

**Ethiopian Economics Association
(EEA)**



***Private Sector Development in Ethiopia:
Trends, Challenges and Policy Issues***

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Abbreviations and Acronyms

ARDL	Autoregressive Distributed Lag
CSA	Central Statistical Agency
EC	European Commission
ECM	Error Correction Model
EEA	Ethiopian Economics Association
EIC	Ethiopian Investment Commission
FDI	Foreign Direct Investment
FDRE	Federal Democratic Republic of Ethiopia
GERD	Great Renaissance Dam
GoE	Government of Ethiopia
GTP-I	Growth and Transformation Plan I
GTP-II	Growth and Transformation Plan II
HGER	Home-Grown Economic Reform
IDS	Industrial Development Strategy
MoF	Ministry of Finance
MoFED	Ministry of Finance and Economic Development
MSEs	Micro and Small Enterprises
NBE	National Bank of Ethiopia
PASDEP	Plan for Accelerated and Sustained Development to End Poverty
PDC	Planning and Development Commission
SDPRP	Sustainable Development and Poverty Reduction Program
SSA	Sub-Saharan Africa
TAK-IRDI	TAK-Innovative Research and Development Institution
ToT	Terms of Trade
TYDP	Ten Years Development Plan
WB	World Bank

Executive Summary

The role of the private sector³ in driving sustainable and inclusive growth, poverty reduction, and creating jobs is indispensable. In order to effectively use the opportunities available for sustainable development and transformation of the Ethiopian economy and to further leverage the private sector, it is important to examine the structure and performance of private sector development, identify important bottlenecks and challenges, and further investigate its contribution to the economy. A time series ARDL model was employed using secondary data collected from various official sources from 1991 to mid 2021.

Since the early 2000s, the government has implemented successive policies and strategies that promote private sector development in the country. As a result, an increase in private sector investment projects (both domestic and foreign) has been observed since 2003. However, the majority of the investment has been carried out by domestic investors. The implementation rate of projects in all development plan periods has been very low and has shown a decline in the agriculture sector's investment from 2000 onwards. Over the last three decades, the service sector has been the leading sector in terms of total capital inflow into the private sector (domestic and foreign). The industry follows the service sector, while lower investment projects were observed in the agriculture sector.

Although promising signals that the industrial sector has begun to emerge over recent years, with less participation of domestic private investors in the manufacturing sub-sector and with no or little agriculture sector investment, this indicates a less nascent structural change to the productive sector of the economy. The policy lesson from GTP I and II suggests that scaling up the support given to the manufacturing sub-sector for agriculture is crucial in the years to come. A balanced policy support for the productive sector between the manufacturing and agriculture sectors, with special attention to the manufacturing sector, is crucial during the current TYDP periods. Moreover, domestic private sector investment has not yet been channeled into the

³ Private sector consists of all economic activities run by individuals and firms for profit and is activities outside the public sector. It encompasses firms formally registered investors by the Ethiopian Investment commission.

productive sector (agriculture and manufacturing) and export market, which has a trickle-down effect towards industrialization and structural transformation of the economy. On the other hand, in terms of the creation of employment opportunities, the leading sector is the service sector. However, declining trends in permanent employment opportunities were observed over the last three decades. Hence, the private sector plays a less satisfactory role in employment generation, exports, and economic growth of the country.

The study identified key constraints and challenges hindering the domestic private sector from entering the productive sectors, export markets, and stimulating greater private sector investment in the economy. The key constraints and challenges include: 1) inadequate physical infrastructure (that is, electricity, transport and logistics, and water supply services); 2) restricted access to input markets (that is, lack of access to financial services, limited access to land, lack of a technically skilled labor force, and lack of raw materials); 3) shortage of foreign exchange; 4) weak institutional framework (such as ineffective regulatory environments, malpractice in the informal market, corruption, customs, trade, and tax-related issues); and 5) political unrest and the prevalence of the COVID-19 pandemic are the fundamental causes of the constraints of private sector investment in Ethiopia.

For the private sector to play the expected transformation role in the economy, the government should resolve the bottlenecks and create an enabling business environment through: providing a range of incentive schemes in priority sectors of the economy, better functioning of input markets (labor, land, and capital) through undertaking reform in the financial sector, enhancing coordination within and between different layers of the government; and improving human resource shortages; providing quality physical infrastructure and supplying inputs through strengthening inclusive public-private-partnerships; creating an enabling business environment in the industrial parks; ensuring consistent management strategies, minimizing bureaucratic inefficiencies in the government and financial institutions; and designing short and long-term adaptation and recovery interim plans to protect the private sector investment from the adverse effects of COVID-19 by providing various economic incentives.

