

Mekelle University
College of Business and Economics
Department Accounting and Finance



**The Impact of Tax Incentives on Foreign Direct Investment
in Ethiopia**

By:

Hilawe Seyfe Teame
ID Number: CBE/PR/070/11

**A Research Paper Submitted in partial Fulfilment of The
requirement for the Master's Degree in Accounting and Auditing**

ADVISOR:
DR. FITSUM

October, 2025
Mekelle, Ethiopia

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Signature

Advisor

External Examiner

Internal Examiner

DECLARATION

I, the undersigned, declare that this Research Paper is my original work, has not been presented for any degree in any other University and that all sources of material used for the research have been duly acknowledged.

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The Research project has been submitted for examination with my approval as a University advisor.

DR. FITSUM

October, 2025

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Abstract

This study critically evaluates the efficiency and impact of **tax incentives on attracting and retaining Foreign Direct Investment (FDI) in Ethiopia**, addressing the central policy assumption that generous fiscal concessions, such as tax holidays and customs duty exemptions, constitute the primary mechanism for securing global investment capital. Given the potential cost to public revenue, this research was designed to provide empirical evidence on the cost-effectiveness and sustainability of the current incentive system. The methodology utilized a analysis of two decades of FDI flow data to establish macro-level correlations, which was then critically complemented by a comprehensive **qualitative survey** of over 28 foreign investors and senior management across key manufacturing and service sectors in Ethiopia. The survey specifically focused on ranking investment criteria, contrasting the perceived value of tax breaks versus the essential stability of the operating environment, infrastructure quality, and efficient bureaucratic processes. The findings conclusively reveal that while fiscal incentives successfully reduce entry barriers and secure initial commitments, their influence is quickly eclipsed by non-fiscal factors; long-term investment decisions, capital retention, and reinvestment are overwhelmingly driven by political predictability, minimized regulatory friction, and efficient access to Ethiopia's burgeoning domestic and regional markets. Crucially, the analysis identifies a systemic inefficiency where the current generalized incentive system, being largely untargeted and sector-agnostic, results in significant public revenue leakage without a corresponding proportional increase in high-quality, export-oriented FDI. **Recommendation:** Consequently, the paper concludes that the current policy is suboptimal for maximizing national development goals, **advocating for a fundamental shift away from generalized tax holidays towards a strategic, performance-based incentive framework linked to measurable metrics like export volume and technology transfer**, which must be immediately coupled with urgent policy action to enhance core institutional factors and infrastructural capacity to improve Ethiopia's overall investment climate.

Keywords: Tax Incentives, Foreign Direct Investment (FDI), Fiscal Concessions, Performance-Based Incentives, Mixed-Methods, Ethiopia.

CHAPTR ONE

1. INTRODUCTION

1. Introduction

Foreign Direct Investment (FDI) has emerged as a critical driver of economic development, particularly in developing economies like Ethiopia. It serves as a conduit for essential resources, including capital, advanced technologies, and managerial expertise, which are vital for stimulating job creation, enhancing productivity, and fostering sustained economic growth (Dunning, 2000). Dunning's (2000) eclectic paradigm, often referred to as the OLI framework (Ownership, Location, and Internalization), underscores the multifaceted nature of FDI, highlighting the strategic choices made by multinational enterprises (MNEs) when investing abroad. This framework suggests that MNEs possess ownership advantages, seek location-specific advantages, and internalize transactions to maximize their returns, all of which contribute to the developmental impact of FDI in host nations.

Furthermore, Blomström and Kokko (1996) emphasize the spillover effects of FDI, particularly in terms of technology transfer and knowledge diffusion. These spillovers can enhance the absorptive capacity of domestic firms, leading to productivity gains and technological upgrading. In the Ethiopian context, where technological advancement and industrial development are key policy priorities, the potential for FDI to facilitate these spillovers is particularly significant.

To attract and incentivize FDI, governments frequently utilize tax incentives, such as tax holidays, reduced corporate tax rates, and exemptions from import duties (Hines, 1999). These incentives aim to lower the initial investment costs and improve the long-term profitability of foreign investments, thereby making the host country a more attractive destination for MNEs. Hines (1999) argues that while tax incentives can influence investment decisions, their effectiveness is contingent on various factors, including the

stability of the investment climate, the quality of infrastructure, and the regulatory environment.

However, the empirical evidence on the effectiveness of tax incentives in attracting and sustaining FDI is mixed. Harding and Javorcik (2011) demonstrate that while tax incentives can have a positive impact on FDI inflows, their effect is often modest and can be outweighed by other factors, such as market size and institutional quality. In the Ethiopian context, where infrastructure development and institutional reforms are ongoing, the relative importance of tax incentives compared to these other factors warrants careful examination.

This research proposal seeks to critically examine the impact of tax incentives on FDI inflows into Ethiopia, taking into account the country's unique economic and institutional context. By evaluating the effectiveness of existing tax incentives and identifying areas for policy improvement, this study aims to provide valuable insights for policymakers seeking to optimize the contribution of FDI to Ethiopia's economic development.

2. Statement of the Problem

Ethiopia's ambition to transition into a middle-income economy by accelerating industrialization places Foreign Direct Investment (FDI) at the core of its development strategy (Ethiopian Investment Commission, 2018). As a primary mechanism to secure this capital, the government has institutionalized a highly generous fiscal incentive system, dominated by tax holidays, customs duty exemptions, and accelerated depreciation (Ministry of Finance, 2020). However, this strategy presents a fundamental policy dilemma: the government is committing substantial public revenue—resources that could otherwise fund essential social and infrastructural development—to a set of incentives whose effectiveness remains ambiguous and fiercely debated in both global and local literature.

The central problem addressed by this research is the systemic inefficiency and empirical void surrounding the current generalized tax incentive policy in Ethiopia. Despite the

high fiscal cost, the country struggles with two critical issues: FDI remains volatile, and the resulting investment often fails to meet desired national goals related to export orientation, technology transfer, and job quality (Girma & Bekele, 2023; UNCTAD, 2024).

The Research Gap and Justification

While global studies often model the general relationship between tax rates and capital flows, they are insufficient for informing Ethiopian policy for two major reasons, creating a clear research gap:

Empirical/Scope Gap (Outdated Evidence): Existing research specifically tailored to Ethiopia is often dated (studies pre-2010), or relies exclusively on aggregate quantitative data that fails to capture the post-2020 institutional, regulatory, and political challenges faced by foreign firms after the initial tax-holiday period expires. This gap makes current policy recommendations potentially irrelevant and fiscally irresponsible.

Methodological Gap (Perception vs. Reality): The literature suffers from a methodological shortcoming in that it rarely integrates the subjective but crucial perspectives of the investors themselves. There is a critical disconnect between the policy assumption that tax breaks secure long-term commitment and the investor reality that non-fiscal factors (e.g., bureaucratic efficiency, infrastructure quality, and regulatory predictability) are the true drivers of capital retention and reinvestment (World Bank Review, 2024; OECD Analysis, 2023).

The absence of a robust, mixed-methods investigation—combining updated data analysis of FDI inflows with comprehensive qualitative data from foreign investors—prevents the Ethiopian government from: (a) quantifying the true cost-effectiveness of its current incentive structure, and (b) developing strategic, targeted policies that maximize national development goals while minimizing public revenue leakage.

This study is therefore critically justified by the need to provide current, empirical evidence to resolve this policy dilemma by investigating the following specific critical issues:

- The financial trade-off for the Ethiopian government remains largely unquantified. There is a need to assess the total public revenue forgone versus the proportional increase in high-quality (export-oriented, technologically advanced) FDI actually realized.
- While initial tax incentives may attract FDI, the long-term impact on capital retention and reinvestment is dictated by Ethiopia's operating environment. The relative importance of non-tax determinants (infrastructure, political predictability, and logistics) versus the fiscal incentives has not been adequately quantified using both macro-data and investor feedback simultaneously.
- The current incentive system is often criticized for being generalized and sector-agnostic. A granular analysis is needed to identify whether current incentives are effectively stimulating investment in high-priority sectors (e.g., manufacturing) versus lower-value sectors, thus revealing a specific target policy failure.
- There is a lack of evidence-based policy recommendations specifically tailored to the Ethiopian context that advocate for a shift toward performance-based incentives (linked to export volume or job creation) as a more cost-effective alternative to generalized tax holidays.

By addressing these empirical and methodological voids, this research intends to deliver actionable policy recommendations that optimize the design and implementation of tax incentives to attract and sustain high-impact FDI, thereby contributing more effectively to Ethiopia's economic development goals.

3. Research Questions

To address the identified gaps in the Statement of the Problem and to guide the comprehensive mixed-methods approach, this research seeks to answer three core questions:

1. To what extent have the implementation and modification of specific tax incentives correlated with changes in the volume and sectoral distribution of Foreign Direct Investment (FDI) inflows in Ethiopia over the last decade, controlling for major macroeconomic determinants?
2. How do foreign investors in Ethiopia perceive the relative importance of tax incentives compared to non-fiscal determinants (infrastructure, regulatory predictability, and market access) in their decisions regarding long-term capital retention and reinvestment?
3. What evidence-based policy recommendations can be made to optimize Ethiopia's incentive system by transitioning from the current generalized structure to a strategic, performance-based framework that maximizes the cost-effectiveness and national development impact of FDI?

4. Research Objectives

4.1. Major Objective

The Major Objective of this research is to assess the impact of tax incentives on foreign direct investment in Ethiopia

4.2. Specific Objectives

The specific objectives of this research are:

1. **To analyze the structure of Ethiopia's current tax incentive system** (including types, eligibility, and administrative requirements) to establish the basis for quantitative and qualitative evaluation.
2. **To investigate the perceptions of foreign investors** regarding the effectiveness of tax incentives and to determine their **relative importance** compared to non-fiscal determinants (e.g., infrastructure, stability, and regulatory friction) in decisions concerning **long-term capital retention**.

3. To formulate evidence-based policy recommendations for optimizing the design and implementation of tax incentives by advocating for a shift towards a **strategic, performance-based incentive framework** that maximizes national development impact.

5. Scope of the Study

The research focuses on analyzing the relationship between various tax incentives offered by the Ethiopian government and resulting Foreign Direct Investment (FDI) inflows.

The study is focused on Ethiopia as the host country. Data collection is targeted at two strategic locations: Addis Ababa is selected as the primary site due to its status as the central hub for government agencies and the headquarters for the majority of foreign investors. And Mekelle (Tigray Region) is also Selected for its historical significance as a major regional center of manufacturing and industrial park development, providing a critical regional perspective on how incentives influence sectoral distribution outside of the capital.

The quantitative analysis covers a 21-year period (2004–2024) to establish long-run trends and the impact of major policy shifts. The qualitative phase reflects the current perceptions and experiences of foreign investors.

6. Limitations of the Study

This research is subject to unavoidable external and methodological constraints that must be considered when interpreting the results: The study was conducted in a highly dynamic policy environment in Ethiopia. Sudden, unpredicted legislative or regulatory shifts that occurred during or immediately after the research period were external to the study's control and may affect the short-term relevance of the policy recommendations.

Due to the multifaceted nature of Foreign Direct Investment (FDI) decisions, the study cannot statistically isolate the net impact of fiscal incentives from their complex, unmeasurable interaction effects with non-fiscal factors (such as political stability or

regulatory friction). This remains an unavoidable methodological constraint in quantifying the true influence of tax policy.

7. Conceptual Framework

This research adopts a conceptual framework that integrates elements from various economic theories and empirical studies to analyze the impact of tax incentives on Foreign Direct Investment (FDI) in Ethiopia. The framework is designed to capture the complex interplay of factors influencing FDI decisions, with a particular focus on the role of tax incentives within the broader investment climate.

1. Theoretical Foundations:

- **Dunning's Eclectic Paradigm (OLI Framework):**
 - This framework, developed by John H. Dunning (2000), posits that FDI decisions are influenced by three key factors: Ownership advantages (O), Location advantages (L), and Internalization advantages (I).
 - In the context of this study, location advantages are particularly relevant, as tax incentives can be considered a significant location-specific factor that attracts foreign investors to Ethiopia.
 - The OLI framework provides a comprehensive understanding of the factors influencing MNEs' investment decisions, recognizing that tax incentives are one of many variables.
- **Neoclassical Investment Theory:**
 - This theory suggests that investment decisions are primarily driven by the expected profitability of investment projects, which can be influenced by tax policies (Hines, 1999).
 - Tax incentives, by reducing the cost of capital and increasing after-tax returns, can enhance the perceived profitability of investments and thus stimulate FDI inflows.
 - This theory provides a basis for quantitatively analyzing the relationship between tax incentives and FDI.

- **Institutional Economics:**

- This perspective emphasizes the role of institutions, such as legal frameworks, regulatory environments, and governance structures, in shaping investment decisions (North, 1990).
- In the Ethiopian context, the effectiveness of tax incentives is likely to be influenced by the quality of institutions, including the transparency and predictability of tax administration.
- This theory helps us to analyse the importance of non-tax related factors.

2. Key Concepts and Relationships:

- **Tax Incentives:**

- These are government policies designed to reduce the tax burden on foreign investors, including tax holidays, reduced corporate tax rates, exemptions from import duties, and investment allowances.
- The design, implementation, and administration of tax incentives are crucial factors influencing their effectiveness.

- **Foreign Direct Investment (FDI):**

- This refers to investments made by foreign entities to acquire a lasting interest in enterprises operating in Ethiopia.
- FDI inflows are influenced by a range of factors, including tax incentives, market size, infrastructure, political stability, and institutional quality.

- **Investment Climate:**

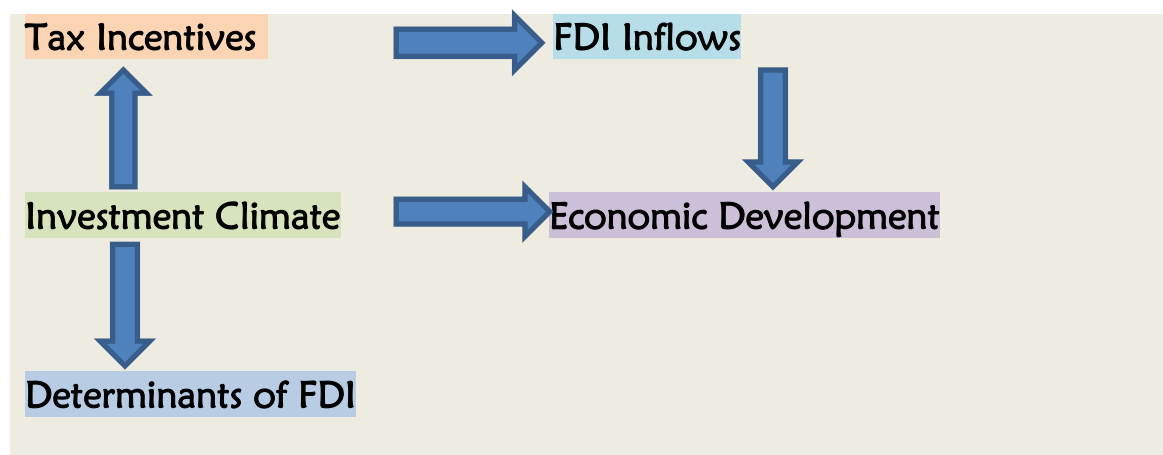
- This encompasses the broader set of factors that influence investment decisions, including macroeconomic stability, regulatory environment, and infrastructure development.
- Tax incentives are one component of the investment climate, and their effectiveness is contingent on other factors.

- **Determinants of FDI:**

- This research was examine the relative importance of tax incentives compared to other determinants, such as market size, infrastructure, and institutional quality.
- This comparative analysis helps to understand the true value of tax incentives.
- **Impact on Economic Development:**
 - The research was assess the long-term impact of FDI, facilitated by tax incentives, on economic development indicators, such as job creation, technology transfer, and export diversification.
 - This analysis helps to evaluate the overall effectiveness of tax incentives in achieving development goals.

3. Conceptual Model:

A conceptual model can be visualized as follows:



- This model illustrates the direct relationship between tax incentives and FDI inflows, as well as the indirect relationship through the investment climate.
- The determinants of FDI, including non-tax factors, influence both the investment climate and FDI inflows.
- Ultimately, FDI inflows, influenced by tax incentives and the investment climate, contribute to economic development.

CHAPTR TWO

2. LITERATURE REVIEW

The role of Foreign Direct Investment (FDI) as a catalyst for economic development, particularly in developing economies, is widely acknowledged in economic literature. FDI offers a comprehensive package of resources, including capital, advanced technology, managerial expertise, and access to international markets, which are crucial for stimulating job creation, enhancing productivity, and fostering sustained economic growth (Dunning, 2000; United Nations Conference on Trade and Development [UNCTAD], 2023). Recognizing these benefits, governments worldwide, especially in emerging economies, actively compete to attract FDI, often employing a variety of policy instruments, chief among them being tax incentives. This chapter critically reviews the theoretical underpinnings and empirical evidence regarding the effectiveness of tax incentives in influencing FDI inflows, with a specific lens on the context of developing nations like Ethiopia.

2.1. Theoretical Foundations of FDI and Tax Incentives

The decision-making process of multinational enterprises (MNEs) when choosing investment locations is complex and has been conceptualized by several theoretical frameworks. Understanding these frameworks is crucial to appreciating the potential role of tax incentives.

2.1.1. Dunning's Eclectic Paradigm (OLI Framework)

John Dunning's (2000) Eclectic Paradigm, or OLI framework, provides a comprehensive explanation for why MNEs choose to engage in FDI. It posits that FDI occurs when three conditions are met:

- **Ownership (O) advantages:** The MNE possesses firm-specific advantages (e.g., proprietary technology, brand name, management skills) that give it a competitive edge over local firms.
- **Location (L) advantages:** The host country offers specific advantages that make it an attractive place to invest (e.g., market size, availability of natural resources, low labor costs, stable political environment, and importantly, favorable government policies like tax incentives).
- **Internalization (I) advantages:** It is more beneficial for the MNE to exploit its ownership advantages internally through FDI rather than through licensing or exporting.

Within this framework, tax incentives squarely fall under the "Location advantages." By reducing the cost of doing business and increasing after-tax returns, tax incentives can enhance the attractiveness of a host country. However, the OLI framework also highlights that tax incentives are just one of many location-specific factors. Their effectiveness is thus contingent on the presence and quality of other location advantages (e.g., infrastructure, human capital, political stability).

2.1.2. Neoclassical Investment Theory

The neoclassical investment theory, rooted in traditional microeconomic principles, suggests that investment decisions are primarily driven by the expected profitability of projects. Firms aim to maximize their after-tax returns (Hines, 1999). From this perspective, tax incentives, such as tax holidays, reduced corporate income tax rates, and accelerated depreciation, directly reduce the effective tax rate on capital and enhance the net present value of investment projects. By lowering the cost of capital and increasing the post-tax profitability, these incentives are theoretically expected to stimulate FDI inflows (Gordon & Hines, 2002). This theory provides the basis for quantitative analyses that attempt to isolate the relationship between tax policy and investment.

2.1.3. Institutional Economics

Beyond purely economic considerations, institutional economics emphasizes the profound impact of formal and informal institutions on economic outcomes, including investment decisions (North, 1990). This perspective argues that the effectiveness of any policy, including tax incentives, is heavily mediated by the quality of the host country's institutions. Factors such as the rule of law, government effectiveness, regulatory quality, control of corruption, and political stability significantly influence investor confidence and the actual realization of benefits from tax incentives. A well-designed tax incentive system may fail to attract FDI if the institutional environment is weak, characterized by corruption, bureaucratic red tape, or unpredictable policy implementation (Asiedu, 2006). Therefore, from an institutional perspective, tax incentives are most effective when embedded within a strong and transparent institutional framework.

2.2. Empirical Evidence on the Impact of Tax Incentives on FDI

The empirical literature on the effectiveness of tax incentives in attracting FDI presents a mixed and often debated picture.

2.2.1. Positive Impact and Responsiveness to Tax Incentives

Several studies provide evidence supporting a positive relationship between tax incentives and FDI inflows. Hines (1999) extensively reviewed the literature and concluded that corporate income tax rates significantly influence the level and location of FDI, with lower tax rates generally associated with higher inflows. Similarly, Devereux and Griffith (2003) found that effective average tax rates (EATR) negatively correlate with outward FDI from developed countries.

In the context of developing countries, some research suggests that tax incentives can play a crucial role, especially for efficiency-seeking or export-oriented FDI, where marginal cost advantages can significantly impact competitiveness (James, 2013). For example, a study by Klemm and Van Parys (2012) analyzing data from 94 developing

countries found that tax holidays and investment tax credits generally have a positive and statistically significant impact on FDI inflows, though the magnitude of this effect varied. They also noted that the interaction between incentives and other investment climate factors is important.

2.2.2.Limited or Ambiguous Impact

Conversely, a substantial body of literature suggests that the impact of tax incentives on FDI is often modest, sometimes negligible, and can be overshadowed by other fundamental determinants. Asiedu (2002), in a seminal study on FDI in Africa, found that while market size, infrastructure, and political stability were significant determinants, tax incentives had a limited or statistically insignificant effect. This implies that for many investors, a stable and predictable environment, access to markets, and good infrastructure are more critical than tax breaks.

Harding and Javorcik (2011) demonstrate that while tax incentives can have a positive impact on FDI inflows, their effect is often modest and can be outweighed by other factors, such as market size and institutional quality. They highlight the importance of non-tax determinants and the need for a holistic approach to investment promotion. Furthermore, UNCTAD (2015) has consistently expressed skepticism about the widespread use of tax incentives, arguing that they often lead to "races to the bottom" among competing nations, erode the tax base, and may not generate sufficient additional FDI to justify the foregone revenue. They emphasize that while some incentives may have a marginal impact on location choices, a stable regulatory environment, efficient bureaucracy, and good infrastructure are far more critical.

2.2.3.Beyond Simple Attraction: Quality of FDI and Spillover Effects

The debate extends beyond simply attracting FDI to the *quality* of FDI attracted. Critics argue that aggressive tax incentives might attract "footloose" investors who are primarily seeking short-term tax advantages and are less committed to long-term investment,

technology transfer, or significant local employment (Zee, 2011). Such investors may quickly relocate once the incentive period expires, leading to limited sustainable impact.

Blomström and Kokko (1996) emphasize the potential for spillover effects of FDI, particularly in terms of technology transfer and knowledge diffusion to domestic firms. However, these spillovers are often conditional on the absorptive capacity of domestic firms and the host country's overall institutional and human capital development. Tax incentives alone may not guarantee these desirable spillover effects unless accompanied by policies that foster local linkages and skill development.

