhanced. Because it became a witness since 1998 E.C that large number of investors more flowing as a result of changes in structure and prevailing of giving services.

In general, in order to raise the level of private investment, there should be a hospitable environment for investors. The regional Investment promotion capacity has to be enhanced and constraints be solved.



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## Annex 1: Questions for bureau employees

The purpose of this questionnaire is to assess and identify challenges of investment promotion in Amhara National Regional State, and suggest possible solutions.

Procedure:-

1. Give equal attention to all questions
2. Use pencils if it is possible
3. Freely change their answer whenever necessary
4. Use ✓ mark for multiple questions and use free spaces given for subjective or open ended
5. Not to write their names

Questions

1. How do you evaluate investment opportunities availability in Amahra National Regional State?  
 a) Excess      b) Moderate      c) limited      d) uncertain

2. Would you list opportunities as per their sectors?

- a) Agriculture-----  
 -----  
 -----
- b) Industry/Manufacturing-----  
 -----  
 -----
- c) Social services-----  
 -----  
 -----
- d) Tourism-----  
 -----  
 -----

3. Is the region utilizing the available opportunities?

- a) Yes                      b) No

4. If your response for question No. 3 No, what are the possible reason?

-----  
 -----  
 -----



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ence of private investment engaged in Amhara National Regional

very low e) uncertain

6. If your choice for question No. 5 is low and very low what do you think are the possible factors?

Possible factors or challenges are provided below,

Select the one you consider pressing.

- A) Service related to loan
- B) Service provision bureaucracy
- C) Tax burden
- D) High loan interest
- E) Lack of market
- F) Absence of incentive
- G) Promotion inefficiency
- H) Political instability
- I) Absence of profit
- J) Any other -----

7. Would you rank the challenges listed above starting from the first rank by giving No. one to the most pressing challenge and ninth to the least pressing one?

8. Would you give the possible solutions or remedial measures for the challenges listed under question No. 7?

- i. -----
- ii. -----
- iii. -----
- iv. -----
- v. -----

9. If you have any additional comments on measures to be taken by the regional government, private investors and the community at large please indicate in the space provided below for each.

- Regional Government -----
- Private investors -----
- Community -----

The purpose of this questionnaire is to assess and identify challenges of investment promotion in Amhara National Regional State, and suggest possible solutions.

Procedure:-

1. Give equal attention to all questions
2. Use pencils if it is possible
3. Freely change their answer whenever necessary
4. Use ✓ mark for multiple questions and use free spaces given for subjective or open ended
5. Not to write their names

Questions

1. What is your investment sector?
  - A) Agriculture      B) Industry/Manufacturing      C) Construction
  - D) Education and Health      E) Hotel and Tourism      F) Finance/bank, insurance etc/
  - G) Other business
  
2. What was the finance source for you investment?
  - A) Private saving /equity      B) Loan      C) Loan and Equity
  - D) Grant      E) Specify if any other -----
  
3. How do you evaluate the finance service/availability to obtain loan?
  - A) Very simple/accessible      B) Not a such difficult
  - D) Difficult      E) Impossible to obtain loan
  
4. How do you evaluate interest charge for loan?
  - A) Low      B) Moderate      C) High      D) Very high
  
5. What was your information source that helped you to decide your investment sector/project?
  - A) Promotion made by investment office
  - B) Mass media
  - C) Other government body/institution
  - D) Other investor
  - E) None



- E) Any other -----
15. What are the challenges for expanding you current investment or start new?
- A) Political unstaibility      B) Inflation                      C) loan unavailability
- D) Absence of market demand                      D) any other-----
16. May you rank the above challenges starting form the most pressing
- vi. -----
- vii. -----
- viii. -----
- ix. -----
- x. -----
17. If you have any additional comments on measures to be taken by the regional government, private investors and the community at large please indicate in the space provided below for each.
- Regional Government -----
  - Private investors -----
  - Community -----