The ARDL model revealed that the real effective exchange rate and credit have positive and significant effects both in the short and long run. On the

other hand, government expenditure and real interest rates were found to be positive and significant only in the short run. The results suggest that macroeconomic policies should be aligned with the comparative advantage of the country. To this end, encouraging a high-value export-led manufacturing sector and thereby strengthening Ethiopia's overseas purchasing power (improving the negative real effective exchange rate), undertaking government expenditure on capital investment (such as preferably on physical infrastructure and development of industrial parks), and provision of adequate financial services will leverage private sector investment in Ethiopia.

1. Introduction

1.1. Background and Motivation

The role of the private sector in driving sustainable and inclusive growth, poverty reduction, and creating jobs in developing countries is indispensable. For instance, a report by the European Commission (EC) revealed that the private sector provides approximately 90% of jobs in developing countries (EC, 2014). The sector is also important in contributing to the growth of gross domestic investment and allocating resources efficiently (Nwakoby and Bernard, 2016). The private sector is, thus, identified as an essential stakeholder in fighting poverty, creating employment opportunities, ensuring long-term economic growth and hence a pathway towards inclusive economic growth and transformation of the economy.

In Ethiopia, the private sector plays a leading role in the structural transformation process towards industrialization and, hence, has been given much emphasis by the Government of Ethiopia (GoE) over the last two decades. This was noticed in several national policy documents, including the Industrial Development Strategy (IDS) (2002); Sustainable Development and Poverty Reduction Program (SDPRP) (2002/2003-2004/2005); Plan for Accelerated and Sustained Development to End Poverty (PASDEP) (2005/2006-2009/2010); Growth and Transformation Plan I (GTP-I) (2010/2011-2014/2015); and Growth and Transformation Plan II (GTP-II) (2015/2016-2019/2020). In particular, during the GTP-I and II periods, the government recognized the key role of private sector development in the process of economic development of the nation and spurred its engagement in the productive sectors of the economy. In response to this, various administrative, institutional and policy reform measures have been taken to leverage the private sector involvement in the productive sector of the economy, particularly, in the manufacturing sector (MoFED, 2010; PDC, 2016).

In response to the 2018 political reform in the country, the Ethiopian government introduced some restructuring measures to stimulate the performance of major economic sectors and made changes in the institutional arrangements. In connection to this, the government formulated a three-year Home-Grown Economic Reform (HGER) interim plan that emphasized the role of private sector development in sustaining the economic growth trajectory of

the country. HGER serves as a bridge between the GTP–II and the Ten Years’ Development Plan (TYDP) (2021-2030). The TYDP aims to sustain the rapid economic growth achieved during GTP-I and GTP-II by addressing key priority strategic pillars: ensure quality economic growth and shared prosperity, improve productivity and competitiveness; undertake institutional transformation; strengthen the technological capability and digital economy; ensure private sector leadership in the economy; ensure equitable participation of women and children; enhance access to justice and efficient civil services, build a climate-resilient green economy; and strengthen regional peace building and economic integration. The plan gives due consideration to private sector development, aiming at strengthening their participation in key productive sectors in the years to come. However, the potential role of the private sector in sustainable development and the structural transformation of the economy were not fully optimized until recently.

Despite policy support over the last two decades, the contribution of the private sector to the national economy, as compared to the public sector, is less satisfactory. The economic growth that the country has registered in the last decade has been largely driven by public investments such as transport, energy, and social services (EEA, 2015; WB, 2016b). As a result, the share of public investment in GDP increased from 5% in the early 1990s to an average of around 15% in 2018/2019 (Mulu, 2019). According to the World Bank, Ethiopia recorded the third highest public investment but the sixth-lowest private investment in the world. Such types of huge public investment might complement private sector development or “crowding in” effects due to the expansion of crucial infrastructure. At the same time, it might also create “crowding out” effects due to the shortage of loanable funds and foreign exchange at the central bank (WBa, 2016). Therefore, to identify the key macroeconomic determinants of private investment in the country, more information is required on these factors.