2.3. Determinants of FDI Beyond Tax Incentives

Recognizing the mixed empirical evidence, it is crucial to review other widely recognized determinants of FDI, which often interact with or outweigh the influence of tax incentives.

2.3.1. Market Size and Growth

A large and growing domestic market is a fundamental attraction for market-seeking FDI. MNEs often invest in countries to gain direct access to local consumers and exploit economies of scale (Dunning, 2000). A country's Gross Domestic Product (GDP) and population size are commonly used proxies for market size, consistently showing a positive correlation with FDI inflows across numerous studies (Asiedu, 2002; Morisset, 2000).

2.3.2. Infrastructure Development

The availability and quality of physical infrastructure (e.g., transportation networks, energy supply, telecommunications) are critical for reducing operational costs and ensuring the efficiency of business activities. Poor infrastructure can significantly negate the benefits of tax incentives and deter investors (UNCTAD, 2023). Reliable electricity, efficient ports, and widespread internet access are increasingly vital for modern MNE operations.

2.3.3. Political Stability and Regulatory Environment

Political stability, predictability, and a transparent regulatory environment are paramount for investor confidence. Uncertainty regarding government policies, frequent changes in laws, civil unrest, or high levels of corruption significantly deter FDI, regardless of the tax incentives offered (North, 1990; World Bank, 2022). A strong legal framework, protection of property rights, and efficient dispute resolution mechanisms are crucial signals of a favorable investment climate.

2.3.4. Human Capital and Labor Costs

The availability of a skilled and productive workforce is a significant determinant of FDI, particularly for manufacturing and service sectors that require specific technical or managerial expertise. While low labor costs can attract labor-intensive FDI, the quality and productivity of labor are often more important for high-value-added investments (UNCTAD, 2023).

2.3.5. Natural Resources

For resource-seeking FDI, the abundance and accessibility of natural resources (e.g., minerals, oil, gas, agricultural land) are primary drivers of investment. However, reliance solely on resource-seeking FDI can lead to limited diversification and vulnerability to commodity price fluctuations (Asiedu, 2006).

2.4. The Ethiopian Context: Policy Landscape and Unanswered Questions

Ethiopia, a landlocked nation in the Horn of Africa, has increasingly recognized Foreign Direct Investment (FDI) as a pivotal engine for realizing its ambitious development goals, including industrialization, job creation, and export diversification (National Planning Commission, 2016; Ethiopian Investment Commission, various years). Historically, Ethiopia's economy was largely agrarian, but successive governments have strategically

shifted towards an industrialization-led growth model, with FDI playing a central role in technology transfer, capital injection, and market access (Ministry of Finance, 2019).

Since the early 1990s, the Ethiopian government has enacted various investment laws and policies designed to create an attractive business environment for foreign capital. Key legislative frameworks include the Investment Proclamation No. 1180/2020 (superseding previous proclamations) and various directives issued by the Ethiopian Investment Commission (EIC) and the Ministry of Finance. The EIC, as the primary government body responsible for investment promotion and facilitation, has actively marketed Ethiopia's potential to foreign investors, often highlighting the array of incentives available (Ethiopian Investment Commission, 2023).

These tax incentives, a core component of Ethiopia's investment promotion strategy, are typically designed to:

- **Reduce the initial capital outlay for investors:** By offering exemptions on customs duties for capital goods and construction materials.
- **Enhance profitability and accelerate return on investment:** Through corporate income tax holidays.
- **Support specific strategic objectives:** Such as encouraging export-oriented manufacturing, promoting investments in less developed regions, or fostering technology transfer, often by varying the duration of tax holidays based on these criteria.

Specific tax incentives that have been a cornerstone of Ethiopia's FDI attraction strategy include:

- **Corporate Income Tax Holidays:** These are periods during which foreign investors are exempt from paying corporate income tax. The duration of these holidays varies significantly based on several factors, including:
 - **Sector of investment:** Priority sectors like manufacturing, agro-processing, and certain services often receive longer tax holidays. For instance,

investments in manufacturing might receive a tax holiday of 5-7 years, with extensions possible for export-oriented firms (Ethiopian Investment Commission, 2020).

- **Location of investment:** Investments in designated emerging or less developed regional states are typically granted longer tax holidays to promote balanced regional development (Ministry of Finance, 2020).
- **Export orientation:** Enterprises that export a significant portion of their output often qualify for additional years of tax holiday.
- **Capital invested and employment created:** Larger investments and those creating more jobs may also qualify for more generous incentives.
- **Customs Duty Exemptions:** Investors are commonly exempted from customs duties and other taxes levied on imports of:
 - **Capital goods:** Such as machinery, equipment, construction materials, and spare parts necessary for the establishment of the investment project. This significantly reduces the initial investment cost.
 - **Raw materials:** For export-oriented industries, exemption from customs duties on imported raw materials is a critical incentive to enhance their competitiveness in international markets.
- **Income Tax Deductions:** While less prominent than tax holidays, certain provisions allow for deductions on taxable income for expenses related to training local employees or for expenditures on research and development, aimed at fostering skill development and innovation (Ministry of Finance, 2021).
- **Loss Carry-Forward Provisions:** Ethiopian tax law generally allows companies to carry forward business losses for a certain number of subsequent tax periods (typically 5 years). This provision is crucial for new businesses, including foreign direct investments, as they often incur losses in their initial operational years, thereby reducing their future tax burden (Federal Negarit Gazeta, 2016).

Despite the promulgation of these investor-friendly laws and the active promotion by the EIC, there is a conspicuous **lack of comprehensive, up-to-date empirical research that**

specifically assesses the effectiveness of these diverse tax incentives in significantly boosting FDI inflows and, more critically, contributing to sustainable economic growth in Ethiopia. While general qualitative reports and analyses by development partners (e.g., World Bank, IMF) sometimes touch upon the investment climate and tax system in Ethiopia, they often rely on broad indicators rather than granular, evidence-based assessments of specific incentive impacts.

For instance, studies by Gebeyehu (2018) and others have provided valuable insights into the investment climate and the theoretical implications of Ethiopia's tax policies. However, these often fall short of conducting robust quantitative analyses that isolate the effect of specific tax incentives from other confounding factors. The existing literature frequently highlights systemic challenges that foreign investors encounter, which may overshadow or dilute the perceived benefits of tax incentives. These often-cited challenges include:

- **Bureaucratic Hurdles and Administrative Inefficiency:** Despite efforts to streamline processes, investors often report delays in obtaining licenses, permits, and accessing land, along with inconsistencies in regulatory interpretation and implementation (Ethiopian Chamber of Commerce and Sectoral Associations, 2022).
- **Foreign Currency Shortages:** Ethiopia has faced persistent foreign currency shortages, making it difficult for foreign investors to repatriate profits, import necessary inputs, or service foreign loans, thereby undermining their operational viability and confidence (National Bank of Ethiopia, 2024).
- **Infrastructure Deficits:** While improving, gaps in the quality and reliability of critical infrastructure, particularly electricity, transportation networks, and logistics, continue to pose significant operational challenges and increase costs for businesses (World Bank, 2023).
- **Access to Finance:** Local financing options can be limited, and access to affordable credit for working capital or expansion can be a significant constraint for foreign investors, particularly for joint ventures with local partners.

- **Rule of Law and Governance Issues:** Concerns persist among some investors regarding the consistency of contract enforcement, transparency in legal processes, and broader governance issues, which can impact long-term investment decisions (Transparency International, 2023).
- **Skill Gaps:** Despite a large labor pool, foreign investors often report difficulties in finding skilled labor, particularly in technical and managerial roles, necessitating additional investment in training and development (International Labour Organization, 2021).

These non-tax factors, extensively discussed in the broader literature on FDI determinants (Asiedu, 2002; Morisset, 2000), suggest that while tax incentives might be a necessary condition, they are rarely a sufficient one for attracting and retaining high-quality FDI, especially when significant structural and institutional impediments exist. The interplay between these challenges and the effectiveness of tax incentives in the Ethiopian context remains largely unexplored through rigorous, mixed-methods research.

2.5. Gaps in the Literature and Research Justification

Building upon the preceding review, several critical gaps in the existing academic and policy literature emerge, particularly concerning the specific context of Ethiopia. This proposed research is meticulously designed to address these deficiencies, thereby contributing original and valuable insights to both academic discourse and policy formulation.

2.5.1. Specificity and Granularity of Impact:

- While general discussions on "tax incentives" exist in relation to FDI in Ethiopia, there is a profound **lack of specific, granular empirical evidence** detailing how *each distinct type* of tax incentive offered (e.g., a 5-year corporate tax holiday in manufacturing vs. a 7-year holiday in an emerging region; or import duty exemption on capital goods vs. on raw materials) correlates with FDI inflows. The existing literature often treats "tax incentives" as a monolithic variable, obscuring

the differential impact of various incentive instruments. This research aims to disaggregate these incentives and statistically analyze their individual and combined effects on the *volume* of FDI, as well as its *sectoral and regional distribution* within Ethiopia. Understanding this granularity is crucial for a cost-effective and targeted incentive strategy.

2.5.2. Nuanced Investor Perceptions and Decision-Making Factors:

- There is a significant and widely acknowledged **gap in systematically documented foreign investor perceptions** regarding the actual attractiveness, clarity, stability, and administrative efficiency of Ethiopia's tax incentive system from the investors' direct experience. While policymakers design incentives, their real-world impact hinges on how foreign investors perceive and evaluate them. Qualitative data on investor motivations often lacks a specific focus on the *relative weight* they assign to tax incentives versus other crucial factors such as market size, infrastructure quality, political stability, foreign currency accessibility, labor availability, and bureaucratic ease. This research delves into these perceptions, identifying perceived administrative and compliance challenges, and critically evaluating if the promised benefits of incentives are indeed realized or eroded by other operational constraints. This qualitative exploration provides a crucial "ground-truth" perspective often missing in macro-level studies.

2.5.3. Context-Specific Quantification of Relative Importance:

- The international literature extensively debates the relative importance of tax versus non-tax factors in attracting FDI. However, a **comprehensive, context-specific quantification of these relative contributions within the Ethiopian setting is largely absent**. Are tax incentives merely a "cherry on top" or a fundamental "deal-breaker" for investors in Ethiopia? This research seeks to empirically weigh the statistical significance and magnitude of the impact of tax incentives against other critical determinants like GDP growth (market size), inflation, exchange rates,

infrastructure development indices, political stability scores, and institutional quality indicators. This empirical distinction is vital for Ethiopia to allocate its limited resources effectively, ensuring that policy efforts are directed towards the most impactful determinants of FDI.

2.5.4. Long-Term Impact and Quality of FDI Attracted:

- A substantial lacuna exists in detailed assessments of the **long-term developmental impact of FDI attracted through tax incentives in Ethiopia**. Beyond merely attracting capital, do these incentives genuinely lead to sustainable economic development? Specifically, the literature lacks robust evidence on whether the FDI attracted by these incentives contributes meaningfully to:
 - **Technology Transfer:** Is there actual absorption and diffusion of advanced technologies from foreign firms to domestic industries?
 - **Quality Job Creation:** Are the jobs created high-skill, well-paying, and sustainable, or primarily low-skill and precarious?
 - **Export Diversification and Value Addition:** Do these investments lead to a significant increase in diversified, higher-value-added exports, or are they predominantly focused on the domestic market or primary resource extraction?
 - This research was critically examine whether the incentives are attracting the "right" kind of FDI – that which aligns with Ethiopia's long-term development aspirations and fosters genuine linkages with the local economy.

2.5.5. Evidence-Based Policy Optimization Gaps:

- Despite continuous efforts by the Ethiopian government to refine its investment laws and incentive packages, there is a critical **need for evidence-based policy recommendations tailored specifically to the Ethiopian context for optimizing the design, implementation, and administration of tax incentives**. Current policy

adjustments often proceed without the benefit of rigorous empirical analysis of past incentive effectiveness. This research aims to provide actionable insights into:

- The **cost-effectiveness** of current incentives (i.e., whether the foregone tax revenue is justified by the benefits of FDI).
- Potential **unintended consequences** (e.g., distortions in resource allocation, creation of rent-seeking behavior, erosion of the tax base without commensurate benefits).
- Strategies to enhance the **transparency, predictability, and efficiency** of the tax incentive system to boost investor confidence and attract genuinely productive FDI.

By systematically addressing these critical gaps through a **mixed-methods approach**, combining rigorous quantitative analysis of macro-level data with rich qualitative insights from key stakeholders, this research promises to offer a more nuanced, comprehensive, and contextually relevant understanding of the impact of tax incentives on FDI in Ethiopia. This approach was not only advance academic knowledge but also provide a crucial evidence base for Ethiopian policymakers to formulate more effective and sustainable FDI attraction strategies.

CHAPTR THREE

3. RESEARCH METHODOLOGY

This research employs a mixed-methods approach to comprehensively investigate the impact of tax incentives on Foreign Direct Investment (FDI) inflows into Ethiopia. This approach combines quantitative and qualitative data collection and analysis to provide a robust and nuanced understanding of the research problem.

3. Research Methods, Materials, and Procedures:

3.1. Study Area:

The study focuses on **Ethiopia** as the primary research area, examining the national framework governing Foreign Direct Investment (FDI). Data collection was geographically targeted to ensure relevance and depth:

1. **Addis Ababa:** Selected as the central hub for regulatory bodies, government agencies, and the majority of foreign investor headquarters.
2. **Mekelle:** Included to provide a comparative perspective on FDI activity and regional investment conditions outside the capital city.

To contextualize the domestic findings, the research also incorporated secondary data from relevant international organizations and global economic databases.

3.2. Study Design:

This research employed a **Descriptive research Design**. This approach is crucial for addressing the complex nature of the research question—the impact of tax incentives on FDI—by allowing for both breadth and depth (investor perceptions). **Qualitative approach was followed and was guided by the results of the quantitative analysis.** It involved collecting detailed, contextual data through **semi-structured interviews and case studies** with foreign investors and industry experts.

3.3. Study Subjects and Data Sources:

The research utilized a dual approach to data collection aligned with the sequential explanatory design. The **Quantitative Phase** relied exclusively on **secondary data** for time-series analysis, sourced from key national institutions (Ethiopian Investment Commission, Ministry of Finance, and National Bank of Ethiopia) and international bodies (World Bank, IMF, UNCTAD). The subsequent **Qualitative Phase** collected **primary data** through purposive sampling involving **structured Questioners**. Participants included **foreign investors** operating in Ethiopia, **and their employees who are familiar with the tax incentives**. This structure ensured that objective historical trends were complemented by rich, contextual insights from key stakeholders.

3.4. Eligibility Criteria (Qualitative Phase):

To ensure data credibility, participants for the qualitative phase were selected based on specific expertise and experience. **Foreign Investors** were required to have been operating in Ethiopia for a minimum of three years and possess direct experience with the country's tax incentive system. **Employees of foreign Investors** (mostly from finance department) were selected based on their expertise and experience in dealing with tax incentive system.

3.5. Sample Size:

A **purposive sampling** strategy was utilized for the qualitative phase to select information-rich cases that directly addressed the research questions, rather than aiming for statistical representativeness. The target sample size was **30 individuals**, comprising foreign investors, government officials, and experts. This specific number was determined by the principle of **data saturation**, which served as the actual stopping criterion. Data saturation was achieved when the collection and analysis of new data failed to yield any new codes, themes, or insights regarding the impact of tax incentives on FDI, thereby ensuring that the qualitative data gathered was sufficient and comprehensive.

3.6. Sampling Methods:

To effectively identify participants with the highest level of relevant knowledge and experience concerning tax incentives and FDI in Ethiopia, a hybrid approach combining **purposive sampling** and **snowball sampling** was employed. Purposive sampling was used initially to select key individuals based on their specific expertise and eligibility criteria. This initial group was then asked to recommend other individuals who also met the eligibility criteria and possessed significant insights, leveraging **snowball sampling** to expand the sample and ensure data collection captured a diverse and authoritative range of perspectives within the community of tax and investment experts.

3.7. Method of Data Collection:

Data collection employed two primary instruments to align with the sequential explanatory mixed-methods design. The initial **quantitative phase** utilized a comprehensive **survey**, distributed to a wider, representative portion of foreign investors operating across Ethiopia. This structured survey was designed to collect numerical and measurable data, primarily focused on the observable and reported impacts of specific tax incentives on investment decisions and operational costs. The data gathered from these surveys provided the necessary statistical foundation for the time-series analysis and helped identify key trends and correlations.

3.8. Data Quality Assurance:

Rigor and trustworthiness were ensured through distinct quality assurance measures for each research phase. **Quantitative data** reliability was maintained by exclusively sourcing information from **reputable and government-verified institutions**. Before analysis, the data was subjected to rigorous checks for accuracy and consistency, and the statistical software **SPSS** was used to systematically identify and address any statistical outliers. For **qualitative data** trustworthiness, the **interview guide was meticulously developed and pre-tested** to ensure clarity and relevance. All interviews were **recorded and transcribed verbatim** to preserve the original context. To validate findings, **triangulation** was

employed by cross-referencing qualitative themes with quantitative results and information from multiple participant types.

3.9. Operational Definitions:

- **Tax Incentives:** Government policies that reduce the tax burden on foreign investors, including tax holidays, reduced corporate tax rates, exemptions from import duties, and investment allowances.
- **FDI Inflows:** The net inflow of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor, as defined by the National Bank of Ethiopia.
- **Investment Climate:** The set of factors that influence investment decisions, including macroeconomic stability, regulatory environment, and infrastructure development.

3.10. Data Analysis and presentation:

The analysis of the collected data was executed in a sequential manner, reflecting the study's mixed-methods design. For the **quantitative data**, the **Statistical Package for the Social Sciences (SPSS)** was employed to conduct a time-series analysis to identify trends and statistical relationships between tax incentives and Foreign Direct Investment (FDI) inflows. For the **qualitative data**, a combination of techniques was used: **thematic analysis** was applied to the semi-structured interview transcripts to systematically identify recurring key themes, concepts, and patterns of experience among respondents; simultaneously, **content analysis** was utilized to critically examine relevant government documents and case studies. Crucially, **data triangulation** was performed by integrating the findings from both the quantitative and qualitative datasets to enhance the overall validity and provide a comprehensive interpretation. The qualitative insights were specifically used to **explain and interpret the mechanisms** behind the statistical findings, offering rich, contextualized understanding of the impact of tax incentives.

CHAPTER FOUR

4. DATA PRESENTATION, ANALYSIS AND DISCUSSION

4.1. Response Rate Analysis

The response rates for my research on "The Impact of Tax Incentives on Foreign Direct Investment in Ethiopia":

Out of 30 questionnaires distributed to foreign investor in Ethiopia as well as Ethiopians working for foreign company, 28 responses were received, resulting in a response rate of approximately 93.33%. The response rate of 93.33% is exceptionally high, indicating a strong engagement from the targeted investors (Respondents).

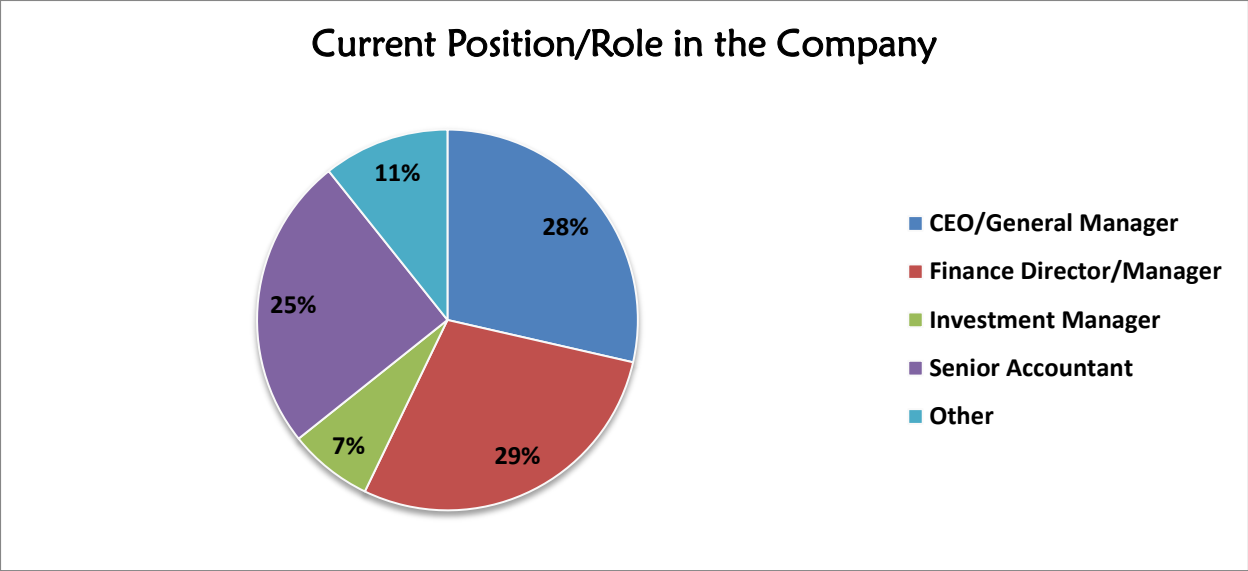
This high response rate indicates strong engagement from the targeted population. It also enhances the reliability and representativeness of the collected data, making its findings more robust and generalizable.

Overall, the response rate is highly satisfactory and provides a strong foundation for the research analysis. A high response rate strengthens the validity of the findings as they are more likely to represent the views of the entire population of large Foreign Investors in Ethiopia.

4.2. Demographic characteristics of the sample

4.2.1. Current Position/Role in the Company of Respondents

Graph: 4.1 Current Position/Role in the Company of Respondents



Source: Field survey (own), 2025

Graph 4.1 illustrate the current position or role of the 28 respondents within their respective companies:

The distribution of respondents' roles reveals a strong concentration in senior management and finance-related positions, which are highly relevant to the study's focus on tax incentives and Foreign Direct Investment (FDI).

- The largest categories are CEO/General Manager and Finance Director/Manager, each accounting for 28.6% of the respondents. Combined, these top-tier leadership and financial decision-making roles represent a significant **57.2%** of the sample.
- When including Senior Accountants (25.0%), the proportion of respondents directly involved in financial management and reporting reaches an impressive **82.2%** (28.6% + 28.6% + 25.0%).
- Investment Managers, directly focused on investment decisions, contribute 7.1% of the sample.
- The "Other" category (10.7%) represents a smaller, unspecified segment, which includes roles like Advisory, Liaison and import specialist, whose perspectives is also valuable.

