The Spillover Effect of Foreign Direct Investment on the Productivity of Domestic Firms: The Case of Ethiopian Manufacturing Firms

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ABSTRACT

This study investigates the spillover effects of foreign direct investment on the productivity of domestic firms in Ethiopian manufacturing sector. Panel data is used by taking a time period from 2012-2015 which is obtained from central statistical agency of Ethiopia. From all regions of the country, 7912 medium and large scale manufacturing foreign and domestic firms are used in this study. The study discusses on three important issues: 1) “Does foreign firms performed better productivity than domestic firms?” 2) “Does domestic firms get benefits from foreign firms within the same sector?” 3) “Does the spillover effect of FDI differ from regions that have more number of foreign firms to regions that have small number of foreign firms?” In order to achieve these objectives, both descriptive and econometrics analysis are used. Random effect model is used in order to see the spillover effect of FDI on domestic firm’s productivity. Different diagnostic tests are used in order to check the appropriateness of the model. The findings of this study shows that foreign firms are performed better productivity than domestic firms. In addition, the result of the study showed that FDI have positive horizontal spillover effect on the productivity of domestic firms. But this positive horizontal spillover effect is geographically limited; the spillover effect is higher in regions that have more number of foreign firms than regions that have small number of foreign firms. Based on this result, the study implied policy makers should continue to adopt policies that can attract foreign investors and domestic firms should create favorable relationship with foreign firms.

Key words: Foreign direct investment, spillover effect, productivity, regional spillover, RE

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