Ethiopia’s private sector is predominantly characterized by small-scale, informal, and service sectors mostly operating in domestic markets where returns are high and quick. The sectoral distribution of the domestic private sector shows that investors are not vigorously entering the productive sectors (manufacturing and agriculture) and the export market, which are a critical pathway toward industrialization and structural transformation. Instead, most

domestic private investors are increasingly concentrated in the service sector and/or the domestic market (Mulu, 2019). For instance, during the GTP-I period, of a total of 123 operational domestic private investment projects that received investment licenses from regions, 88 (71%) projects were engaged in the service sector, 21 (17%) projects in the manufacturing sector, and 14 (11%) projects in the agriculture sector (NPC, 2016). This indicates a need to identify weaknesses and constraints hindering the domestic private sector from robustly entering the productive sectors and thereby improving the country's export trade competitiveness and building its capacity for resilience to shocks.

According to Ambachew (2010) and Amanu (2020), the main factors influencing Ethiopian private sector development include: domestic market size; return to capital; resource availability; degree of trade openness and liberalization; infrastructural facilities; macroeconomic and political instability; incentive packages; and infrastructural and institutional facilities. Furthermore, studies by Kolli (2010), Mulu (2019), Solomon (2001), TAK-IRDI (2016), and others outlined the weakness of the role of private sector development and its role in economic transformation in the short run. In contrast, there are virtually no specific, nationally representative studies that extensively explored the long-term trends, challenges, and policy options and examined the role of the private sector in the economic development process over the last three decades, thereby directing future needed policy intervention in Ethiopia. In response, this study aims to examine the structure and performance of private sector development, identify important bottlenecks and challenges, and further investigate its contribution to the economy over the last three decades, proposing implementable policy recommendations to play a more pronounced role in the national economy.

1.2. Objectives of the Study

The main aim of this research is to assess the structure and performance of private sector development over the past three decades and identify the challenges in Ethiopia.

More specifically, the study addresses the following specific objectives:

1. examine the effectiveness of policies and programs that are aimed at promoting private sector investment in Ethiopia;

2. assess trends in private sector investment in the country;
3. assess the engagement of the private sector investment in Ethiopia's economy across different sectors (agriculture, industry, and services) and subsectors;
4. identify the factors that impede private sector investment participation in various sectors;
5. identify the constraint and challenges that the private sector faces in its economic participation; and
6. identify the short and long run determinants of private investment over the last three decades.

2. Research Methodology

In this section, the data sources for the study, data acquisition approaches, methods of data analysis, and model justification and specification are discussed sequentially.

2.1. Data Type and Sources

The main data sources used for the study were collected from various official sources, such as the National Labor Force Survey, Primary Manufacturing Survey, Enterprise Survey, Phone Survey, World Development Indicators of the World Bank, and Ethiopian Investment Commission (EIC) databases. In addition, the annual reports of the Central Statistical Agency (CSA), National Bank of Ethiopia (NBE), Planning and Development Commission (NDC), and Ministry of Finance (MoF) were consulted.

An extensive desk review of existing policies, strategies, programs and plans for private sector development in Ethiopia was conducted. This review was performed to evaluate the effectiveness of policies, strategies, programs and plans designed to promote private sector investment over the last three decades. The study also consulted various development plans, namely: IDS (2002), PASDEP (2005/2006–2009/2010), GTP I (2010/2011–2014/2015), GTP II (2015/2016–2019/2020), and TDPP (2020/2021–2029/2030). Furthermore, pertinent sources, such as academic journals and books, annual reports, and policy brief papers, relevant to the study were critically reviewed.

2.2. Method of Data Analysis

A combination of descriptive and econometric analyses was applied to address the objectives of the study. The theoretical framework and econometric model specification are explained and specified in subsequent sections.