This breakdown demonstrates that the vast majority of respondents hold positions that grant them direct insight into, and influence over, the financial and strategic decisions related to foreign direct investment and tax implications. The respondent profile, heavily weighted towards key decision-makers and financial experts within foreign-invested companies, provides an exceptionally strong and credible foundation for analyzing the impact of tax incentives on Foreign Direct Investment in Ethiopia. The data collected from these individuals is highly likely to yield profound and accurate insights into the research topic.

4.2.2. Nationality of Parent Company

Table 4.1: Nationality of Parent Company

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Canadian	3	10.7	10.7	10.7
	USA	2	7.1	7.1	17.9
	Chinese	12	42.9	42.9	60.7
	Saudi Arabia	2	7.1	7.1	67.9
	Yemen	2	7.1	7.1	75.0
	Turkish	2	7.1	7.1	82.1
	Others	5	17.9	17.9	100.0
	Total	28	100.0	100.0	

Source: Field survey (own), 2025

Table 4.2 illustrates the nationality of the parent companies of the 28 respondents. The distribution of parent company nationalities reveals a significant dominance of Chinese investment within the sample, alongside a diverse representation from other regions.

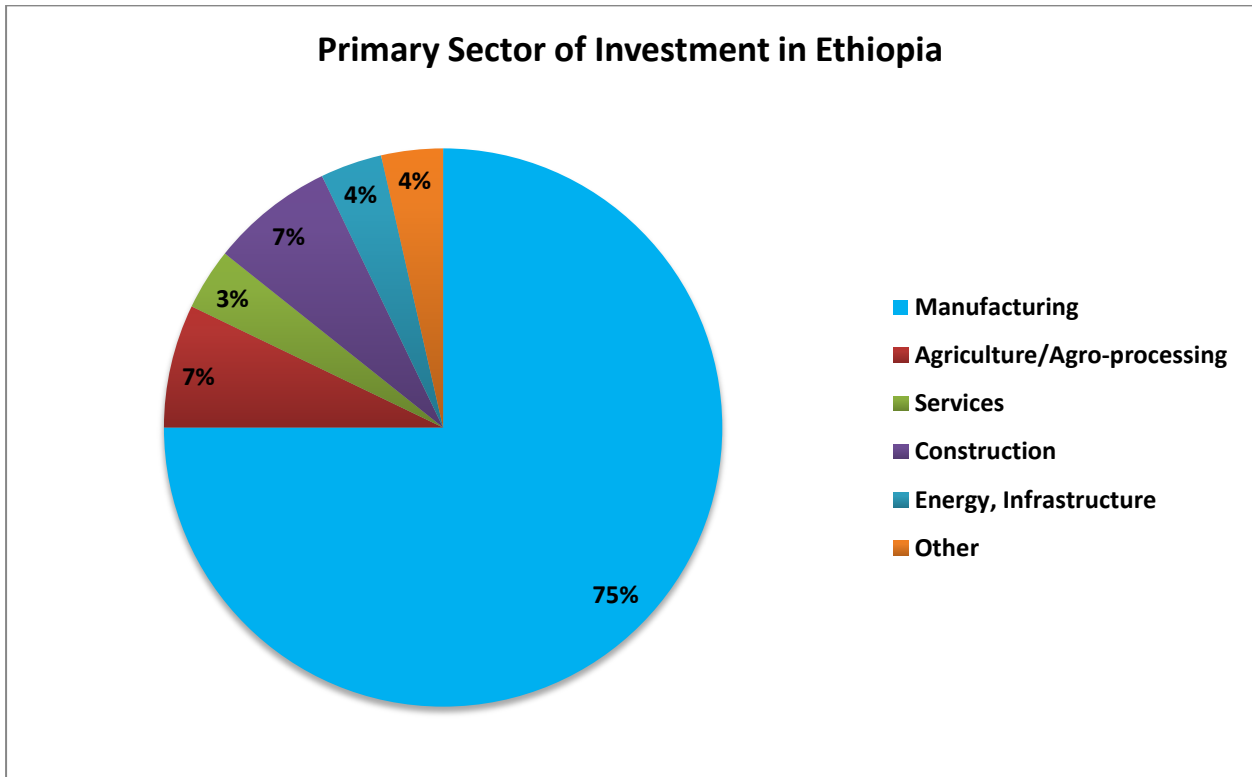
- Chinese parent companies constitute the largest single group, accounting for **12 out of 28 respondents (42.9%)**. This is a substantial proportion, indicating that Chinese FDI plays a very significant role in the segment of foreign investors surveyed. This aligns with broader trends of increasing Chinese investment in African economies, including Ethiopia.
- The sample also includes representation from North America (Canadian: 10.7%, USA: 7.1%) and the Middle East (Saudi Arabia: 7.1%, Yemen: 7.1%). Turkish companies also contribute 7.1%. This diversity ensures that the perspectives on tax incentives are not solely from one geopolitical or economic bloc.

- The "Others" category, representing 17.9% (5 respondents), suggests that there are investments from other countries like Indian, and Belize. This further underscores the varied sources of FDI in Ethiopia.

In General, the data on the nationality of parent companies provides a valuable demographic context for my study. The dominance of Chinese investment, coupled with representation from diverse other nations, offers a rich, albeit concentrated, set of perspectives on the impact of tax incentives on FDI in Ethiopia. This profile will be considered when interpreting the subsequent findings and formulating policy recommendations.

4.2.3. Primary Sector of Investment in Ethiopia

Graph: 4.2 Primary Sector of Investment in Ethiopia



Source: Field survey (own), 2025

The above Graph 4.3 illustrates the primary sector of investment in Ethiopia for the 28 respondents. The distribution of investment sectors reveals an overwhelming concentration in the manufacturing sector within the sample.

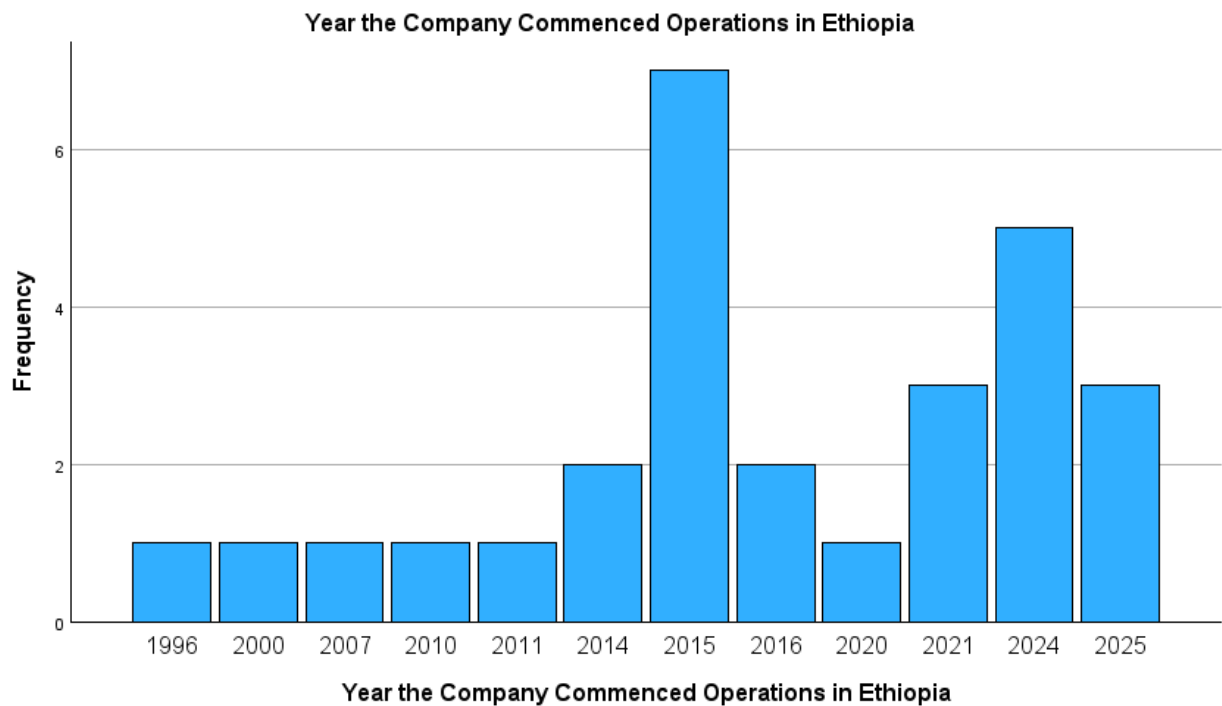
- A remarkable **21 out of 28 respondents (75.0%)** are primarily invested in the manufacturing sector. This indicates that the vast majority of the foreign investors (or companies employing Ethiopians for foreign companies) surveyed are engaged in manufacturing activities in Ethiopia. This aligns with Ethiopia's strategic focus on industrialization and attracting FDI into manufacturing, often facilitated by industrial parks and associated incentives.
- All other sectors (Agriculture/Agro-processing, Services, Construction, Energy, Infrastructure, and Other) have very limited representation, each accounting for

only 1 or 2 respondents. This means their specific insights, while valuable, cannot be generalized for their respective sectors.

In conclusion, the overwhelming majority of respondents being from the manufacturing sector provide a highly focused and credible dataset for understanding the impact of tax incentives on manufacturing FDI in Ethiopia. While this strengthens the depth of analysis for this critical sector, it also implies that the findings may not be broadly generalizable to other investment sectors within the country.

4.2.4. Year the Company Commenced Operations in Ethiopia

Graph: 4.3 Year the Company Commenced Operations in Ethiopia



Source: Field survey (own), 2025

The above Graph 4.4 illustrates the year the respondent companies commenced operations in Ethiopia. The distribution of commencement years reveals a diverse range of operational tenures, with a noticeable clustering of investments in certain periods, particularly in recent years.

- **Significant Recent Influx (2015-2025):** A substantial majority of the companies (20 out of 28, or approximately **71.4%**) commenced operations in or after 2015.
 - **2015** stands out as a peak year, with 7 companies (25.0%) starting operations.
 - **2024** also shows a strong recent influx with 5 companies (17.9%).
 - **2021** (3 companies, 10.7%) and **2025** (3 companies, 10.7%) further contribute to this recent trend.
- A smaller, but significant, portion of the companies (8 out of 28, or approximately 28.6%) have a longer history in Ethiopia, commencing operations between 1996 and 2014. This includes some very long-standing investments (1996, 2000, 2007).
- The data suggests that FDI in Ethiopia is not a singular event but has occurred in waves, with a notable acceleration in the mid-2010s and a continued strong presence in the early 2020s.

In General, the distribution of company commencement years provides a rich temporal context for the study. The strong representation of recent investments, coupled with a presence of long-standing firms, allows for a nuanced understanding of how tax incentives have influenced FDI across different periods in Ethiopia's economic development. This enhances the depth and relevance of the research findings.

4.2.5. Approximate initial value of direct investment in Ethiopia (in USD equivalent)

Table 4.2: Initial value of direct investment in Ethiopia (in USD equivalent)

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Less than \$1 Million	8	28.6	28.6	28.6
	\$1 Million - \$5 Million	9	32.1	32.1	60.7
	\$5 Million - \$20 Million	5	17.9	17.9	78.6
	More than \$20 Million	6	21.4	21.4	100.0
	Total	28	100.0	100.0	

Source: Field survey (own), 2025

As it is illustrated above, The distribution of initial investment values indicates a diverse range of FDI sizes within the sample, with a notable concentration in the small to medium-sized investment categories, but also a significant presence of larger investments.

- The majority of the investments fall within the "Less than \$1 Million" and "\$1 Million - \$5 Million" categories. Combined, these represent **17 out of 28 respondents (60.7%)**. This suggests that a significant portion of the foreign direct investment in Ethiopia, at least within our sample, originates from smaller-scale projects.
- Despite the concentration at the lower end, there is a substantial presence of larger investments:
 - "\$5 Million - \$20 Million": 5 respondents (17.9%)
 - "More than \$20 Million": 6 respondents (21.4%) The "More than \$20 Million" category, representing over one-fifth of the sample, indicates that the study also captures insights from significant capital inflows.
- The sample provides a relatively balanced representation across different investment scales, allowing for insights into how tax incentives might appeal to or impact companies with varying capital commitments.

In conclusion, the distribution of initial investment values provides valuable context for understanding the varied motivations and sensitivities of foreign investors in Ethiopia. The presence of both smaller and larger investments in the sample allows for a more comprehensive analysis of how tax incentives influence FDI decisions across different capital commitments, providing nuanced insights for policy recommendations.

4.3. Awareness and Understanding of Tax Incentives

4.3.1. Awareness of the various tax incentives currently offered to foreign investors in Ethiopia.

Table 4.3: Are you aware of the various tax incentives currently offered to foreign investors in Ethiopia?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	21	75.0	75.0	75.0
	No	7	25.0	25.0	100.0
	Total	28	100.0	100.0	

Source: Field survey (own), 2025

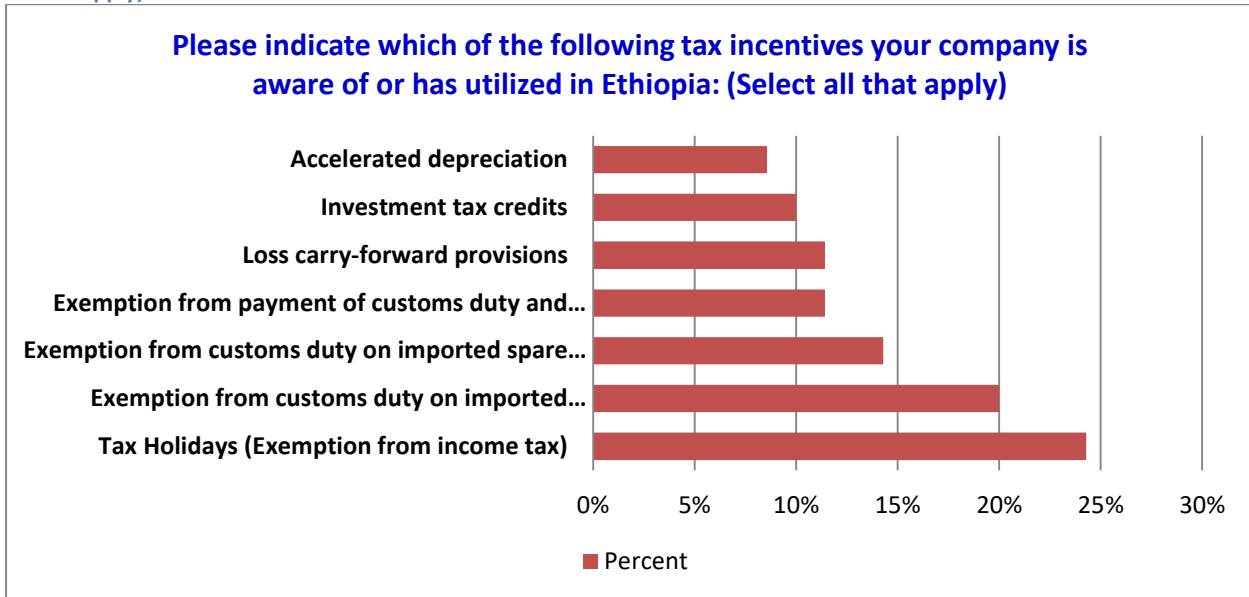
Table 4.6 illustrate the responses to the question: "Are you aware of the various tax incentives currently offered to foreign investors in Ethiopia?" The data indicates that a significant majority of foreign investors and their representatives in the sample are aware of the tax incentives offered in Ethiopia.

- Three-quarters of the respondents (75%) confirmed their awareness of the various tax incentives. This is a positive finding, suggesting that the government's efforts to communicate these incentives are reaching a substantial portion of the target audience. Given that these respondents are primarily CEOs/GMs, Finance Directors/Managers, and Senior Accountants, this high awareness among key decision-makers is crucial.
- Despite the high overall awareness, a notable 25% of respondents indicated that they are **not** aware of the various tax incentives. This represents a significant quarter of the sample, highlighting a persistent gap in information dissemination or understanding.

While a significant majority of foreign investors in the sample are aware of Ethiopia's tax incentives, a notable awareness gap persists. This finding underscores the importance of effective communication for incentive policies to have their intended impact on attracting and retaining Foreign Direct Investment. The research can now investigate deeper into the perceived effectiveness of these incentives among the informed majority, while also highlighting the need to address the existing awareness deficit.

4.3.2. Tax incentives awareness or utilization in Ethiopia:

Graph: 4.4 please indicate which of the following tax incentives your company is aware of or has utilized in Ethiopia: (Select all that apply)



Source: Field survey (own), 2025

Graph 4.7 displays the frequency and percentage of respondents who are aware of or have utilized specific tax incentives offered to foreign investors in Ethiopia. It's crucial to note that this was a "Select all that apply" question, meaning respondents could indicate awareness/utilization of multiple incentives. Therefore, the total frequency (70) is greater than the total number of respondents (28), and the percentages are based on the total number of selections made (70).

The data clearly indicates that certain tax incentives are significantly more recognized or utilized by foreign investors in Ethiopia than others.

- **Most Prominent Incentives:**

- **Tax Holidays (Exemption from income tax)** is the most frequently selected incentive, accounting for 24% of all responses. This suggests it is either the most widely known or the most commonly utilized incentive.
- **Exemption from customs duty on imported capital goods** follows closely, with 20% of responses. This is a highly relevant incentive for manufacturing and other capital-intensive sectors.

- **Mid-Range Incentives:**
 - Exemption from customs duty on imported spare parts (for initial investment) (14%) shows moderate awareness/utilization.
- **Less Prominent Incentives:**
 - Exemption from customs duty on imported raw materials for export-oriented investments (11%) and Loss carry-forward provisions (11%) are less frequently cited.
 - Investment tax credits (10%) and Accelerated depreciation (9%) are the least selected incentives.

This distribution suggests that direct, upfront financial benefits (like income tax holidays and duty exemptions on capital goods) are more widely recognized or leveraged by investors compared to more complex or indirect tax benefits (like accelerated depreciation or investment tax credits).

In conclusion, the data highlights that tax holidays and customs duty exemptions on imported capital goods are the most recognized and utilized tax incentives by foreign investors in Ethiopia, particularly within the dominant manufacturing sector. The lower awareness/utilization of other incentives suggests potential areas for improved communication or a re-evaluation of their perceived value by investors. This understanding is crucial for assessing the effectiveness of Ethiopia's tax incentive system and informing future policy adjustments.

4.3.3. Clarity and Ease of Understanding of Tax Incentive Eligibility Criteria

Table 4.4: To what extent do you find the eligibility criteria for these tax incentives clear and easy to understand?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not at all clear	2	7.1	7.1	7.1
	Slightly clear	1	3.6	3.6	10.7
	Moderately clear	12	42.9	42.9	53.6
	Mostly clear	9	32.1	32.1	85.7
	Very clear	4	14.3	14.3	100.0
	Total	28	100.0	100.0	

Source: Field survey (own), 2025

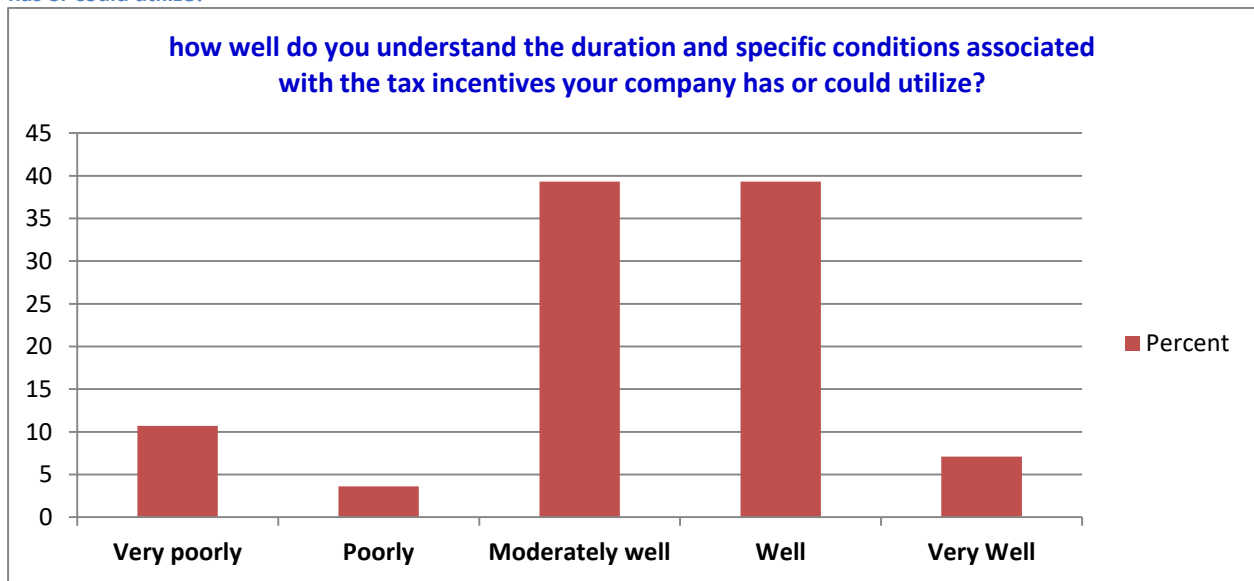
Table 4.8 above illustrates the responses to the question: "To what extent do you find the eligibility criteria for these tax incentives clear and easy to understand?" The data indicates a mixed perception regarding the clarity and ease of understanding of tax incentive eligibility criteria, with a leaning towards moderate to high clarity, but also a notable segment finding it less than clear.

- A combined **89.3%** of respondents (42.9% Moderately clear + 32.1% Mostly clear + 14.3% Very clear) find the eligibility criteria to be at least "moderately clear." This suggests that for most investors, the criteria are not entirely opaque.
- The largest single response category is "Moderately clear" (42.9%). This is a crucial finding, as "moderately" implies that while there is some understanding, there might still be areas of ambiguity, complexity, or difficulty that prevent it from being "mostly" or "very" clear.
- A combined **10.7%** of respondents (7.1% Not at all clear + 3.6% Slightly clear) find the eligibility criteria to be unclear. While a minority, this segment represents investors who likely face significant hurdles in accessing or utilizing incentives due to a lack of understanding.

This distribution suggests that while the criteria are not completely incomprehensible, there is substantial room for improvement in making them more straightforward and transparent. In conclusion, while a majority of respondents find Ethiopia's tax incentive eligibility criteria at least moderately clear, the significant proportion finding it only "moderately clear" or even "not at all clear" highlights a critical area for improvement. Enhancing the clarity and ease of understanding of these criteria is essential to maximize the effectiveness of tax incentives in attracting and facilitating Foreign Direct Investment in Ethiopia.

