The Nexus between Foreign Direct Investment, Domestic Investment and GDP of Ethiopia: What do Local Investors perceive about FDI inflows?

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ABSTRACT

The present study examined trends in foreign direct investment (FDI) inflows into Ethiopia, investigated the effect of FDI on domestic investment (DI), examined the long run equilibrium relationship between foreign direct investment (FDI), private domestic investment (PriDI) and Public domestic investment (DI), and gross domestic product (GDP) of Ethiopia. It also empirically analyzed the perceptions of local investors towards the entry of foreign investment in to the country. Both quantitative and qualitative approaches were used in order to complement and strengthen the analysis to capture different perspectives. Using the time series data of Ethiopia for the period 1992 to 2017, the study employed an asymmetric auto-regressive distributed lag (NARDL) model based on the standard theoretical and empirical literature on domestic investment-foreign direct investment and economic growth relationship. The empirical studies indicated that FDI has a crowding in effect to DI and FDI is complementary to DI. Further, to examine the long run causal relationship between private domestic investment, public domestic investment, foreign direct investment and economic growth, upon testing the data for Stationarity, this study employed the Auto Regressive Distributed Lag (ARDL) bound test of cointegration. Finally, the Granger causality test employed to ascertain the direction of causality between economic growth and its determinants. The empirical results indicate that the private domestic investment, public domestic investment, and foreign direct investment affect GDP positively and also causally connected with the economic growth of the country. Finally, the study analyzed the perceptions of local investors towards foreign direct investment inflows to the country. The empirical study based on probit models revealed that local investors who produce unrelated products, adopt similar technologies and possess trained skilled manpower have positive perception towards the entry of FDI in to Ethiopia. Thus, the results support Economic growth Led FDI (GLF) and FDI-Led economic Growth (FLG) strategy for Ethiopia. The findings further suggest that Ethiopia should continue following FDI promotion and liberal investment economic policy in order to maintain and boost its economic growth.

Key words: FDI, DI, GDP, ARDL, NARDL, Ethiopia