Theoretical framework: This study considered two macroeconomic theories, namely: the multiplier and acceleration theories of investment, as a theoretical framework. Multiplier theory considers investment to be a multiplier effect of the growth of the national economy. The theory states that when the national economy of a nation increases, investment is expected to increase. This theory is

silent about the effects of induced investment. In reality, investment might not instantaneously respond to the change in the national economy, or it might also induce growth rather than be the resultant effect (Nipun, 2018). The acceleration principle, on the other hand, explains more about the implications of induced investment. It explains more about how total output or income can bring about additional investment spending. Put simply, this explains why an increase in national income often leads to a disproportionate increase in investment spending. Indeed, it explains why the amount of investment in an economy does not depend on the absolute level of business activity but on whether the activity level is increasing or decreasing. Subsequently, it clarifies that if there is a change in the national income or output of an economy, then it tends to induce a change in investment. The acceleration posits that a small change in national income or output in such an economy will lead to a greater (accelerated) change in investment in the economy. It describes an accelerated effect on investment of a small change in the demand for or output, that is, an increase in sales of consumer goods in such an economy (Nipun, 2018). Following Ayeni (2020), for this study, macro variables that determine private investment or the nature of the response of investment are introduced to simple accelerated theory. Based on both theoretical and empirical literature, private sector investment in this particular study is explained as:

$$TPI_t = f(LTPI, RGDP, UNEMPT, REER, GOVEX, TOT, CREDIT, INFL, RIR)$$

Where:

TPI = Total Private Investment

LTPI = lagged value of *TPI*

RGDP = Real gross domestic product

UNEMPT = Rate of Unemployment

REER = Real effective exchange rate

GOVEX = Government expenditure

TOT = Terms of Trade index

CREDIT = credit provided to private sector

INFL = Inflation

RIR = Real interest rate

ARDL Model Justification and Specification: The ARDL model proves to be a suitable method to estimate the influence of time lag effects of explanatory variables in multivariate time series analysis (Pearn, 2001). Unlike the competing VAR models, the ARDL model treats the parsimonious lags of the right-hand variables as an independent variable (Pesaran and Shin, 1999). For this reason, the only cointegration and error-correction method that allows some of the independent variables to be nonstationary ($I(1)$) and some to be stationary ($I(0)$) is the ARDL bounds testing approach. In other words, the ARDL approach to cointegration has the advantage of avoiding the classification of variables (the independent variables) of interest into $I(0)$ or $I(1)$, and unlike conventional cointegration tests, there is no need for unit root or stationary pretesting (Pesaran *et al.*, 2001). Therefore, to estimate the long-term relationship between private investment and repressors, the ARDL model was selected for the study. The ARDL model involves two stages. In the first stage, it examines whether there is a long-run relationship between the variables under investigation. Second, it estimates the coefficient of the short-run relations and the associated error correlated models.

In order to put the dependent and independent variables on the same level and to make the econometric estimation robust, the differencing of all variables involved has proven to be crucial. Therefore, differenced values simply changes in the variables, and interpretations of coefficient estimates become more logical. Moreover, the tabulated F values (Pesaran and Shin, 2009) have upper and lower bounds, where the upper bound assumes that all the variables are $I(1)$ stationary, and the lower bound assumes that all the variables are $I(0)$ stationary. Therefore, examining whether a variable is $I(1)$ or $I(0)$ stationary, which requires differencing, helps to come up with a conclusion in the case where the calculated F-statistics lie within the upper and lower bounds. Based on what has been brought up earlier, the ARDL model for constraints on private sector investment is given as:

$$\begin{aligned}
\Delta \ln TPI = & \beta_0 + \sum_{i=1}^j \beta_1 \Delta \ln TPI_{t-j} + \sum_{i=1}^k \beta_2 \Delta \ln RGDP_{t-k} + \sum_{i=1}^m \beta_3 \Delta \ln UEMPT_{t-m} \\
& + \sum_{i=1}^q \beta_4 \Delta \ln REER_{t-q} + \sum_{i=1}^z \beta_5 \Delta \ln GOVEX_{t-z} + \sum_{i=1}^f \beta_6 \Delta \ln TOT_{t-f} \\
& + \sum_{i=1}^h \beta_7 \Delta \ln CREDIT_{t-h} + \sum_{i=1}^l \beta_8 \Delta \ln INFL_{t-l} + \sum_{i=1}^n \beta_9 \Delta \ln RIR_{t-n} + \mu_1 \ln TPI \\
& + \mu_2 \ln RGDP + \mu_3 \ln UEMP + \mu_4 \ln REER + \mu_5 \ln GOVEX + \mu_6 \ln TOT \\
& + \mu_7 \ln CREDIT + \mu_8 \ln INFL + \mu_9 \ln RIR + e_i
\end{aligned}$$

Where:

TPI: Total private investment (the dependent variable) measured in million USD
RGDP: Real gross domestic product (a proxy for demand conditions in the economy);

GOVEX: Government expenditure on investment (a proxy for public investment);