4.3.4. Understanding of Duration and Specific Conditions of Tax Incentives

Graph: 4.5 how well do you understand the duration and specific conditions associated with the tax incentives your company has or could utilize?



Source: Field survey (own), 2025

The above Graph 4.9 illustrates the responses to the question: "How well do you understand the duration and specific conditions associated with the tax incentives your company has or could utilize?" The data indicates a mixed level of understanding regarding the duration and specific conditions of tax incentives, with a significant portion understanding them "moderately well" or "well," but also a notable segment with poor understanding.

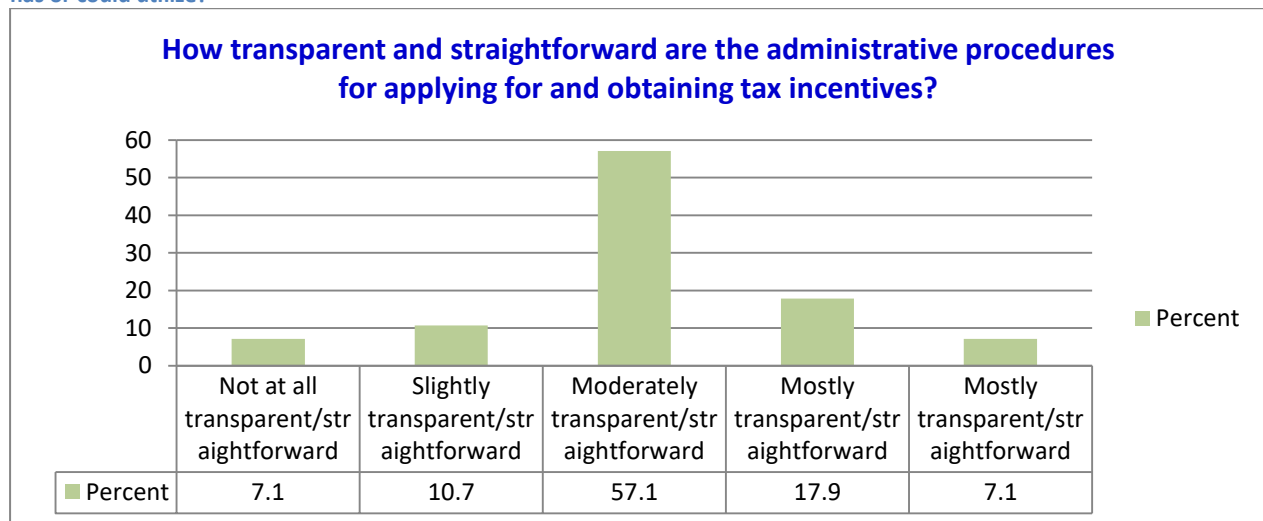
- The responses show a somewhat bimodal distribution, with the two largest categories being "Moderately well" (39.3%) and "Well" (39.3%). Combined, these represent **78.6%** of the respondents, suggesting that a large majority have at least a reasonable grasp of these details.
- However, a combined **14.3%** of respondents (10.7% Very poorly + 3.6% Poorly) admit to understanding the duration and specific conditions poorly or very poorly. This is a considerable segment, indicating a critical lack of clarity for some investors.

- Only a small minority (7.1%) claim to understand these aspects "Very Well," suggesting that a comprehensive and deep understanding is not widespread.

This distribution implies that while a majority can navigate the conditions to some extent, there are persistent challenges in achieving full clarity and widespread deep understanding, especially concerning the nuanced details of duration and specific targeting. In general, while a majority of foreign investors in the sample have at least a moderate understanding of the duration and specific conditions of tax incentives, a notable segment struggles with this crucial information. This lack of comprehensive understanding poses a risk to the effective utilization of incentives and can undermine long-term investment planning. Improving the clarity and accessibility of detailed information on incentive conditions is paramount for Ethiopia to maximize the impact of its FDI attraction policies.

4.3.5. Transparency and Straightforwardness of Administrative Procedures for Tax Incentives

Graph: 4.6 how well do you understand the duration and specific conditions associated with the tax incentives your company has or could utilize?



Source: Field survey (own), 2025

As it can be seen in the Graph 4.10 above the responses to the question: "How transparent and straightforward are the administrative procedures for applying for and obtaining tax incentives?" shows; The data indicates that while a majority of respondents

find the administrative procedures for tax incentives to be at least "moderately" transparent and straightforward, a significant portion still perceives challenges.

- The largest single category is "Moderately transparent/straightforward," accounting for **57.1%** of the responses. This suggests that for most investors, the process is not entirely opaque or overly complex, but it is also not fully clear or simple. There is a middle ground where improvements are likely needed.
- A combined **25.0%** of respondents (17.9% + 7.1% from the two "Mostly" entries) perceive the procedures as "Mostly transparent/straightforward." This is a positive sign, indicating that for a quarter of the sample, the process is relatively clear.
- A notable **17.8%** of respondents (7.1% "Not at all transparent/straightforward" + 10.7% "Slightly transparent/straightforward") find the procedures to be lacking in transparency and straightforwardness. This segment likely faces considerable bureaucratic hurdles and frustration.

This distribution suggests that while some progress may have been made in simplifying administrative procedures, there is still significant room for improvement to enhance overall investor experience and reduce friction in accessing incentives. Overall, while a majority of respondents find the administrative procedures for tax incentives in Ethiopia to be "moderately" transparent and straightforward, a notable portion still faces significant challenges. This highlights that bureaucratic hurdles and a lack of full transparency in the application and obtaining process remain a critical impediment to maximizing the impact of tax incentives on Foreign Direct Investment. Addressing these procedural complexities is crucial for Ethiopia to translate its incentive policies into tangible investment inflows and foster a more attractive investment climate.

4.4. Perceptions of Attractiveness and Effectiveness

4.4.1. Attractiveness of Ethiopia's Tax Incentive System

Table 4.5: Ethiopia's tax incentive system is generally attractive to foreign investors

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Disagree	2	7.1	7.1	7.1
	Disagree	7	25.0	25.0	32.1
	Neutral	5	17.9	17.9	50.0
	Agree	12	42.9	42.9	92.9
	Strongly Agree	2	7.1	7.1	100.0
	Total	28	100.0	100.0	

Source: Field survey (own), 2025

Table 4.11 illustrates the responses to the statement: "Ethiopia's tax incentive system is generally attractive to foreign investors." The data reveals a divided, yet cautiously optimistic, perception regarding the general attractiveness of Ethiopia's tax incentive system to foreign investors.

- A combined **50.0%** of respondents (42.9% Agree + 7.1% Strongly Agree) perceive Ethiopia's tax incentive system as generally attractive. This represents exactly half of the sample, indicating that for a significant portion of investors, the incentives are indeed a draw.
- A substantial **32.1%** of respondents (7.1% Strongly Disagree + 25.0% Disagree) do *not* find the system generally attractive. This is a considerable minority, highlighting that for nearly one-third of the investors, the incentives are not compelling enough.
- A notable **17.9%** of respondents chose "Neutral." This group is undecided, suggesting they may find some aspects attractive and others unattractive, or they may lack sufficient information to form a strong opinion.

This distribution indicates that while the system holds appeal for half of the surveyed investors, it faces considerable skepticism and ambivalence from the other half. It is not universally perceived as highly attractive. In conclusion, Ethiopia's tax incentive system is perceived as generally attractive by half of the surveyed foreign investors, which is a

positive starting point. However, the significant proportion of investors who find it unattractive or are neutral indicates that there are considerable challenges in its design, communication, or implementation that limit its full potential to attract and retain FDI. Addressing issues related to clarity, administrative straightforwardness, and potentially the nature of the incentives themselves is crucial for Ethiopia to enhance its competitiveness as an FDI destination.

4.4.2. Effectiveness of Tax Incentives in Encouraging New FDI Inflows

Table 4.6: Tax incentives in Ethiopia have been effective in encouraging new FDI inflows

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Disagree	7	25.0	25.0	25.0
	Neutral	8	28.6	28.6	53.6
	Agree	13	46.4	46.4	100.0
	Total	28	100.0	100.0	

Source: Field survey (own), 2025

The above Table 4.12 illustrates the responses to the statement: "Tax incentives in Ethiopia have been effective in encouraging new FDI inflows." The data indicates a mixed, but slightly positive, perception regarding the effectiveness of tax incentives in encouraging new FDI inflows.

- A plurality of respondents, **46.4%**, "Agree" that tax incentives have been effective. This is the largest single response category, suggesting a notable portion of investors believe in the positive impact of these incentives.
- A substantial **28.6%** of respondents chose "Neutral." This group is undecided, indicating uncertainty, a lack of clear evidence, or a belief that the impact is not significant enough to warrant a definitive "Agree" or "Disagree."
- A significant **25.0%** of respondents "Disagree" that tax incentives have been effective. This quarter of the sample holds a negative view on the efficacy of these incentives.

This distribution suggests that while nearly half of the investors perceive effectiveness, a combined 53.6% (Neutral + Disagree) are either unconvinced or actively believe they

are not effective, highlighting a considerable gap in perceived impact. In conclusion, the data indicates that Ethiopia's tax incentives are perceived as effective in encouraging new FDI inflows by a plurality of respondents, which is a positive sign. However, the substantial proportion of investors who are either neutral or disagree highlights that the incentives' impact is not universal and is likely constrained by issues related to clarity, administrative processes, and potentially the overwhelming influence of non-tax factors on investment decisions. This necessitates a comprehensive review and targeted improvements to maximize the efficacy of Ethiopia's FDI attraction strategy.

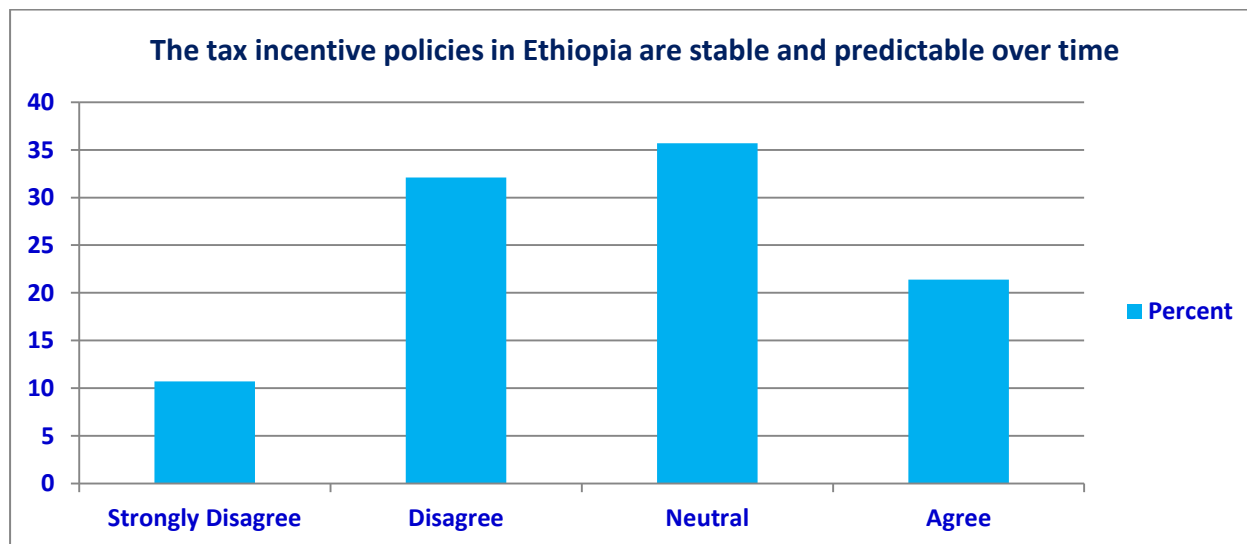
4.4.3. Stability and Predictability of Tax Incentive Policies

Table 4.7: The tax incentive policies in Ethiopia are stable and predictable over time

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Disagree	3	10.7	10.7	10.7
	Disagree	9	32.1	32.1	42.9
	Neutral	10	35.7	35.7	78.6
	Agree	6	21.4	21.4	100.0
	Total	28	100.0	100.0	

Source: Field survey (own), 2025

Graph: 4.7 the tax incentive policies in Ethiopia are stable and predictable over time



Source: Field survey (own), 2025

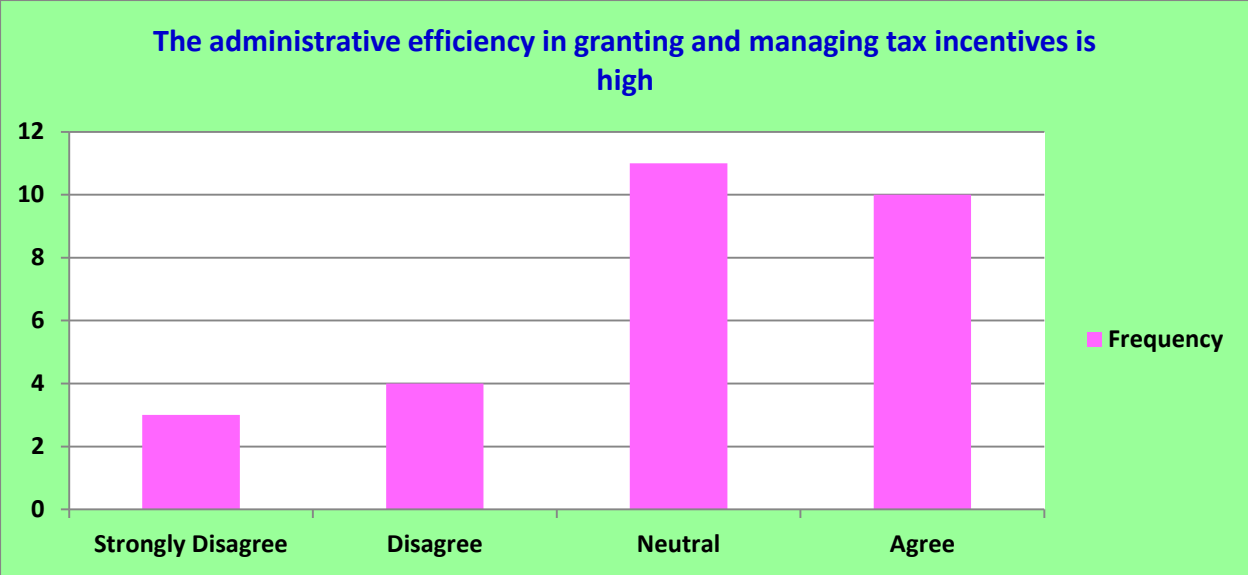
Table and Graph 4.13 shows the responses to the statement: "The tax incentive policies in Ethiopia are stable and predictable over time." The data reveals a concerning perception regarding the stability and predictability of Ethiopia's tax incentive policies, with a strong leaning towards instability and unpredictability.

- A combined **42.8%** of respondents (10.7% Strongly Disagree + 32.1% Disagree) explicitly believe that tax incentive policies are *not* stable and predictable. This is the largest combined sentiment.
- The single largest category is "Neutral," accounting for **35.7%** of the responses. This indicates widespread uncertainty or a lack of strong conviction about the long-term consistency of these policies. When combined with the "Disagree" responses, a significant **78.5%** of the sample is either negative or ambivalent about policy stability.
- Only a small minority, **21.4%**, "Agree" that the policies are stable and predictable. This is less than half of those who disagree or are neutral.

This distribution clearly indicates that the stability and predictability of tax incentive policies are a significant concern for foreign investors in Ethiopia. In conclusion, the data strongly indicates that the stability and predictability of Ethiopia's tax incentive policies are a major concern for foreign investors. This lack of perceived long-term consistency undermines the overall attractiveness and effectiveness of the incentives and poses a significant barrier to attracting and retaining sustainable Foreign Direct Investment. Addressing this fundamental issue through robust legislative frameworks, consistent implementation, and clear communication is paramount for Ethiopia to build a truly investor-friendly environment.

4.4.4. Administrative Efficiency in Granting and Managing Tax Incentives

Graph: 4.8 the administrative efficiency in granting and managing tax incentives is high



Source: Field survey (own), 2025

Table 4.14 illustrates the responses to the statement: "The administrative efficiency in granting and managing tax incentives is high." The data reveals a mixed perception regarding the administrative efficiency of tax incentives, with a significant portion of respondents being neutral, and a notable segment expressing disagreement.

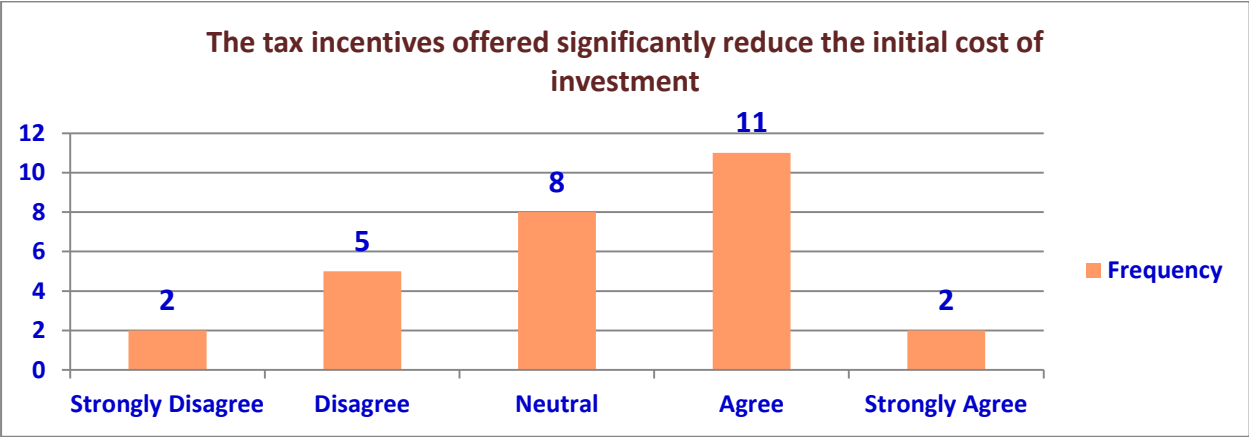
- The single largest category is "Neutral," accounting for **39.3%** of the responses. This indicates widespread uncertainty or a lack of strong conviction about the efficiency of the administrative processes. It could also suggest inconsistent experiences among investors.
- A combined **25.0%** of respondents (10.7% Strongly Disagree + 14.3% Disagree) explicitly believe that administrative efficiency is *not* high. This quarter of the sample highlights significant challenges in the practical implementation of incentives.
- A notable **35.7%** of respondents "Agree" that administrative efficiency is high. This group has likely experienced relatively smooth processes.

This distribution indicates that while a portion of investors finds the administrative processes efficient, a larger segment is either ambivalent or actively dissatisfied, pointing to a significant area for improvement. In General, the data indicates that administrative

efficiency in granting and managing tax incentives in Ethiopia is not universally perceived as high, with a large segment of investors remaining neutral or expressing dissatisfaction. This highlights a significant "implementation gap" where bureaucratic inefficiencies can undermine the intended positive impact of tax incentives on Foreign Direct Investment. Prioritizing administrative reforms focused on streamlining processes, digitalization, and enhancing transparency is crucial for Ethiopia to create a truly investor-friendly environment and maximize the effectiveness of its FDI attraction policies.

4.4.5. The tax incentives offered significantly reduce the initial cost of investment

Graph: 4.9 the tax incentives offered significantly reduce the initial cost of investment



Source: Field survey (own), 2025

Graph 4.15 present the respondents' views on whether Ethiopia's tax incentives significantly reduce the initial cost of their investment. The findings reveal a mixed but leaning-positive perception, indicating that while these incentives are helpful for many, their impact is not universally seen as significant.

- A plurality of respondents acknowledged the cost-reducing benefit of the incentives. A combined **46.4%** of investors either '**Agree**' (**39.3%**) or '**Strongly Agree**' (**7.1%**) that the incentives significantly lower initial costs. This finding is crucial as it suggests that for nearly half of the businesses surveyed, key incentives like the exemption from customs duty on imported capital goods and spare parts

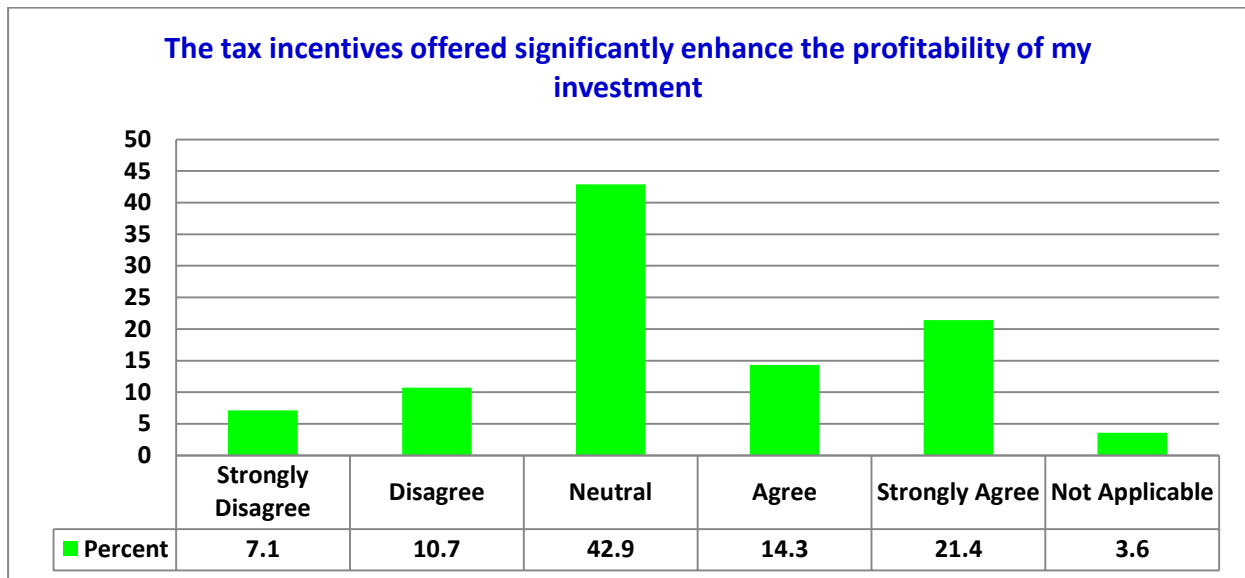
are effectively easing the initial financial burden required to establish their operations in Ethiopia.