UEMPT: Rate of unemployment (proxy for factor availability)

CREDIT: Credit to private sector (proxy for liquidity constraints);

INFL: Rate of inflation (proxy for macroeconomic uncertainties/instability);

REER: Terms of Trade Index (proxy for export competitiveness)

TOT: Terms of trade (proxy for trade balance)

RIR: Real interest rate (proxy for demand for saving)

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5, \beta_6$ and $\beta_7, \beta_8, \beta_9$ are short-run coefficients to be estimated, and $\mu_0, \mu_1, \mu_2, \mu_3, \mu_4, \mu_5, \mu_6$ and μ_7, μ_8 and μ_9 are long-run coefficients

To determine whether there is a long-run relationship among the variables in co-integrating equation (1), the null hypothesis of no long-run relationship (i.e. H_0 : the long run coefficients are jointly equal to zero) is tested against the alternative hypothesis of a long-run relationship (i.e., H_1 : The long run coefficients are jointly different from zero) using the F-statistic (Wald test). The decision rule is that if the computed F-statistic is greater than the upper critical bound, then, the null hypothesis can be rejected, suggesting co-integration. On the other hand, if the computed F-statistic is less than the lower critical bound, the test fails to reject the null hypothesis, and it can be concluded that there is no co-integration. Given the case where the test statistic lies within the lower and upper critical bounds, conclusive inference can only be made once the order of the integration of the underlying regressors is known (Pesaran *et al.*, 1999).

3. Results and Discussions

The results of the study are discussed and presented in the following order: First, policies and programs aimed at promoting private sector development and their challenges and effectiveness are thoroughly discussed. Second, factors that have hindered private sector participation in different sectors over the last three decades were analyzed. In the third part, the contribution of private investment to the Ethiopian economy over the last three decades was described. Finally, the long- and short-run relationships between key macroeconomic determinants and private investment were estimated, inspected, and interpreted.

3.1. Private-Sector Development in Ethiopia

Over the last three decades, the government of Ethiopia has been implementing various policies and strategies. It started with the Industrial Development Strategy (IDS), which has been in practice to date. Subsequently, a five-year Sustainable Development and Poverty Reduction Program (SDPRP) was implemented from 2002/2003-2004/2005. Then, a Plan for Accelerated and Sustained Development to End Poverty (PASDEP) was implemented from 2005/2006 to 2009/2010, which was sequentially followed by the Growth and Transformation Plan-I (GTP-I) (2010/2011 to 2014/2015) and the Growth and Transformation Plan-II (GTP-II) (2015/2016 to 2019/2020). Currently, based on GTP I and GTP II progress evaluation results and the Home-Grown Economic Reforms (HGER) policy direction, the government designed and implemented the Ten-Year Development Plan (TYDP) in 2020/2021 to be implemented until 2029/2030.

In 2002, the government of Ethiopia implemented the first five-year development plan called the Sustainable Development and Poverty Reduction Program (SDPRP) (2002/2003- 2004/2005). During the year, the government designed and implemented a comprehensive separate strategy known as the Industrial Development Strategy (IDS). The strategy recognized the private sector as an engine for fostering industrialization and augmenting the structural transformation process of the economy. The strategy clearly stated that the government tasks for promoting private sector development include: (i) creating

a conducive business environment at all levels for all; and ii) providing direct support to strategically selected subsectors of private sector investment, such as: textiles and apparel, meat, agro-processing industries, construction, and Micro and Small Enterprises (MSEs). In addition, IDS provides a range of support programs (such as economic incentives and capacity building) for cluster development in the above priority areas of private investment in Ethiopia (FDRE, 2002).

The PASDEP (2005/2006 to 2009/2010) builds on policy support initiatives in the SDPRP and IDS aiming for the development of the private sector for the structural transformation and industrial development of the country. The plan envisaged creating a conducive business environment for private sector investment by providing multifaceted support, undertaking various reforms (such as institutional, regulatory, and financial sectors), and strengthening the complementary role of the government with greater domestic and foreign private participation. The plan considers private sector development as a key for realizing the development of the industrial and export sectors of the economy. The plan identified key sectors for private sector investment participation that include (i) agricultural and rural sector; (ii) infrastructure, construction, power generation, and downstream telecommunication services; and (iii) social sectors such as private primary and secondary schools in urban areas; technical and vocational training, and higher education; as well as opportunities in the private provision of health care services. As outlined in the plan, the role of the government is to support and fill the gaps that could not be adequately covered by the private sector and maintain macroeconomic stability, a stable exchange rate, and a lower inflation rate, which are integral parts of private sector development in Ethiopia (MoFED, 2006).

In GTP-I (2010/2011 to 2014/2015), the government aimed to ensure macroeconomic stability to create a conducive investment environment for the private sector's development, such as: enabling the manufacturing industry to play an active role in the economy, revising the investment code to encourage further private sector investment, undertaking privatization of government-owned industries to the private sector, maintaining international competitiveness, and providing support and creating an enabling environment for private sector engagement in productive subsectors, particularly manufacturing subsectors. It also aimed to provide direct support for capacity-

building programs such as twinning programs, benchmarking kaizen, industrial input supply, and skill development programs for the private manufacturing industry sector. Moreover, the plan clearly that government investment in the development of industrial parks with the aim of transferring it to private investors with the utmost transparency and accountability (MoFED, 2010).

Under GTP-II (2015/2016-2016), the plan builds on the GTP-I and recognizes private sector development as a key for creating employment, jobs, and enhancing income on a sustainable basis. The plan also clearly explains the vision to becoming a leader in the light manufacturing (sub)sector in Africa. The plan gives special attention to utilizing opportunities available for sustainable development and transformation of domestic investors. To this end, the plan envisages redirecting domestic private investors from service and construction subsectors toward manufacturing and providing institutional support for the transition of small manufacturing enterprises to medium and large scales. The development of aggressive industrial parks and agro-processing zones in different parts of the country contributed to addressing the bottlenecks related to production and logistic constraints and, thereby, enhancing the productivity, quality, and competitiveness of both domestic and foreign investors. In addition, the plan aims to create a conducive environment for foreign direct investment (FDI) and attract investment in the key sectors of the economy (manufacturing). To this end, the revision of investment regulations was endorsed and approved by parliament and the Council of Ministers in 2012 (PDC, 2016). In contrast to PASDEP, GTP-I and II placed less emphasis on balanced private sector investment in the productive sector of the economy (both agriculture and industry).

The ongoing TYDP (2020/2021 to 2029/2030) adopted private sector-led economic growth as one of the strategic pillars. It aims to create a conducive investment atmosphere and incentivize domestic investors, aiming to strengthen their participation in the key productive sectors of the economy; build strong and market-led public-private partnerships to ensure the establishment of an inclusive and pragmatic market economy; enhance the provision of quality infrastructure to attract quality FDI inflow to the county; identify and optimize new sources of growth; empower and stimulate private sector investment in strategic key areas that provide inclusive growth; and emphasize public-private partnerships on problem-solving innovations and research activities for

inclusive growth and sustainable development. Moreover, the plan also aims to strengthen the role of FDI in industrial parks to make Ethiopia's growth momentum more sustainable in the years to come (PDC, 2020).

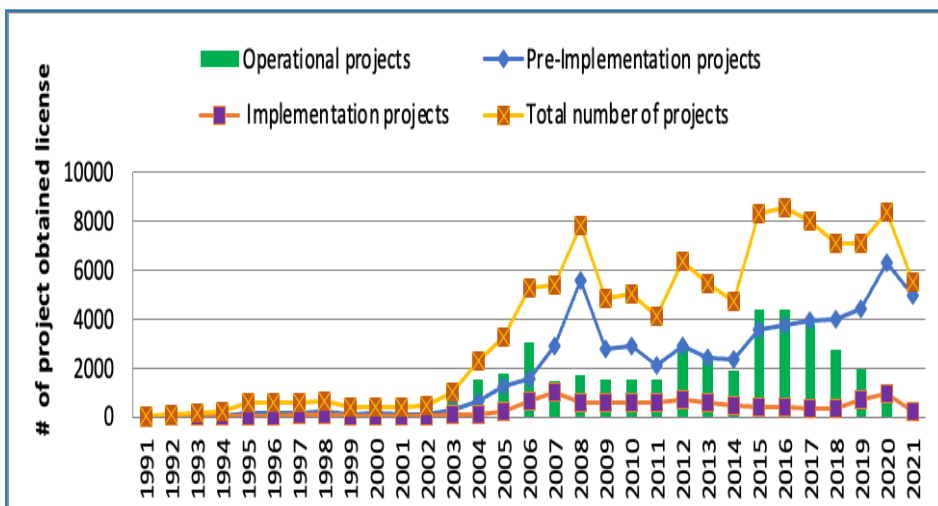
3.1.1. Structure and Performance of Private Sector Investment Across Development Plans