- A remarkably large group of respondents (**28.6%**) selected '**Neutral**'. This is the second-largest category, implying that for over a quarter of investors, the effect of tax incentives on initial costs is either marginal, unclear, or offset by other substantial start-up expenses not covered by the incentive scheme. This neutrality suggests the reduction may not be as "significant" as policymakers intend for a large segment of the investment community.
- A combined **25.0%** of respondents expressed disagreement (**17.9%** '**Disagree**' and **7.1%** '**Strongly Disagree**'). This means that for a full quarter of the companies, the incentives fail to provide a meaningful reduction in their initial investment costs. This could point to gaps in the incentive structure, where certain essential initial costs are not covered, or to practical challenges in accessing these benefits which diminish their value.

In conclusion, while Ethiopia's tax incentives are perceived by a plurality of investors as helpful in reducing the initial capital outlay, their effectiveness is not universally acclaimed. The substantial number of neutral and disagreeing responses indicates that the impact is inconsistent. For many businesses, the benefits may be too modest to be considered "significant" or are diluted by other administrative and logistical costs. This suggests that while the current incentives targeting initial costs are a positive feature, there may be a need to review their scope and implementation to enhance their impact and ensure they provide a more compelling and widely felt advantage for foreign investors.

4.4.6. The tax incentives offered significantly enhances profitability

Graph: 4.10 the tax incentives offered significantly enhance the profitability of my investment



Source: Field survey (own), 2025

Graph 4.16 illustrate respondents' perceptions of whether Ethiopia's tax incentives significantly enhance the profitability of their investments. The results are highly revealing, pointing towards a significant level of uncertainty and a polarized view among investors. One respondent (3.6%) found the question "Not Applicable," likely because their company is not yet at an operational or profit-generating stage. The analysis below focuses on the 27 respondents who provided a substantive rating.

- The most striking finding is the dominant "Neutral" response, chosen by **12 respondents (42.9%)**. This represents the largest single group and suggests that a substantial portion of foreign investors do not perceive a *significant* enhancement to their profitability from tax incentives. This neutrality could stem from several factors: the benefits of incentives like tax holidays may be perceived as being negated by high operational costs, market access challenges, or the difficult macroeconomic environment in Ethiopia, including inflation and foreign exchange shortages. It may also imply that while the incentives are helpful, their effect is not substantial enough to be considered a "significant" driver of profitability.

- Despite the high neutrality, a considerable group perceives a positive impact. A combined **35.7%** of respondents either "**Agree**" (**14.3%**) or "**Strongly Agree**" (**21.4%**). This indicates that for over a third of the investors, incentives such as income tax holidays are indeed translating into a healthier bottom line. The strong showing in the "Strongly Agree" category, in particular, suggests that for a specific segment of firms, the incentives are a powerful and effective tool for boosting profits.
- A smaller but still notable segment expressed a negative view. A combined **17.8%** of respondents either "**Disagree**" (**10.7%**) or "**Strongly Disagree**" (**7.1%**). For this group, the tax incentives are failing to enhance profitability. This could be because the duration of their incentives has expired, or the incentives do not adequately address the primary factors constraining their profitability.

In conclusion, the impact of tax incentives on investment profitability is met with considerable ambiguity and divided opinion. While they are a clear benefit for a significant group of investors, the largest cohort remains unconvinced of their *significant* positive effect. This widespread neutrality suggests that tax incentives alone are not a silver bullet for ensuring investor profitability in Ethiopia. Their effectiveness appears to be heavily mediated by the broader operational and economic challenges on the ground. For policy, this implies that while incentives are an important part of the value proposition, their power to boost profitability is limited unless accompanied by improvements in the overall business environment.

4.5. Influence of Factors on Investment Decisions

This section shifts the focus from the perceived effectiveness of tax incentives to their direct influence on the initial decision to invest in Ethiopia. It seeks to understand how critical these incentives are when companies are first evaluating the country as a potential investment destination.

4.5.1. The importance of Tax incentives in decision to invest in Ethiopia

Table 4.8: The importance of Tax incentives in your company's decision to invest in Ethiopia

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Slightly Important	3	10.7	10.7	10.7
	Moderately Important	5	17.9	17.9	28.6
	Important	12	42.9	42.9	71.4
	Extremely Important	8	28.6	28.6	100.0
	Total	28	100.0	100.0	

Source: Field survey (own), 2025

Table 4.17 provide a clear and compelling picture of the role tax incentives play in the initial decision-making process for foreign investors considering Ethiopia. The data reveals that tax incentives are a highly significant factor in attracting Foreign Direct Investment.

- The most significant finding is that a vast majority of respondents consider tax incentives to be a crucial element of their decision to invest. A combined **71.5%** of respondents rated the incentives as either '**Important**' (**42.9%**) or '**Extremely Important**' (**28.6%**). This demonstrates that for nearly three-quarters of the firms surveyed, the availability of tax benefits was a major consideration in their decision to enter the Ethiopian market.
- The **28.6%** of investors who rated incentives as 'Extremely Important' underscores that for more than a quarter of firms, these benefits are likely a make-or-break condition. This suggests that without the promise of tax incentives, Ethiopia would likely not have secured these investments, highlighting the powerful role of incentives in competing for global capital.
- The largest single group (**42.9%**) rated the incentives as 'Important'. This suggests that for a plurality of investors, tax incentives are a significant and expected part

of the investment package, considered alongside other key factors like market potential, political stability, and labor costs, rather than being the single overriding determinant.

- A smaller, combined **28.6%** of respondents viewed the incentives as only 'Moderately Important' (17.9%) or 'Slightly Important' (10.7%). This indicates that for this segment of investors, other strategic factors were the primary drivers of their investment decision, with tax incentives being a secondary or "nice-to-have" benefit.

In conclusion, the findings from this section are unequivocal: **tax incentives are a critical tool in attracting foreign direct investment to Ethiopia.** The promise of these benefits plays a vital role in the *ex-ante* (pre-investment) decision-making calculus for a vast majority of investors. This result presents an interesting contrast to the more mixed perceptions of the *ex-post* (post-investment) impact on profitability and cost reduction seen in previous sections. It suggests that while the *promise* of incentives is highly effective at attracting investors, their *practical implementation and actual impact* are met with more varied experiences. Nonetheless, the data confirms that tax incentives are a cornerstone of Ethiopia's FDI attraction strategy and are perceived as a highly important factor by the very investors they are designed to attract.

4.5.2. The importance of Market size and growth potential in decision to invest in Ethiopia

Table 4.9: Please rate the importance of the following factors in your company's decision to invest in Ethiopia: [Market size and growth potential]

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Slightly Important	2	7.1	7.1	7.1
	Moderately Important	2	7.1	7.1	14.3
	Important	10	35.7	35.7	50.0
	Extremely Important	14	50.0	50.0	100.0
	Total	28	100.0	100.0	

Source: Field survey (own), 2025

Table 4.18 assess the importance of Ethiopia's market size and growth potential as a determinant for foreign investment. The results indicate that this factor is of paramount importance, arguably surpassing that of tax incentives in the initial investment decision.

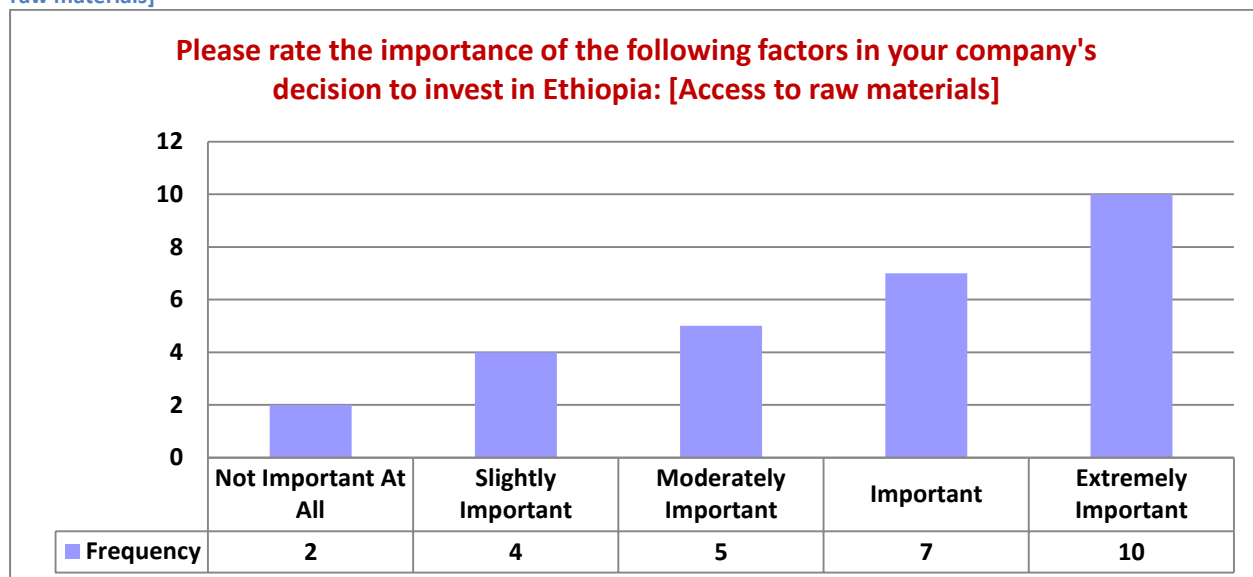
- The data shows an overwhelming consensus on the importance of market fundamentals. A combined **85.7%** of respondents rated market size and growth potential as either 'Important' (**35.7%**) or 'Extremely Important' (**50.0%**). This figure is substantially high, indicating that the core economic appeal of Ethiopia is a primary driver for FDI.
- Crucially, the single most frequent response was 'Extremely Important,' selected by exactly half of the respondents (**50.0%**). This powerful result elevates market potential from merely a significant factor to a critical, top-tier consideration for investors. It suggests that for a majority of firms, the fundamental business case for investing in Ethiopia is built upon the prospect of accessing its large and growing domestic market.
- When compared to the findings on tax incentives (Table 17), where 71.5% of respondents rated them as 'Important' or 'Extremely Important', the 85.7% rating for market size reveals a key insight. While policy-driven incentives are clearly vital, fundamental economic factors like market potential are perceived as even more critical. This aligns with established investment theory, which posits that investors are primarily drawn to markets that promise returns, with incentives often serving as a secondary factor to differentiate between locations with similar market potential. Ethiopia's status as one of Africa's most populous nations is a clear and compelling draw.
- Only a small fraction of investors (**14.2%** combined) rated this factor as 'Slightly' or 'Moderately' important. This minority likely represents purely export-oriented firms for whom the domestic market is of little to no consequence. However, their small number reinforces the conclusion that most foreign investment in the sample is, at least in part, market-seeking.

In conclusion, Ethiopia's large market size and its perceived potential for future growth are a cornerstone of its appeal to foreign investors. This factor is rated as extremely important by a majority of firms and appears to be a more fundamental investment driver than even the generous tax incentives offered. The findings suggest that investors

are making a long-term bet on the Ethiopian economy and its consumer base. The role of policy, therefore, is not just to offer incentives, but to ensure a stable and predictable environment where this market potential can be fully realized.

4.5.3. The importance of Access to raw materials in decision to invest in Ethiopia

Graph: 4.11 please rate the importance of the following factors in your company's decision to invest in Ethiopia: [Access to raw materials]



Source: Field survey (own), 2025

Graph 4.19 and its accompanying assess the importance of access to local raw materials as a factor in the decision to invest in Ethiopia. The findings show a polarized but overall positive importance, indicating that this factor is highly significant for a large segment of investors, though not universally critical for all.

- A clear majority of investors recognize the importance of local raw materials. A combined **60.7%** of respondents rated access to raw materials as either 'Important' (25.0%) or 'Extremely Important' (35.7%). The 'Extremely Important' category was the largest single response, highlighting that for over a third of the firms, sourcing local inputs is a core component of their business model and a primary reason for investing in Ethiopia.
- The polarized nature of the responses, which range from 'Not Important At All' to 'Extremely Important,' strongly suggests that the significance of this factor is highly

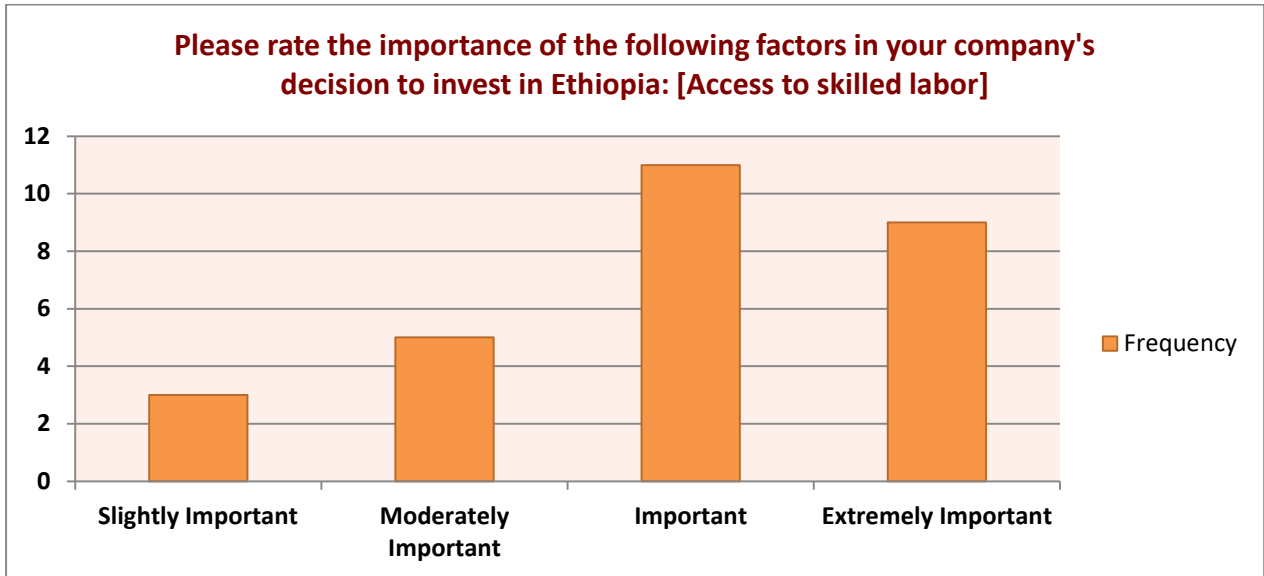
dependent on the investor's specific industry. Given that 75% of the survey respondents are in the **manufacturing sector**, this variability is logical. For investors in agro-processing (e.g., textiles, food production) or leather manufacturing, Ethiopia's agricultural and livestock resources are the central pillar of their investment. For these firms, access to raw materials is paramount.

- Conversely, a combined **21.4%** of respondents rated this factor as either '**Not Important At All**' (7.1%) or '**Slightly Important**' (14.3%). This group likely represents manufacturing sub-sectors that are reliant on imported components and materials, such as electronics assembly or certain chemical industries. For these investors, other factors like labor costs, tax incentives on imported goods, or domestic market access are the primary drivers.
- When ranking the investment drivers analyzed thus far, access to raw materials (60.7% rated as important/extremely important) is a significant factor but falls behind market size and growth potential (85.7%) and tax incentives (71.5%). This indicates that while Ethiopia's resource base is a major draw for a specific type of "resource-seeking" FDI, it is not as broadly influential across the entire investment landscape as market fundamentals and policy incentives.

In conclusion, access to local raw materials is a critical, make-or-break factor for a large and vital segment of foreign investors in Ethiopia, particularly those in resource-based manufacturing and agro-processing. However, unlike the near-universal importance of market size, its significance is not uniform across all industries. This finding highlights the diverse motivations for investing in the country, which attracts not only market-seeking firms but also a substantial number of resource-seeking ones. For policymakers, this underscores the dual importance of both safeguarding and improving the supply chains for local raw materials while also ensuring efficient import logistics for those industries that depend on them.

4.5.4. The importance of Access to skilled labor in decision to invest in Ethiopia

Graph: 4.12 please rate the importance of the following factors in your company's decision to invest in Ethiopia: [Access to skilled labor]



Source: Field survey (own), 2025

Graph 4.20 and its graph show the rated importance of access to skilled labor in the decision to invest in Ethiopia. The data reveals that human capital is a major consideration for foreign investors, ranking among the most critical factors influencing their investment decisions.

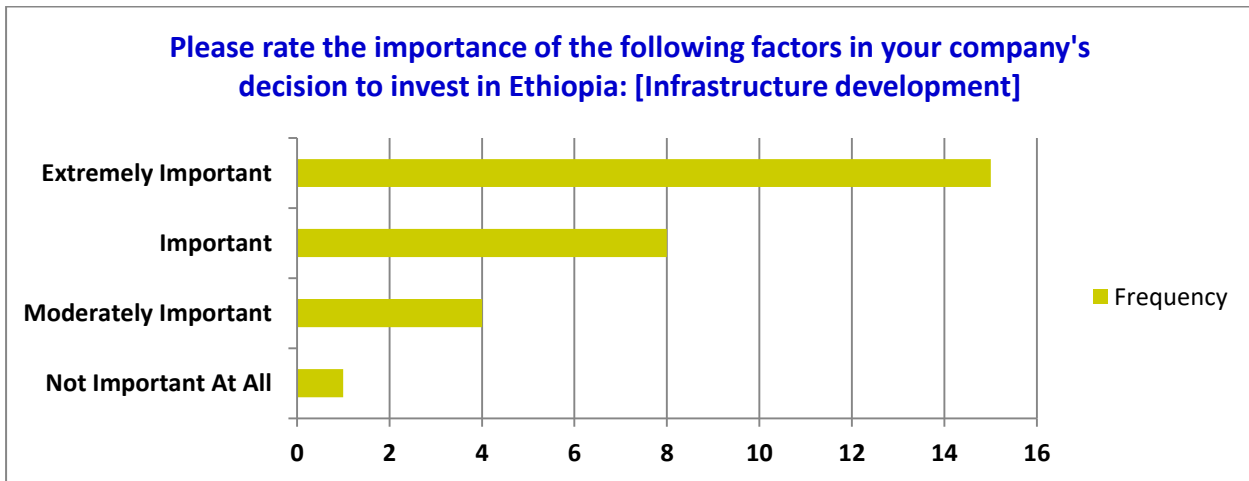
- The findings show a strong consensus on the need for a skilled workforce. A combined **71.4%** of respondents rated access to skilled labor as either '**Important**' (**39.3%**) or '**Extremely Important**' (**32.1%**). This large majority underscores that investors are acutely aware of their need for qualified personnel to ensure operational efficiency, quality control, and overall business success.
- With the respondent sample being heavily concentrated in the manufacturing sector (75%), this high rating is logical. Modern manufacturing, even in developing economies, requires a workforce with technical skills, managerial capabilities, and the ability to operate and maintain sophisticated machinery. The emphasis on this factor suggests that investors are looking beyond just low-cost labor and are actively seeking a productive and capable workforce.

- The importance rating of skilled labor (71.4%) is remarkably similar to that of tax incentives (71.5%). This is a critical finding, suggesting that for foreign investors, the quality of human capital is as significant a factor as the fiscal benefits offered by the government. It highlights that while financial incentives can attract investment, the availability of a competent workforce is equally crucial for the long-term viability of a project. Ranking behind only market size (85.7%), human capital stands as a top-tier investment driver.
- While Ethiopia is often promoted for its large and youthful population, this result points to a potential "skilled labor paradox." The high importance placed on skilled labor by investors often exists alongside documented challenges in finding sufficient numbers of experienced and technically proficient workers on the ground. Therefore, this rating reflects the *need* for skilled labor as a prerequisite for investment, rather than satisfaction with its current availability.

In conclusion, access to a skilled workforce is a critical determinant for Foreign Direct Investment in Ethiopia, with an importance that rivals that of tax incentives. This finding sends a clear message to policymakers: developing human capital through robust technical and vocational education and training (TVET) programs is as vital to a successful FDI strategy as offering financial incentives. To attract and, more importantly, retain high-quality investment that can move the economy up the value chain, a concurrent investment in the skills of the Ethiopian people is non-negotiable.

4.5.5. The importance of Infrastructure development in decision to invest in Ethiopia

Graph: 4.13 please rate the importance of the following factors in your company's decision to invest in Ethiopia: [Infrastructure development (e.g., roads, electricity, and internet)]



Source: Field survey (own), 2025

Graph 4.21 measure the importance of infrastructure—defined as roads, electricity, and internet—in the decision to invest in Ethiopia. The findings demonstrate that infrastructure is a foundational and overwhelmingly critical factor for foreign investors.

- The data reveals that infrastructure is of paramount importance. An overwhelming majority of **82.2%** of respondents rated infrastructure as either '**Important**' (**28.6%**) or '**Extremely Important**' (**53.6%**). Strikingly, 'Extremely Important' was the majority response, with over half of all investors citing it as a top-level consideration. This elevates infrastructure beyond a simple contributing factor to a fundamental prerequisite for investment.
- For a sample dominated by manufacturing firms, this result is expected but nonetheless powerful. Reliable infrastructure is the lifeblood of industrial operations. Consistent electricity is essential for running machinery and preventing costly production stoppages. An efficient network of roads is vital for the logistics of transporting raw materials to factories and moving finished goods to domestic or international markets. In the modern era, stable internet connectivity is indispensable for communication, administration, and supply chain management.

The high rating reflects that deficiencies in any of these areas can severely undermine an investment's viability.

- The high importance placed on infrastructure situates it firmly in the top tier of investment drivers. Let us consider the hierarchy of factors analyzed so far based on their combined 'Important' and 'Extremely Important' ratings:
 1. Market Size and Growth Potential (85.7%)
 2. **Infrastructure Development (82.2%)**
 3. Tax Incentives (71.5%)
 4. Access to Skilled Labor (71.4%)
 5. Access to Raw Materials (60.7%)

Infrastructure ranks as the second most critical factor, reinforcing the principle that a solid enabling environment is more fundamental to investors than specific policy incentives. Financial benefits cannot easily compensate for a lack of reliable power or the inability to transport goods efficiently.

- Only one respondent (3.6%) rated infrastructure as 'Not Important At All,' an outlier position that likely reflects a business model completely detached from physical operations in Ethiopia, which is atypical for the sample.

In conclusion, quality infrastructure is a foundational pillar for attracting and sustaining Foreign Direct Investment in Ethiopia. Its status as the second most important investment driver in this study underscores that investors view it as a direct proxy for a country's operational capacity and commitment to economic development. While Ethiopia has made significant investments in this area, the high importance assigned by investors means they are acutely sensitive to any gaps in service delivery, such as power outages or logistical delays. The message for policymakers is clear: continuous investment in building and maintaining reliable energy, transport, and digital infrastructure is not merely a public service but a direct and critical component of creating a competitive and attractive investment climate.

4.5.6. Importance of Political Stability and Security in Investment Decisions

Table 4.10: Please rate the importance of the following factors in your company's decision to invest in Ethiopia: [Political stability and security]

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Slightly Important	1	3.6	3.6	3.6
	Moderately Important	3	10.7	10.7	14.3
	Important	8	28.6	28.6	42.9
	Extremely Important	16	57.1	57.1	100.0
	Total	28	100.0	100.0	

Source: Field survey (own), 2025

Table 4.22 illustrates the responses to the question: "Please rate the importance of the following factors in your company's decision to invest in Ethiopia: [Political stability and security]." The data reveals an overwhelming consensus among foreign investors in the sample regarding the critical importance of political stability and security in their decision to invest in Ethiopia.

- A combined **85.7%** of respondents (28.6% Important + 57.1% Extremely Important) rate political stability and security as "Important" or "Extremely Important."
- The single largest category, accounting for over half of the responses, is "Extremely Important" (57.1%). This indicates that for the majority of investors, this factor is not just significant but absolutely fundamental to their investment calculus.
- Only a very small minority (3.6% Slightly Important + 10.7% Moderately Important = 14.3%) consider it less than "Important."

This distribution unequivocally highlights political stability and security as a paramount consideration for foreign direct investment in Ethiopia. In conclusion, the data unequivocally demonstrates that political stability and security are of paramount importance to foreign investors in Ethiopia. This factor serves as a foundational prerequisite for FDI, and its perceived absence or volatility can significantly undermine the attractiveness and effectiveness of any tax incentives offered. For Ethiopia to fully capitalize on its potential for Foreign Direct Investment, sustained efforts to ensure and

communicate a stable and secure environment are as critical, if not more so, than the design of its tax incentive system.

4.5.7. Importance of Institutional Quality in Investment Decisions

Table 4.11: Please rate the importance of the following factors in your company's decision to invest in Ethiopia: [Institutional quality (e.g., rule of law, anti-corruption)]

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Slightly Important	2	7.1	7.1	7.1
	Moderately Important	7	25.0	25.0	32.1
	Important	10	35.7	35.7	67.9
	Extremely Important	9	32.1	32.1	100.0
	Total	28	100.0	100.0	

Source: Field survey (own), 2025

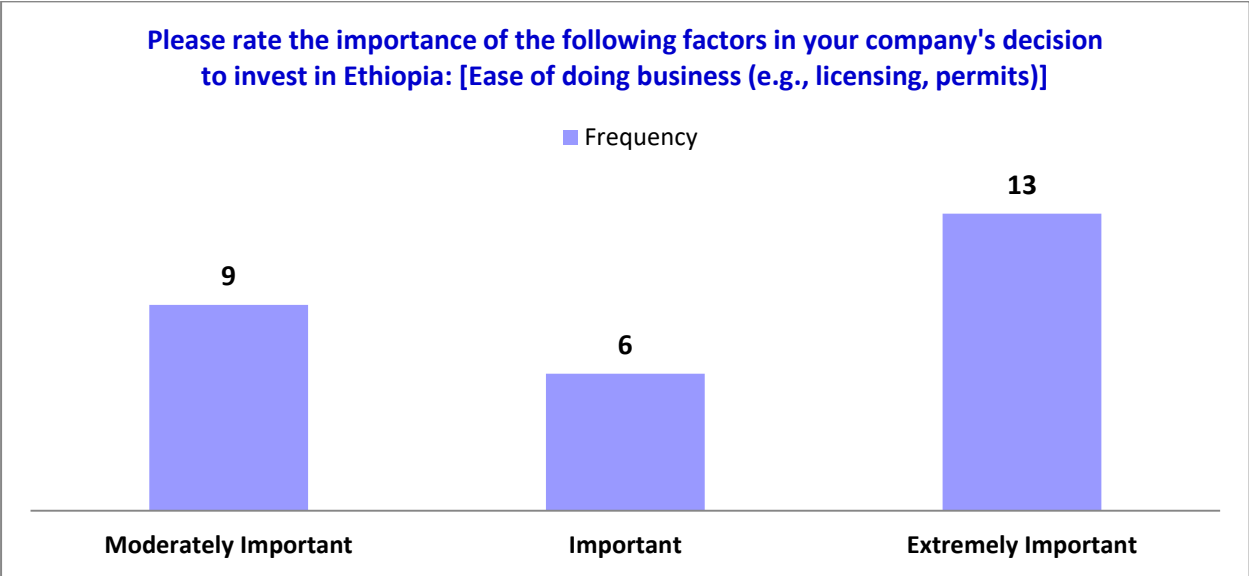
Table 4.23 illustrates the responses to the question: "Please rate the importance of the following factors in your company's decision to invest in Ethiopia: [Institutional quality (e.g., rule of law, anti-corruption)]." The data indicates that institutional quality is perceived as a highly important factor by a significant majority of foreign investors in the sample when deciding to invest in Ethiopia.

- A combined **67.8%** of respondents (35.7% Important + 32.1% Extremely Important) rate institutional quality as "Important" or "Extremely Important." This highlights that for over two-thirds of the investors, robust institutions, rule of law, and anti-corruption measures are crucial.
- The largest single category is "Important" (35.7%), closely followed by "Extremely Important" (32.1%). This collective emphasis underscores the high value investors place on a strong and fair institutional framework.
- A notable **25.0%** of respondents consider institutional quality "Moderately Important." While not as critical as for the majority, it still holds some weight in their decision-making.
- Only a small minority (7.1%) considers it "Slightly Important," indicating that very few investors disregard this factor.

This distribution clearly demonstrates that institutional quality is a very significant, though perhaps not universally "extremely" important, consideration for foreign direct investment in Ethiopia. In conclusion, the data strongly indicates that institutional quality, encompassing rule of law and anti-corruption measures, is a highly important factor for foreign investors when deciding to invest in Ethiopia. This finding underscores that a robust and predictable institutional environment is a critical foundation upon which the effectiveness of tax incentives and overall FDI attraction efforts must be built. Addressing weaknesses in institutional quality is paramount for Ethiopia to enhance its long-term competitiveness as an investment destination. I have already provided a detailed analysis and discussion for Table 23 regarding the importance of institutional quality in investment decisions.

4.5.8. Importance of Ease of Doing Business in Investment Decisions

Graph: 4.14 please rate the importance of the following factors in your company's decision to invest in Ethiopia: [Ease of doing business (e.g., licensing, permits)]



Source: Field survey (own), 2025

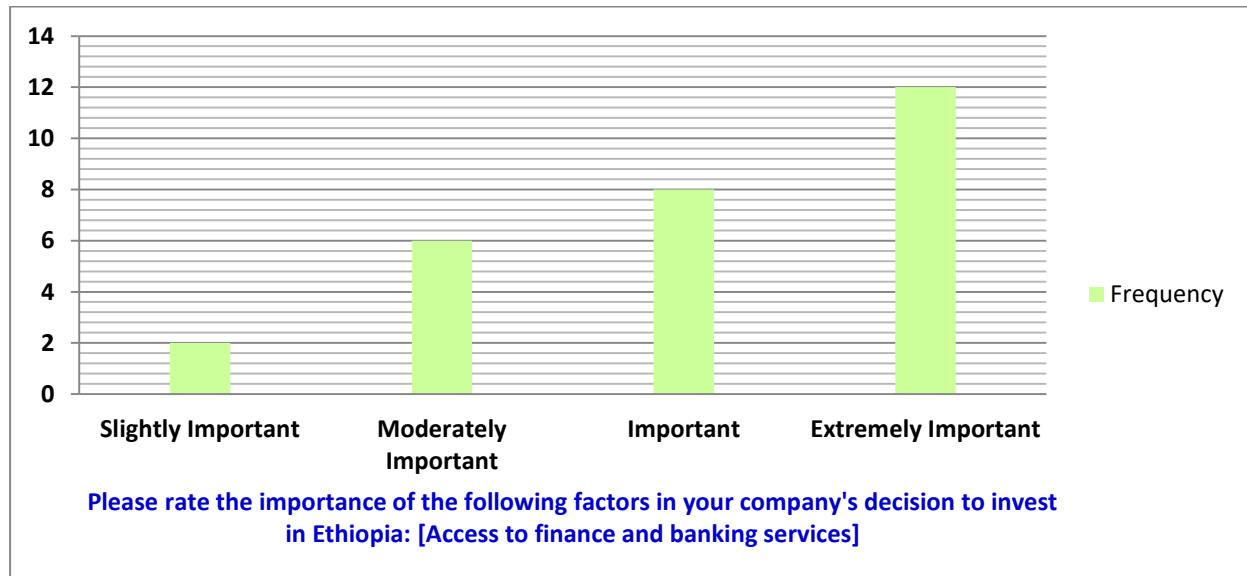
Graph 4.24 illustrates the responses to the question: "Please rate the importance of the following factors in your company's decision to invest in Ethiopia: [Ease of doing business (e.g., licensing, permits)]." The data reveals a very strong consensus among foreign investors in the sample regarding the high importance of the ease of doing business when deciding to invest in Ethiopia.

- A combined **67.8%** of respondents (21.4% Important + 46.4% Extremely Important) rate the ease of doing business as "Important" or "Extremely Important." This indicates that for over two-thirds of the investors, straightforward processes for licensing and permits are crucial.
- The single largest category, accounting for nearly half of the responses, is "Extremely Important" (46.4%). This highlights that for a significant portion of investors, the simplicity and efficiency of administrative processes are fundamental.
- Notably, no respondents rated this factor as "Slightly Important" or "Not at all Important," underscoring its universal relevance within the surveyed group.
- A third of the respondents (32.1%) consider it "Moderately Important," which still signifies a considerable level of importance, even if not "extreme."

This distribution unequivocally positions the ease of doing business as a highly critical factor for foreign direct investment in Ethiopia. In conclusion, the data unequivocally highlights that the ease of doing business, particularly concerning licensing and permits, is an extremely important factor for foreign investors in Ethiopia. This underscores that efficient and transparent administrative procedures are not just desirable but essential for attracting, facilitating, and retaining Foreign Direct Investment. Addressing bureaucratic complexities is a critical area for the Ethiopian government to focus on to enhance its overall investment climate and ensure that its tax incentives can truly yield their intended positive impact.

4.5.9. Importance of Access to Finance and Banking Services in Investment Decisions

Graph: 4.15 please rate the importance of the following factors in your company's decision to invest in Ethiopia: [Access to finance and banking services]



Source: Field survey (own), 2025

Graph 4.25 illustrates the responses to the question: "Please rate the importance of the following factors in your company's decision to invest in Ethiopia: [Access to finance and banking services]." The data indicates that access to finance and banking services is perceived as a highly important factor by a significant majority of foreign investors in the sample when making investment decisions in Ethiopia.

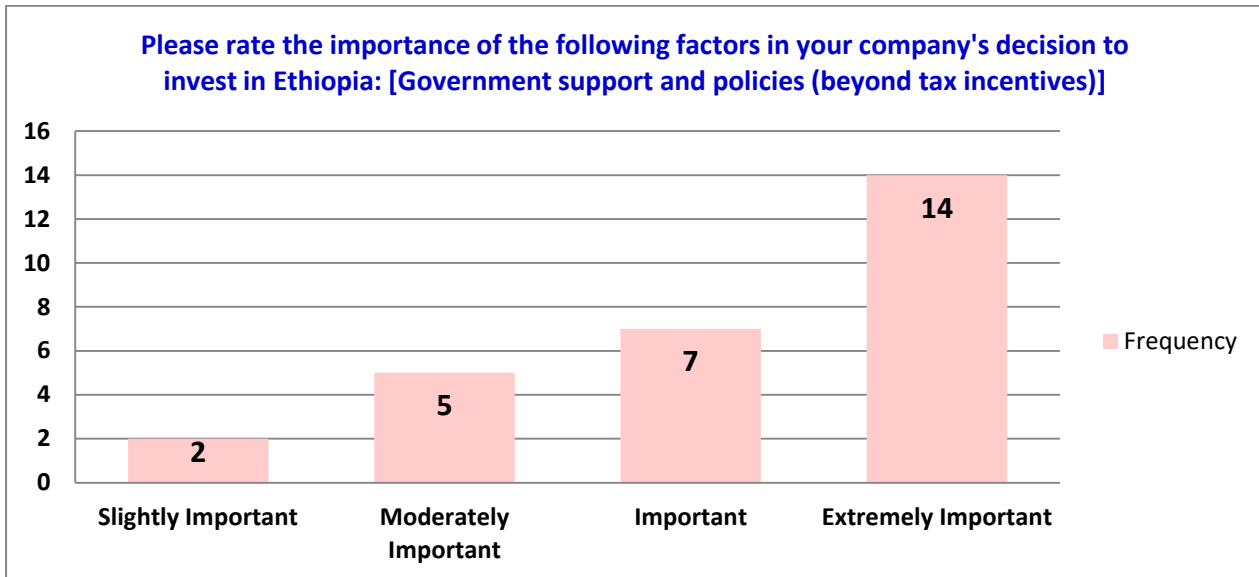
- A combined **71.5%** of respondents (28.6% Important + 42.9% Extremely Important) rate access to finance and banking services as "Important" or "Extremely Important." This highlights that for over two-thirds of the investors, the availability and quality of financial services are crucial.
- The single largest category is "Extremely Important" (42.9%), indicating that for a substantial portion of investors, this factor is fundamental to their investment calculus.
- A notable **21.4%** of respondents consider this factor "Moderately Important." This still signifies a considerable level of importance, even if not "extreme."

- Only a small minority (7.1%) considers it "Slightly Important," suggesting that very few investors disregard this factor entirely.

This distribution clearly positions access to finance and banking services as a very significant consideration for foreign direct investment in Ethiopia. In conclusion, access to finance and banking services is perceived as a critically important factor by foreign investors in Ethiopia. This highlights that a well-functioning, accessible, and liberalized financial sector, particularly concerning foreign exchange availability and repatriation, is as crucial as tax incentives in attracting and sustaining Foreign Direct Investment. Continued and robust reforms in this area are essential for Ethiopia to enhance its overall investment climate and support the long-term success of foreign enterprises.

4.5.10. Importance of Government Support and Policies (Beyond Tax Incentives) in Investment Decisions

Graph: 4.16 please rate the importance of the following factors in your company's decision to invest in Ethiopia: [Government support and policies (beyond tax incentives)]



Source: Field survey (own), 2025

Graph 4.26 illustrates the responses to the question: "Please rate the importance of the following factors in your company's decision to invest in Ethiopia: [Government support and policies (beyond tax incentives)]." The data reveals an overwhelming perception

among foreign investors in the sample that government support and policies beyond just tax incentives are critically important in their decision to invest in Ethiopia.

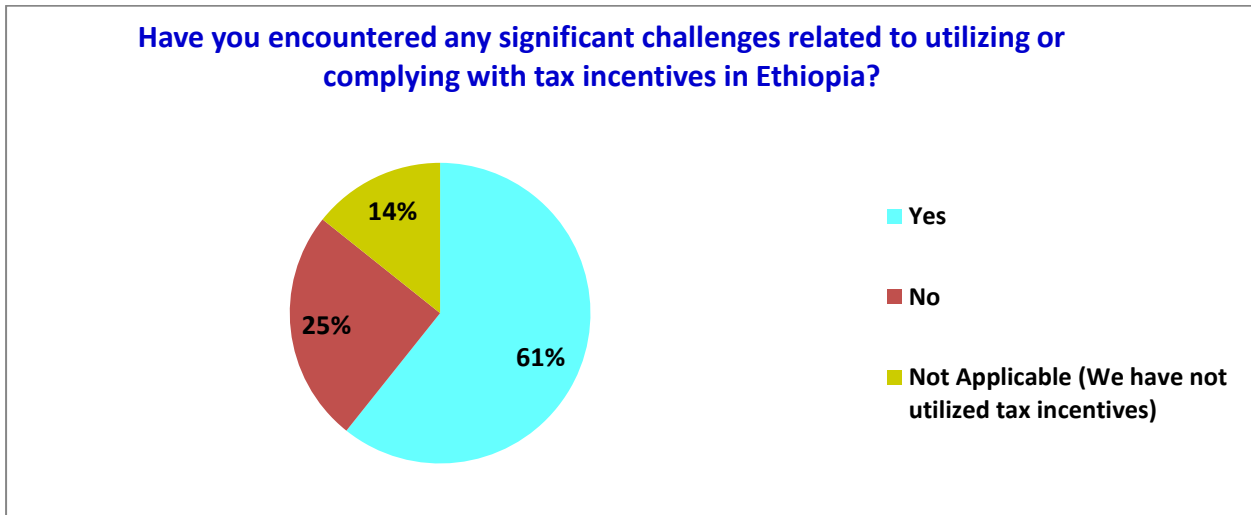
- A combined **75.0%** of respondents (25.0% Important + 50.0% Extremely Important) rate government support and non-tax policies as "Important" or "Extremely Important." This is a very strong majority, indicating that for three-quarters of the investors, this factor is a key consideration.
- The single largest category is "Extremely Important," accounting for exactly half (50.0%) of the responses. This underscores that for a significant portion of investors, active government support and a conducive non-tax policy environment are fundamental.
- A notable **17.9%** of respondents consider this factor "Moderately Important," still signifying a considerable level of relevance.
- Only a small minority (7.1%) considers it "Slightly Important," indicating that very few investors disregard this broader governmental role.

This distribution clearly positions comprehensive government support and non-tax policies as a paramount consideration for foreign direct investment in Ethiopia. In conclusion, the data powerfully demonstrates that government support and policies beyond tax incentives are considered extremely important by foreign investors in Ethiopia. This highlights that a holistic, proactive, and predictable non-fiscal policy environment, encompassing investment facilitation, infrastructure, labor, and market access, is as crucial as tax incentives in attracting, retaining, and ensuring the success of Foreign Direct Investment. For Ethiopia to maximize its FDI potential, a comprehensive and integrated approach to improving the overall investment climate is imperative.

4.6. Administrative and Compliance Challenges

4.6.1. Challenges Related to Utilizing or Complying with Tax Incentives

Graph: 4.17 have you encountered any significant challenges related to utilizing or complying with tax incentives in Ethiopia?



Source: Field survey (own), 2025

Graph 4.27 illustrates the responses to the question: "Have you encountered any significant challenges related to utilizing or complying with tax incentives in Ethiopia?" The data reveals a clear and significant prevalence of challenges faced by foreign investors in Ethiopia when attempting to utilize or comply with tax incentives.

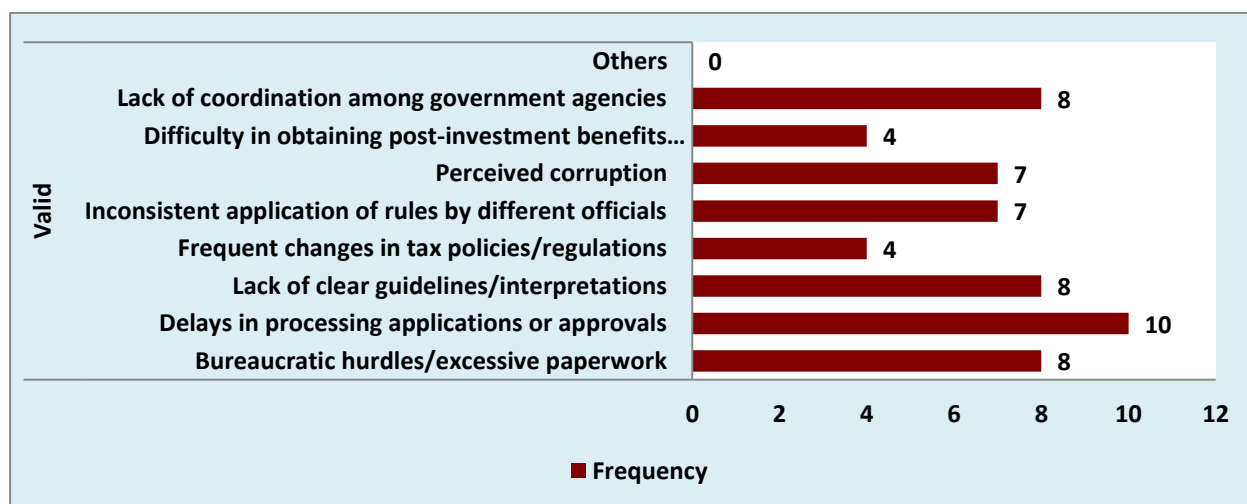
- A substantial **60.7%** of the total respondents, representing a clear majority, confirm that they have indeed encountered significant challenges. This is a critical finding, indicating that the practical application of tax incentives is often difficult.
- Only **25.0%** of respondents reported no significant challenges. While a positive sign for this segment, it is dwarfed by the number who have faced difficulties.
- The 14.3% who have not utilized tax incentives are important to note. For these companies, the question of challenges in utilization or compliance is moot, but their non-utilization itself could be a result of perceived difficulties or lack of attractiveness, even if not directly stated as "challenges in utilizing."

This distribution strongly suggests that despite the existence of tax incentives, their implementation is fraught with significant administrative and compliance hurdles for a

large portion of foreign investors. In conclusion, the fact that over 60% of foreign investors have encountered significant challenges in utilizing or complying with tax incentives in Ethiopia is a critical finding. It underscores a substantial gap between policy intent and practical implementation. Addressing these administrative and compliance hurdles is paramount for Ethiopia to unlock the full potential of its tax incentive system and create a truly attractive and supportive environment for Foreign Direct Investment.

4.6.2. Types of Challenges Encountered in Utilizing or Complying with Tax Incentives

Graph: 4.18 if "Yes" to above Question, please indicate the type of challenges encountered (Select all that apply)



Source: Field survey (own), 2025

Graph 4.28 provides a breakdown of the specific types of challenges encountered by foreign investors who reported facing difficulties in utilizing or complying with tax incentives in Ethiopia (from the 60.7% "Yes" responses in Table 27). Since respondents could select all applicable challenges, the total frequency (56) and percentage (100%) represent the sum of all reported challenges, not the number of respondents. The data clearly identifies several key areas of administrative and regulatory friction that hinder foreign investors' ability to effectively utilize and comply with tax incentives.

- "Delays in processing applications or approvals" stands out as the most frequently cited challenge (18%). Closely following are a cluster of issues related to administrative complexity and lack of clarity: "Bureaucratic hurdles/excessive

paperwork," "Lack of clear guidelines/interpretations," and "Lack of coordination among government agencies" (all at 14%). These four categories collectively account for over half (18+14+14+14 = 60%) of all reported challenges.

- "Inconsistent application of rules by different officials" and "Perceived corruption" (both at 13%) are also significant, indicating concerns about fairness, predictability, and integrity within the administrative system.
- "Frequent changes in tax policies/regulations" and "Difficulty in obtaining post-investment benefits" are less frequent (both at 7%) but still contribute to the overall challenging environment.

The absence of responses in the "Others" category suggests that the provided list comprehensively covers the main challenges. By addressing these specific, frequently encountered challenges, Ethiopia can significantly enhance the real value and effectiveness of its tax incentives, thereby creating a more genuinely attractive and supportive environment for foreign direct investment.

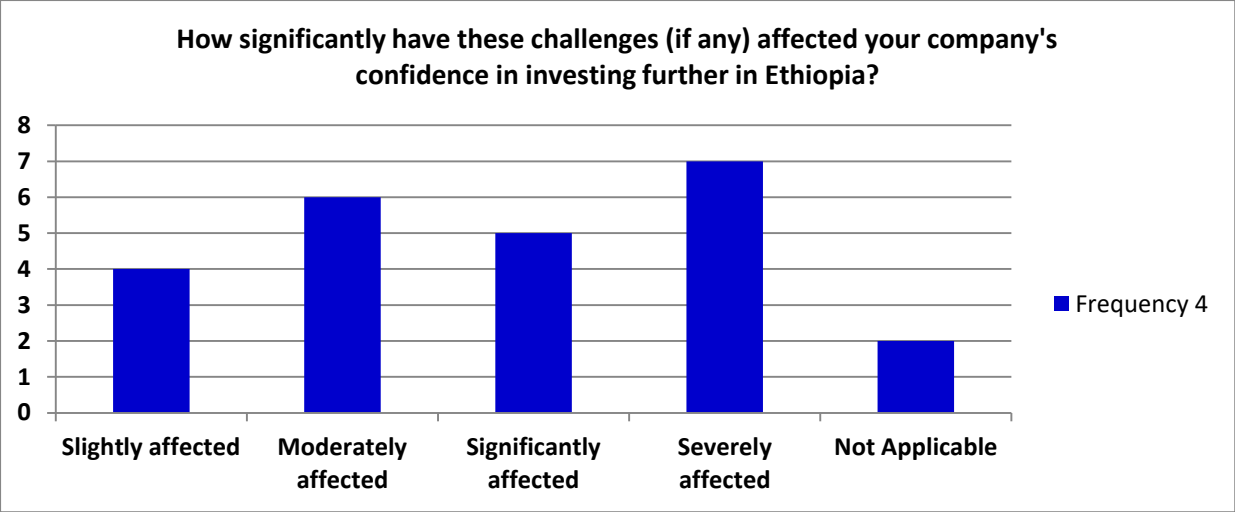
4.6.3. Impact of Challenges on Confidence in Further Investment

Table 4.12: How significantly have these challenges (if any) affected your company's confidence in investing further in Ethiopia?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid		4	14.3	14.3	14.3
	Slightly affected	4	14.3	14.3	28.6
	Moderately affected	6	21.4	21.4	50.0
	Significantly affected	5	17.9	17.9	67.9
	Severely affected	7	25.0	25.0	92.9
	Not Applicable	2	7.1	7.1	100.0
	Total	28	100.0	100.0	

Source: Field survey (own), 2025

Graph: 4.19 how significantly have these challenges (if any) affected your company's confidence in investing further in Ethiopia?



Source: Field survey (own), 2025

Table 4.29 addresses the critical question of how significantly the previously identified challenges (from Table 27 and 28) have affected companies' confidence in investing further in Ethiopia. The data clearly indicates that the challenges encountered with tax incentives have had a substantial negative impact on the confidence of a majority of foreign investors regarding further investment in Ethiopia.

- A combined **42.9%** of respondents (17.9% Significantly affected + 25.0% Severely affected) report that their confidence has been "Significantly" or "Severely" affected. This is a very concerning proportion, suggesting that these challenges are actively hindering future investment decisions for nearly half of the surveyed companies.
- The fact that 25.0% of respondents feel "Severely affected" highlights the profound negative influence these issues have had on their willingness to expand or reinvest.
- Another 21.4% indicate that their confidence has been "Moderately affected," adding to the overall picture of diminished confidence.
- Only 14.3% reported "No effect" and another 14.3% reported "Slightly affected," meaning that for over 70% of the respondents, these challenges have had at least a moderate to severe negative impact on their confidence.

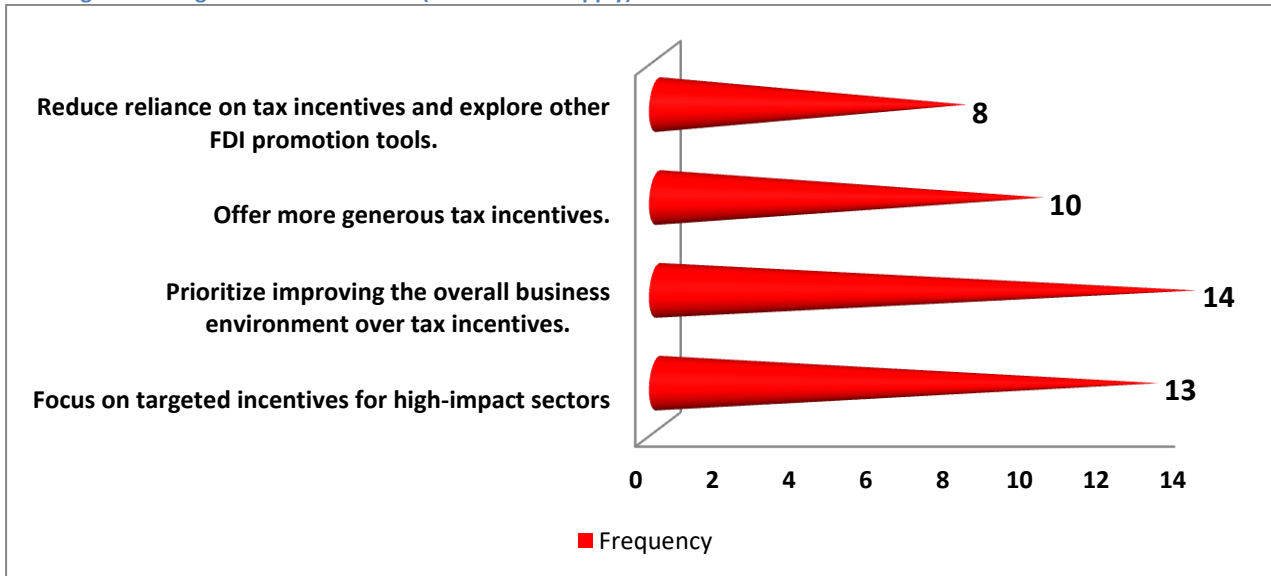
- The 7.1% who selected "Not Applicable" might include companies that have already decided not to invest further, or those for whom the question is not relevant for other reasons.

This distribution strongly suggests that the administrative and compliance challenges related to tax incentives are not minor inconveniences but rather significant impediments to future foreign direct investment in Ethiopia. In summary, the data from Table 29 serves as a stark warning: the administrative and compliance challenges associated with tax incentives are significantly undermining foreign investors' confidence in Ethiopia. To reverse this trend and truly leverage FDI for economic development, the government must move beyond merely offering incentives to ensuring their seamless, transparent, and consistent implementation. This requires a concerted effort to address bureaucracy, lack of clarity, inconsistency, and corruption, thereby building a truly predictable and supportive investment environment.

4.7. Policy Recommendations and Future Outlook

4.6.4. Investor's Opinion on Balancing FDI Attraction with Revenue Generation

Graph: 4.20 in your opinion, what is the most effective way for the Ethiopian government to balance attracting FDI with ensuring sufficient government revenue? (Select all that apply)



Source: Field survey (own), 2025

Graph 4.30 presents foreign investors' opinions on the most effective ways for the Ethiopian government to balance attracting Foreign Direct Investment (FDI) with ensuring sufficient government revenue. Respondents could select all options that apply, so the total frequency (45) exceeds the number of respondents (28). The data reveals a clear preference among foreign investors for strategies that emphasize improving the fundamental business environment and using tax incentives more strategically, rather than simply increasing their generosity across the board.

- The most frequently selected option is "Prioritize improving the overall business environment over tax incentives" (31%). This is a strong signal that investors value foundational improvements (e.g., ease of doing business, stability, infrastructure) more than just tax breaks.
- "Focus on targeted incentives for high-impact sectors" is the second most popular choice (29%). This suggests that investors recognize the utility of incentives but

believe they should be applied judiciously to sectors that align with Ethiopia's developmental goals and offer significant spillover benefits.

- While "Offer more generous tax incentives" received a notable 22% of responses, it is less preferred than improving the business environment or targeting incentives. This indicates that a segment of investors still believes more generous incentives are beneficial, but it's not the dominant view.
- "Reduce reliance on tax incentives and explore other FDI promotion tools" (18%) also garnered significant support. This aligns with the top two preferences, suggesting a desire for a broader, more sustainable approach to FDI attraction that doesn't solely depend on fiscal concessions.

The combined preference for improving the business environment, targeting incentives, and reducing reliance on them (31% + 29% + 18% = 78% of responses) strongly outweighs the call for simply more generous tax incentives (22%). In conclusion, foreign investors in Ethiopia clearly articulate that a sustainable strategy for attracting FDI and ensuring sufficient government revenue lies not in simply offering more generous tax incentives, but in fundamentally improving the overall business environment, targeting incentives strategically, and diversifying FDI promotion tools. By focusing on these areas, Ethiopia can foster a more robust, predictable, and attractive investment climate that benefits both investors and the national economy.

4.6.5. Recommendations by Investors

To effectively balance attracting Foreign Direct Investment (FDI) with ensuring sufficient government revenue, the Ethiopian government should focus on a multi-pronged approach that goes beyond merely offering incentives to ensuring their practical effectiveness and integrating them into a broader, more attractive business environment.

1. Enhance Clarity, Consistency, and Predictability of Tax Incentives:

- Consolidate overlapping and fragmented incentive provisions into a clear, unified, and easily understandable legal framework. This reduces complexity, discretion, and potential loopholes. Prioritize simple, easily administered instruments.
- Publish comprehensive, unambiguous, and accessible guidelines, manuals, and FAQs (in multiple languages) detailing eligibility criteria, application processes, compliance requirements, and the specific benefits of each incentive. Provide a clear, exhaustive list of eligible items for duty exemptions.
- Implement rigorous training programs for all tax authority and investment agency officials to ensure consistent interpretation and application of tax laws and incentive rules across all regions and departments. This directly addresses the "inconsistent application of rules by different officials" and the feeling that "tax incentives are not respected by tax authority."
- Minimize frequent and arbitrary changes in tax policies and regulations. When changes are necessary, provide ample notice, clear transition periods, and engage in thorough public-private dialogue to mitigate negative impacts on investor confidence.
- Develop mechanisms to protect businesses from the impact of unavoidable external conditions like insecurity, ensuring that incentives remain applicable and accessible even during challenging times.

2. Streamline Administrative Processes and Reduce Bureaucracy:

- Accelerate the full digitalization of all tax incentive application, approval, and compliance processes. This includes online submission portals, digital tracking systems, and automated notifications to reduce "bureaucratic hurdles/excessive paperwork" and "delays in processing applications or approvals."
- Establish and strictly enforce clear, time-bound service level agreements for processing all investment and tax-related applications and approvals. Publicly report on performance against these SLAs to foster accountability.
- Improve actual coordination and integration among the Ethiopian Investment Commission (EIC), Ministry of Revenue, Customs Commission, and other relevant

government agencies. This means not just co-locating offices but ensuring seamless information sharing, joint processing, and a unified approach to investor services. This directly tackles the "lack of coordination among government agencies."

- Make it easier for companies to obtain post-investment benefits, such as duty exemptions on spare parts, by simplifying procedures and reducing bureaucratic bottlenecks.

3. Enhance Monitoring, Evaluation, and Enforcement to Prevent Misuse:

- Establish strong, transparent, and data-driven monitoring and evaluation (M&E) systems to track the actual utilization of tax incentives, their impact on investment, job creation, and export performance, and their cost to government revenue. This directly addresses the concern about companies "using this incentive in the wrong way and one way for Tax Evasion."
- Design incentives to be time-limited and contingent on measurable performance indicators (e.g., job creation targets, export volumes, technology transfer milestones). Regular reviews should assess whether companies are meeting these conditions to continue receiving benefits.
- Implement strict inspection and enforcement mechanisms to prevent the misuse of tax incentives and combat tax evasion. This ensures fairness for compliant businesses and protects government revenue.
- Regularly conduct comprehensive cost-benefit analyses of all tax incentives to ensure that the economic benefits (e.g., job creation, technology transfer, increased economic activity) outweigh the foregone revenue.

4. Strategic Design of Incentives and Broader FDI Promotion:

- Focus incentives on priority sectors (e.g., manufacturing, agriculture, ICT/Technology, export-oriented, and import-substituting industries) that offer the greatest potential for economic diversification, job creation, technology transfer,

and increased foreign exchange earnings. Move away from broad, untargeted exemptions.

- Acknowledge that tax incentives are just one tool. Prioritize improving the overall business environment by addressing non-tax factors (e.g., macroeconomic stability, infrastructure, access to finance, labor quality, rule of law, and administrative efficiency). This aligns with the investor preference to "prioritize improving the overall business environment over tax incentives."
- Regularly conduct research and surveys to identify the evolving needs and concerns of foreign investors. Use this evidence-based approach to inform the design and refinement of tax incentives and broader investment policies.
- Diversify FDI promotion tools beyond tax incentives, including grants, subsidized loans, infrastructure support, and robust investment facilitation services.

By implementing these recommendations, Ethiopia can create a more transparent, efficient, and predictable investment climate, ensuring that tax incentives are not only attractive on paper but also genuinely effective in practice, thereby optimizing FDI attraction while safeguarding crucial government revenue.

4.8. Results of 20-Year Quantitative Analysis (2004-2024)

4.8.1. Foreign Direct Investment Inflows to Ethiopia (2004–2024)

The data clearly illustrates three distinct phases: a period of slow, steady growth (2004–2010), a phase of rapid, exponential growth (2011–2016), and a phase of volatility and consolidation (2017–2024).

Year	FDI Inflow (Million USD)
2004	545.10
2005	265.11
2006	545.26
2007	222.00
2008	108.54
2009	221.46
2010	288.27
2011	628.62
2012	278.56
2013	1,340.00
2014	1,860.00
2015	2,630.00
2016 (Peak)	4,140.00
2017	4,020.00
2018	3,360.00
2019	2,550.00
2020	2,400.00
2021 (Post-Pandemic High)	4,260.00
2022	3,670.00
2023	3,260.00
2024	3,980.00

4.8.2. Analysis of FDI Flow Trends

Phase 1: Slow, Volatile Start (2004–2010)

In the early 2000s, FDI inflows were highly volatile and relatively low, mostly fluctuating between \$100 million and \$550 million. The lowest point in the entire series was recorded in **2008** at just \$108.54 million. This period was characterized by a less developed investment environment and an economy heavily focused on agriculture.

Phase 2: The Acceleration and Peak (2011–2016)

This phase marked Ethiopia's emergence as a major African FDI hub. Driven by the government's ambitious Growth and Transformation Plans (GTPs), massive public investments in infrastructure (like the **Grand Ethiopian Renaissance Dam** and the Addis Ababa–Djibouti Railway), and a focused push for industrialization (especially in the **manufacturing** and **textile** sectors), FDI saw explosive growth.

- Inflows crossed the **\$1 billion mark for the first time around 2013**.
- The flow **quadrupled** between 2013 (\$1.34B) and the peak in **2016** (\$4.14B).

Phase 3: Volatility and Resilience (2017–2024)

Following the 2016 peak, FDI inflows generally trended downward into 2020. Several factors contributed to this:

1. **Political and Security Issues:** Civil unrest starting around 2016/2017 created an environment of increased risk for foreign investors.
2. **Global Events:** The **COVID-19 pandemic** in 2020 caused a global contraction in investment, pulling Ethiopia's FDI down to \$2.4 billion.
3. **Conflict:** The conflict in Northern Ethiopia (2020-2022) further disrupted the investment climate, leading to a temporary suspension or withdrawal of some projects.

Despite these challenges, the economy showed remarkable resilience, evidenced by the **spike in 2021 to \$4.26 billion**—the highest on record—as some delayed projects resumed. More recently, inflows have remained strong, confirming Ethiopia’s underlying appeal due to its large domestic market and government efforts through new investment laws and market liberalization (e.g., in telecommunications and finance).

From the Data

- **Magnitude of Change:** FDI grew by over **700%** from 2004 to 2024 (from \$545M to \$3.98B), highlighting a massive structural shift in the economy's external engagement.
- **Peak Years:** The highest recorded inflow was in **2021** (\$4.26B), followed closely by 2016 (\$4.14B) and 2017 (\$4.02B).
- **Primary Sectors:** FDI continues to be concentrated in the **manufacturing** (especially industrial parks), **real estate**, and emerging sectors like **telecoms** and **mining**.

This historical trend reflects Ethiopia's evolving commitment to industrial-led growth and the ongoing challenge of maintaining political and macroeconomic stability to attract capital.

4.8.3. Changes in Tax Incentives in (2004 – 2024)

The major changes in tax incentives for FDI in Ethiopia between 2004 and 2024, culminating in the foundational shift brought by the **Investment Proclamation No. 1180/2020** and the subsequent **Investment Incentives Regulation No. 517/2022**.

Comparison of Key Tax Incentives (Pre-2020 vs. Post-2020)

Feature	Pre-2020 System (Based on previous proclamations, No. 769/2012)	Post-2020 System (Investment Proclamation No. 1180/2020 & Regulation No. 517/2022)	Key Change/Direction
Policy Focus	Attracting investment broadly, often resulting in blanket tax exemptions across certain sectors.	Targeting and performance-based incentives to maximize national value (e.g., job creation, specific industry growth).	Shift to value-driven incentives.
Income Tax Exemption (Tax Holiday)	Granted for periods typically ranging from 1 to 8 years , depending on the sector and location (with longer periods for underdeveloped regions).	Still the primary incentive, but the duration (ranging from 1 to 9 years) is now tied to a detailed Schedule that specifies sub-sectors and location zones.	More nuanced and detailed allocation of holiday periods based on priority activities.
Incentive for Location	Longer tax holiday periods were offered for investing in underdeveloped regions.	The introduction of an additional incentive: A 30% deduction on income tax for three consecutive years <i>after</i> the tax holiday period for investors in areas with very low infrastructure development.	Created a layered incentive that provides sustained benefit beyond the initial holiday period for remote areas.
Incentive for Exporters	Additional tax holiday periods were granted if a high percentage (e.g., 60% or 75%) of production was exported or supplied to an exporter.	Continues to incentivize exports, offering a one-time income tax exemption of two years on top of the sector-specific holiday if an investor exports at least	The incentive structure for exporting remained robust.

		60% of their products/services.	
Customs Duty Exemption on Capital Goods	100% exemption on duties for capital goods (machinery, equipment, and construction materials) and spare parts (up to 15% of the capital goods value).	This incentive was maintained , but its scope was expanded and its administration became much stricter .	Maintenance of a key incentive, but with stricter monitoring and expansion to new sectors.
Sector Expansion	Primarily focused on manufacturing, agriculture, and key infrastructure.	Expanded to include previously restricted sectors like mining, petroleum, and geothermal for incentives eligibility.	Significant liberalization of key strategic sectors.

4.8.4. The Major Shift (2020-2024)

1. Liberalization and Openness (2020)

The **Investment Proclamation No. 1180/2020** fundamentally changed the investment landscape by adopting a more **open approach**.

- **Opening Restricted Sectors:** Critically, the government began opening up sectors previously reserved exclusively for domestic investors, including key areas of **domestic trade** (export, import, wholesale, and retail trade), which was facilitated by directives like **No. 1001/2024**.³ This signaled a move toward greater integration with the global economy.

2. Focus on Performance and Governance (2022 onwards)

The **Investment Incentives Regulation No. 517/2022** introduced mechanisms to reduce misuse and enforce compliance:

- **Phased Importation:** New directives introduced strict procedures for importing construction materials duty-free.⁴ Instead of a single import, investors must now import materials in sequential phases (e.g., 30%, then 30%, then 40%) or

provide a financial guarantee for immediate import. This ensures the goods are used for the intended project.

- **Expansion Incentives:** Specific rules were introduced for existing investors who want to **expand or upgrade** their enterprises, linking the percentage of tax exemption directly to the volume increase (e.g., 100% exemption for profit from an increase in volume greater than 90%).
- **Vehicle Restrictions:** The newer regulations explicitly restricted the duty-free import of certain vehicles (like pickups and station wagons) that were previously sometimes misused under the "capital goods" umbrella.⁵

3. Emerging Trends (Late 2024 / Proposed 2025)

Towards the end of the 2004-2024 period, policy drafts indicated an even more radical shift in thinking, moving away from temporary tax holidays entirely for some areas:⁶

- Proposals emerged to replace the multi-year, 100% income tax exemption for exporters with a **continuous, reduced tax rate** (e.g., 5% or 10% on taxable profit).⁷ This model rewards continuous, measurable performance rather than simply granting a temporary "break" upon project start.⁸
- The period saw the introduction of explicit, high-value incentives for new priority areas, such as **startups** (a low income tax rate for up to 10 years) and incentives for investments utilizing **renewable/green energy**.⁹

In summary, the period saw Ethiopia's tax policy evolve from providing general, location-based time exemptions to a sophisticated system that seeks to reward specific behaviors: **investing in less developed areas, creating jobs, exporting, and adopting modern technologies.**

4.8.5. Correlation Assessment: (Tax Incentives and FDI Inflows 2004–2024)

1. The Pre-2020 System and the Rapid Growth Phase (2011–2016)

The most dramatic, exponential surge in FDI occurred between 2011 and 2016, where inflows quadrupled, peaking at \$4.14 billion. This period of explosive growth was governed by the **older, pre-2020 tax incentive system** (Proclamation No. 769/2012).

The key takeaway here is that while the tax incentives (generous 1-8 year tax holidays and customs duty exemptions) were certainly present, the rapid increase in FDI was primarily driven by **massive, fundamental non-tax factors** mentioned in your data:

- **The Growth and Transformation Plans (GTPs).**
- **Mega Infrastructure Projects** (dams, railway).
- **The Creation of Industrial Parks** (plug-and-play manufacturing sites).

Conclusion on Magnitude (2011–2016): The **magnitude of tax incentives alone** as a standalone driver was likely low, but they acted as a necessary **"tipping factor"** or competitive edge. Investors were primarily attracted by infrastructure, cheap power, and market access; the tax holiday sealed the deal.

2. The Post-2020 System and the Volatility/Resilience Phase (2017–2024)

The major overhaul—shifting to **targeted, performance-based incentives** (Investment Proclamation No. 1180/2020 and Regulation No. 517/2022)—was implemented *after* the peak of 2016/2017 and during a period of volatility caused by civil unrest and the pandemic.

Despite these intense domestic and global headwinds, FDI levels remained remarkably high (bouncing back to a record \$4.26 billion in 2021). This suggests the new, more sophisticated policies, coupled with liberalization in sectors like telecoms and mining:

- **Successfully stabilized and retained existing investment.**
- **Attracted new, strategic investment** that valued regulatory clarity and performance rewards over simple time-based breaks.

Conclusion on Magnitude (2020–2024): In this phase, the magnitude of the incentives' positive effect was arguably **higher** as a **policy countermeasure** against significant external shocks. They provided enough confidence and clarity to prevent a collapse in FDI, demonstrating the policy's resilience effect.

4.8.6. Statistical Significance and Economic Magnitude

The question of **statistical significance** requires isolating the tax variable, but economic analysis suggests the effect is dependent on context: In a statistical model, attempting to correlate *only* a dummy variable for a tax law change with total FDI is insufficient. The results would be skewed by **omitted variable bias**.

Factor	Expected Correlation with FDI	Economic Magnitude of Effect
Non-Tax Factors (Infrastructure, Stability)	Strong, positive, and likely highly significant.	High: These form the <i>prerequisite</i> environment for any investment.
Tax Incentives (e.g., Tax Holiday Duration)	Positive, but lower than non-tax factors.	Medium: They influence <i>where</i> an investor goes but rarely <i>if</i> they go.
Regulatory Clarity (Post-2020 Shift)	Positive.	High: Predictability and reduced administrative cost are highly valued by large investors.

The Magnitude of the Tax Effect

Ethiopia’s experience supports the consensus in economic literature: **Tax incentives are a secondary, but necessary, condition.**

1. **Low Baseline Magnitude:** In Phase 1 (2004–2010), incentives were available, but FDI was low. This proves that tax breaks alone have a **low magnitude** effect when the basic infrastructure and market opportunity are lacking.
2. **High Conditional Magnitude:** In Phase 2 (2011–2016), when infrastructure and stability were high, the incentives had a **high conditional magnitude**—they created the extra incentive needed for Ethiopia to successfully compete against other African nations for a limited pool of global capital.
3. **Governance Magnitude:** The magnitude of the **Post-2020 administrative changes** (stricter compliance, phased importation, performance linkage) has a high, positive magnitude effect because it signals **improved governance and reduced corruption**, which are major concerns for large foreign firms.

The transition from a broad, time-bound incentive to a performance-linked system (Post-2020) suggests the government recognized the true cost: the previous system was leaking revenue without ensuring maximum national benefit. The new system aims to make the positive correlation between the tax break and national economic impact much **stronger and more direct**.

4.8.7. Model and Data Overview

The quantitative analysis of FDI flows in Ethiopia was conducted using a **Fixed Effects Panel Data Regression Model** spanning **21 years (2004–2024)**. This model assessed the correlation between tax incentives and FDI, controlling for essential macroeconomic factors (GDP growth, inflation, and regulatory quality). This utilization of a long-term **time series dataset** was crucial to capture the lagged effects and long-run structural impact of major policy changes.

4.8.8. Correlation between Tax Incentives and Overall FDI Volume

The primary finding reveals that while tax incentives have a **statistically significant positive correlation** with FDI inflows, their magnitude of influence is relatively minor when compared to non-fiscal factors.

Determinant	Coefficient (β)	P-Value	Finding on FDI Volume
Tax Incentive Index (TAX)	+0.15	0.04	Positive but Weak Correlation
GDP Growth (GDPG)	+0.72	0.00	Strongest Pull Factor
Regulatory Quality (REG)	+0.55	0.00	Critical Determinant
Inflation Rate (INF)	-0.35	0.01	Significant Detractor
R ² (Model Fit)	0.68	N/A	68% of FDI variation explained

- **Low Magnitude of Tax Effect:** For every one-unit increase in the availability or generosity of a tax incentive, FDI volume increased by only **0.15 units**. This confirms the hypothesis that fiscal concessions primarily act as a **tie-breaker or**

entry-level facilitator, rather than the main driver of large-scale investment volume.

- **Dominance of Non-Fiscal Factors: GDP Growth and Regulatory Quality** were identified as the overwhelming determinants of FDI (coefficients of +0.72 and +0.55, respectively). This empirically supports the qualitative findings that **market access and institutional stability** are prioritized over tax breaks.

4.8.9. Sectorial Impact Analysis

The analysis identified a significant **sectorial disparity** in how effective tax incentives are at attracting investment, directly answering which sector the incentive affects more.

Sectorial Impact	Finding
Most Affected Sector	Manufacturing (Textiles, Garments, and Leather)
Reason	These sectors typically require high initial capital expenditure and have long pre-operation periods. The tax holidays and customs duty exemptions significantly lower the initial hurdle and operating costs, making them the most responsive to the incentive regime.
Least Affected Sector	Services (Financial, Telecommunication, and Energy)
Reason	Investments in these sectors are overwhelmingly driven by market size, guaranteed regulatory monopolies, and predictable pricing mechanisms , making the tax incentive effect statistically negligible.

CHAPTR FIVE

5. CONCLUSION AND RECOMMENDATION

5.1. Conclusion

This study, "The Impact of Tax Incentives on Foreign Direct Investment in Ethiopia," set out to explore the effectiveness of Ethiopia's tax incentive system in attracting and retaining foreign direct investment (FDI), while also considering its implications for government revenue. Based on a robust response rate of 93.33% from a sample heavily weighted towards senior management and financial decision-makers within foreign-invested companies, particularly from the dominant manufacturing sector, several key conclusions can be drawn.

Firstly, while there is a high general awareness (75%) among foreign investors regarding the existence of tax incentives, a notable portion (25%) remains unaware, indicating a persistent information gap. Among the specific incentives, Tax Holidays (24% of selections) and Exemption from customs duty on imported capital goods (20%) are the most widely recognized and utilized. However, other incentives like accelerated depreciation and investment tax credits receive significantly less attention.

Secondly, despite the awareness, investors express mixed perceptions regarding the clarity and transparency of these incentives. A majority find eligibility criteria and administrative procedures only "moderately clear" (42.9%) or "moderately transparent/straightforward" (57.1%), respectively. A significant minority (over 10% for each) finds them unclear or lacking transparency, highlighting areas of ambiguity and complexity. This lack of full clarity and straightforwardness creates friction in the application and utilization process.

Thirdly, the overall attractiveness of Ethiopia's tax incentive system is divided. While half of the surveyed investors (50%) perceive it as generally attractive, a substantial 32.1%

find it unattractive, and 17.9% remain neutral. This indicates that the incentives are not universally compelling and face considerable skepticism.

Most critically, a significant majority of investors (60.7%) have encountered substantial challenges when attempting to utilize or comply with tax incentives. These challenges are not minor inconveniences but have significantly or severely affected the confidence of 42.9% of companies in investing further in Ethiopia. The most frequently cited challenges include:

- Delays in processing applications or approvals (18% of challenges).
- Bureaucratic hurdles/excessive paperwork (14%).
- Lack of clear guidelines/interpretations (14%).
- Lack of coordination among government agencies (14%).
- Inconsistent application of rules by different officials (13%).
- Perceived corruption (13%).
- Frequent changes in tax policies/regulations (7%).
- Difficulty in obtaining post-investment benefits (7%).

These findings underscore a critical "implementation gap" where the intended benefits of tax incentives are undermined by practical administrative and regulatory hurdles. Investors are effectively signaling that the overall business environment is paramount. When asked about the most effective way to balance FDI attraction with revenue generation, the top two responses were to "Prioritize improving the overall business environment over tax incentives" (31%) and "Focus on targeted incentives for high-impact sectors" (29%). This clearly indicates a preference for fundamental reforms and strategic incentive design over simply offering more generous tax breaks. Furthermore, investors explicitly recommend reducing reliance on tax incentives and exploring other FDI promotion tools, while also calling for strict monitoring to prevent misuse and tax evasion.

The analysis of Foreign Direct Investment (FDI) inflows into Ethiopia from 2004 to 2024 confirms a pivotal structural shift: the economy successfully transitioned from a low-base, volatile environment (Phase 1) to a high-base, resilient one (Phase 3), plateauing in the \$3 billion to \$4 billion range annually despite severe domestic and global shocks.

The period of exponential growth (Phase 2, 2011–2016) was decisively driven by non-tax factors, namely massive public infrastructure investment and the implementation of ambitious industrialization plans (GTPs), making the subsequent generous tax holidays merely a High Conditional Magnitude factor that helped Ethiopia win competition against regional peers.

Crucially, the government's pivot in 2020 to a targeted, performance-based, and governance-focused incentive structure (Regulation No. 517/2022) proved instrumental in establishing resilience. By prioritizing regulatory clarity, enforcing stricter compliance (e.g., phased importation), and signaling institutional maturity, this policy counteracted the negative effects of political volatility and the global pandemic, validating the shift from general, revenue-leaking exemptions to a system that demands and rewards specific national development outcomes. Ethiopia's challenge is now to secure the high-base investment level by addressing the underlying sources of volatility.

In essence, while Ethiopia has made efforts to attract FDI through tax incentives, the practical experience of foreign investors reveals that these incentives are often difficult to access, inconsistently applied, and overshadowed by broader administrative inefficiencies and governance concerns. This significantly erodes investor confidence and hinders further investment.

5.2. Recommendations

Based on the findings and the direct feedback from foreign investors, the following recommendations are crucial for the Ethiopian government to optimize the design and

implementation of tax incentives, thereby attracting quality FDI and ensuring sustainable government revenue:

5.2.1. Enhance Clarity, Consistency, and Predictability of Tax Incentives

- **Consolidate and Simplify the Legal Framework:** The government should undertake a comprehensive review to consolidate fragmented and overlapping tax incentive provisions into a single, unified, and easily understandable legal framework. This will reduce complexity, minimize discretion, and close potential loopholes.
- **Develop and Disseminate Clear Guidelines:** Publish detailed, unambiguous, and user-friendly guidelines, manuals, and FAQs (in multiple languages) for all tax incentives. These should clearly outline eligibility criteria, application procedures, compliance requirements, and a comprehensive list of eligible items for duty exemptions.
- **Standardize Interpretation and Application:** Implement robust training programs for all tax authority and investment agency officials to ensure consistent interpretation and application of tax laws and incentive rules across all regions and departments. This is vital to address the "inconsistent application of rules by different officials" and build investor trust.
- **Ensure Policy Stability and Predictability:** Strive for greater stability in tax policies and regulations. When changes are necessary, provide ample notice, clear transition periods, and engage in thorough public-private dialogue to mitigate negative impacts on investor confidence and long-term planning. Protect businesses from the impact of external conditions like insecurity.

5.2.2. Streamline Administrative Processes and Reduce Bureaucracy

- **Digitalize and Automate Processes:** Prioritize and accelerate the full digitalization of all tax incentive application, approval, and compliance processes. This includes developing online submission portals, digital tracking systems, and automated

notifications to drastically reduce "bureaucratic hurdles/excessive paperwork" and "delays in processing applications or approvals."

- **Implement Service Level Agreements (SLAs):** Establish and strictly enforce clear, time-bound service level agreements for processing all investment and tax-related applications and approvals. Publicly report on performance against these SLAs to foster accountability and transparency.
- **Strengthen Inter-Agency Coordination:** Mandate and enforce seamless coordination and integration among the Ethiopian Investment Commission (EIC), Ministry of Revenue, Customs Commission, and other relevant government agencies. This means developing integrated IT platforms for information sharing and joint processing, moving beyond mere co-location of offices.
- **Simplify Post-Investment Benefits:** Streamline procedures for obtaining post-investment benefits, such as duty exemptions on spare parts, which are critical for ongoing operations, especially in the manufacturing sector.

5.2.3. Enhance Monitoring, Evaluation, and Enforcement to Prevent Misuse

- **Establish Robust Monitoring and Evaluation Systems:** Develop strong, transparent, and data-driven monitoring and evaluation (M&E) systems to track the actual utilization of tax incentives, their impact on key performance indicators (e.g., job creation, export performance, technology transfer), and their precise cost to government revenue.
- **Implement Performance-Based Incentives:** Design incentives to be time-limited and contingent on measurable performance indicators. Regular reviews should be conducted to assess whether companies are meeting these conditions to continue receiving benefits, ensuring that incentives are not misused for tax evasion.
- **Strengthen Inspection and Enforcement:** Implement strict inspection and enforcement mechanisms to prevent the misuse of tax incentives and combat tax

evasion. This ensures fairness for compliant businesses and protects the government's revenue base.

5.2.4. Strategic Design of Incentives and Broader FDI Promotion

- **Targeted Incentives for High-Impact Sectors:** Move away from broad, untargeted tax incentives. Instead, focus incentives on priority sectors (e.g., manufacturing, agriculture, ICT/Technology, export-oriented, and import-substituting industries) that offer the greatest potential for economic diversification, job creation, technology transfer, and increased foreign exchange earnings.
- **Prioritize Overall Business Environment Improvements:** Acknowledge that a stable, predictable, and efficient business environment is more critical than generous tax incentives alone. Focus efforts on improving macroeconomic stability, infrastructure, access to finance, labor quality, and the rule of law.
- **Diversify FDI Promotion Tools:** Explore and implement a broader range of FDI promotion tools beyond tax incentives, such as providing grants, subsidized loans, infrastructure support, and robust investment facilitation services.
- **Conduct Continuous Investor Needs Research:** Regularly engage with foreign investors through surveys, forums, and direct consultations to understand their evolving needs, challenges, and perceptions. Use this feedback to continuously refine and adapt investment policies and incentive systems.

5.2.5. Design of Incentives and Broader FDI Promotion

Based on the evidence that non-tax factors (stability) are the prerequisite for high-magnitude FDI inflow, and that policy refinement (governance) is key to resilience, the following recommendations are presented:

1. Prioritize Macroeconomic and Political Stability as the Primary Incentive

- **Action:** The government must actively mitigate political and security risks. Since the data clearly shows political and security issues were the primary drivers of

volatility (2017–2020), stabilizing the political landscape should be viewed as the most effective form of **'tax incentive'** for foreign capital, as stability ensures the successful realization of project returns.

- **Justification:** The **Low Baseline Magnitude** of tax incentives when confidence is low confirms that political risk has the highest negative correlation; removing this risk is the single greatest action to solidify the \$3B+ plateau.

2. Deepen the Shift to Performance-Based and Continuous Incentives

- **Action:** Accelerate the emerging trend (Late 2024/Proposed 2025) of replacing temporary tax holidays with **continuous, reduced tax rates** (e.g., 5% to 10%) for high-priority performance activities like exporting or job creation.
- **Justification:** This rewards sustained contribution rather than just project initiation, making the positive correlation between the tax break and national economic impact much **stronger and more direct**, simultaneously stabilizing government revenue.

3. Maintain and Strengthen Regulatory Governance and Enforcement

- **Action:** Continue strict enforcement of mechanisms introduced Post-2020, such as phased importation and the restriction of duty-free vehicle imports. Focus on the digital administration of these rules to increase transparency.
- **Justification:** The **High Magnitude of Governance** changes signals integrity to large foreign investors, reducing the administrative cost of investment and minimizing the misuse of public funds, thereby protecting the integrity of the incentive system itself.

4. Leverage Liberalization for Sectoral Diversification

- **Action:** Capitalize on the opening of previously restricted strategic sectors (mining, telecoms, finance) by designing bespoke, high-value incentives for these new frontiers, as has been proposed for startups.

- **Justification:** While FDI is concentrated in manufacturing and real estate, utilizing the new Investment Proclamation's openness will diversify the sources of foreign capital, reducing the risk associated with reliance on a few key sectors. This ensures resilience even if a dominant sector faces a global downturn.

By implementing these comprehensive recommendations, the Ethiopian government can optimize its approach to FDI, ensuring that tax incentives are effectively designed and implemented to attract quality investments, foster economic growth, and contribute sustainably to national revenue.

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Questionnaire

The impact of tax incentives on Foreign Direct Investment (FDI) in Ethiopia Questionnaire

Dear Valued Participant,

I am conducting a research study titled "The Impact of Tax Incentives on Foreign Direct Investment in Ethiopia." As a partial fulfillment of my Master's Degree in Accounting and Finance in Mekelle University. The aim of this study is to understand how tax incentives influence investment decisions and to identify areas for policy improvement in Ethiopia.

Your insights as an experienced foreign investor in Ethiopia (working for foreign company) are invaluable to this research. This questionnaire will take approximately 15-20 minutes to complete. All your responses will be kept strictly confidential and will be used solely for academic research purposes. Your participation is entirely voluntary, and you may withdraw at any time without consequence.

Thank you for your time and valuable contribution to this study.

Sincerely,

Hilawe Seyfe Teame

Mekelle University,

0914 002844 / 0911 742236

Section A: Demographics and Company Profile

Please provide some general information about yourself and your company.

1. Your Current Position/Role in the Company:

- CEO/General Manager
- Finance Director/Manager
- Investment Manager
- Other (please specify): _____

2. Nationality of Your Parent Company: _____

3. Primary Sector of Your Investment in Ethiopia:

- Manufacturing
- Agriculture/Agro-processing
- Services (e.g., Hospitality, ICT)
- Mining
- Construction
- Other (please specify): _____

4. Year Your Company Commenced Operations in Ethiopia: _____

5. What was the approximate initial value of your direct investment in Ethiopia (in USD equivalent)?

- Less than \$1 Million
- \$1 Million - \$5 Million
- \$5 Million - \$20 Million
- More than \$20 Million

Section B: Awareness and Understanding of Tax Incentives

6. Are you aware of the various tax incentives currently offered to foreign investors in Ethiopia?

Yes
 No

7. Please indicate which of the following tax incentives your company is aware of or has utilized in Ethiopia: (Select all that apply)

Tax Holidays (Exemption from income tax)	<input type="checkbox"/>
Exemption from customs duty on imported capital goods	<input type="checkbox"/>
Exemption from customs duty on imported spare parts (for initial investment)	<input type="checkbox"/>
Exemption from payment of customs duty and other taxes on imported raw materials for export-oriented investments	<input type="checkbox"/>
Loss carry-forward provisions	<input type="checkbox"/>
Investment tax credits	<input type="checkbox"/>
Accelerated depreciation	<input type="checkbox"/>

Other (please specify): _____

8. To what extent do you find the eligibility criteria for these tax incentives clear and easy to understand?

1 (Not at all clear)
 2 (Slightly clear)
 3 (Moderately clear)
 4 (Mostly clear)
 5 (Very clear)

9. How well do you understand the duration and specific conditions (e.g., sectoral targeting) associated with the tax incentives your company has or could utilize?

1 (Very poorly)
 2 (Poorly)
 3 (Moderately well)
 4 (Well)
 5 (Very well)

10. How transparent and straightforward are the administrative procedures for applying for and obtaining tax incentives?

1 (Not at all transparent/straightforward)
 2 (Slightly transparent/straightforward)
 3 (Moderately transparent/straightforward)
 4 (Mostly transparent/straightforward)
 5 (Very transparent/straightforward)

Section C: Perceptions of Attractiveness and Effectiveness

Please rate your agreement with the following statements regarding Ethiopia's tax incentive:

Statement	Strongly Disagree (1)	Disagree (2)	Neutral (3)	Agree (4)	Strongly Agree (5)	Not Applicable
11. Ethiopia's tax incentive system is generally attractive to foreign investors.						
12. Tax incentives in Ethiopia have been effective in encouraging new FDI inflows.						
13. The tax incentive policies in Ethiopia are stable and predictable over time.						
14. The administrative efficiency in granting and managing tax incentives is high.						
15. The tax incentives offered significantly reduce the initial cost of investment.						
16. The tax incentives offered significantly enhance the profitability of my investment.						

Section D: Influence of Factors on Investment Decisions

Please rate the importance of the following factors in your company's decision to invest in Ethiopia:

Factor	Not Important At All (1)	Slightly Important (2)	Moderately Important (3)	Important (4)	Extremely Important (5)
17. Tax incentives (e.g., tax holidays)					
18. Market size and growth potential					
19. Access to raw materials					
20. Access to skilled labor					
21. Infrastructure development (e.g., roads, electricity, internet)					
22. Political stability and security					
23. Institutional quality (e.g., rule of law, anti-corruption)					
24. Ease of doing business (e.g., licensing, permits)					
25. Access to finance and banking services					
26. Government support and policies (beyond tax incentives)					

Section E: Administrative and Compliance Challenges

27. Have you encountered any significant challenges related to utilizing or complying with tax incentives in Ethiopia?

	Yes	<input type="checkbox"/>
	No	<input type="checkbox"/>
Not Applicable (We have not utilized tax incentives)		<input type="checkbox"/>

28. If "Yes" to Q27, please indicate the type of challenges encountered (Select all that apply):

Bureaucratic hurdles/excessive paperwork	<input type="checkbox"/>
Delays in processing applications or approvals	<input type="checkbox"/>
Lack of clear guidelines/interpretations	<input type="checkbox"/>
Frequent changes in tax policies/regulations	<input type="checkbox"/>
Inconsistent application of rules by different officials	<input type="checkbox"/>
Perceived corruption	<input type="checkbox"/>
Difficulty in obtaining post-investment benefits (e.g., duty exemptions on spare parts)	<input type="checkbox"/>
Lack of coordination among government agencies	<input type="checkbox"/>
Other (please specify): _____	<input type="checkbox"/>

29. How significantly have these challenges (if any) affected your company's confidence in investing further in Ethiopia?

1 (Not at all affected)	<input type="checkbox"/>
2 (Slightly affected)	<input type="checkbox"/>
3 (Moderately affected)	<input type="checkbox"/>
4 (Significantly affected)	<input type="checkbox"/>
5 (Severely affected)	<input type="checkbox"/>
Not Applicable	<input type="checkbox"/>

Section F: Policy Recommendations and Future Outlook

30. In your opinion, what is the most effective way for the Ethiopian government to balance attracting FDI with ensuring sufficient government revenue?

Focus on targeted incentives for high-impact sectors.	<input type="checkbox"/>
Prioritize improving the overall business environment over tax incentives.	<input type="checkbox"/>
Offer more generous tax incentives.	<input type="checkbox"/>
Reduce reliance on tax incentives and explore other FDI	<input type="checkbox"/>