According to the Ethiopian Investment Commission (EIC, 2021), a total of 113,127 private sector investment projects⁴ were registered across all regional states and city administrations between 1991/2002 and mid-2021. Among the projects, the majority of the investment is owned by domestic private investors (94.75%) (107,189 projects), and the remaining 5.25% (5,938 projects) is owned by foreigners. Of the total investment projects registered, 7.87% or 8,901 projects are in the implementation (construction) stage, 43,363 projects, or 38.33%, have launched operations, while the remaining 59,400 projects, or 52.5%, are pre-implementation (licensed investment) projects by mid-2021. This means that less than half (46%) of the total registered private investment projects are converted into actual investments, indicating the slow pace of implementation of private sector investment projects over the past three decades.

Figure 1 below shows the trends in total private sector investment projects under four different project stages over the last three decades. In response to the IDS in 2002, which clearly states the government's commitment to encouraging private sector investment in Ethiopia, a large number of investment projects (both domestic and foreign investment) have been increasing from 2003 onwards. However, the number of operational projects has been very low and has declined over recent years (from 2015 onwards).

⁴ According to project stage of development, private sector investment projects are classified into different status; pre-implementation (licensed projects), implementation (under-construction), and operational projects (EIC, 2021)

Figure 1: Operational status of private sector investment projects, 1991/1992-2021



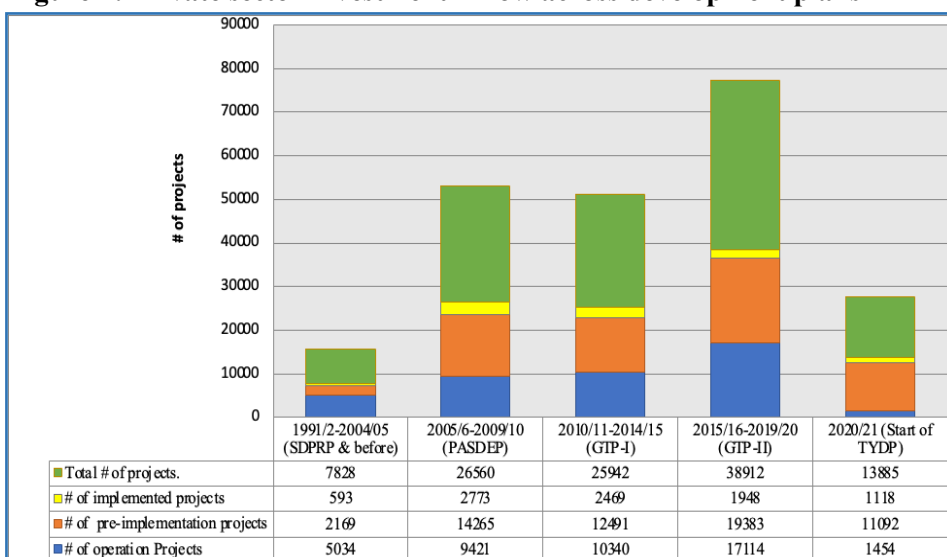
Source: EIC, data accessed on September 2021

According to the official figures from the EIC (2021), private sector investment registered a total capital inflow of 617.3 billion birr from 1991/2002 to mid-2021, of which 238 billion birr capital (38.57%) was invested during the GTP-II periods, which is the leading of all development plan periods, followed by the capital invested 159.2 billion birr (25.79%) during the GTP-I and 115.8 billion birr (18.76%) during the PASDEP periods, respectively. However, the capital invested in private sector investment decreased to 51.9 billion birr (8.41%) at the beginning of the TYDP period. This implies that the total capital invested by private sector investment is leading during the GTP-II period in response to the policy direction that placed emphasis on directing private sector investment toward the manufacturing sector of the economy.

Figure 2 shows private sector investment flow by the status of projects across development plans. The first period spanning 1991/2002 to 2004/2005, which constituted both the SDPRP and IDS, was a period of the beginning of private sector investment inflow in which from a total of 7,828 projects, 7.61% (5,034 projects) were operational during the periods. Subsequently, during the PASDEP periods (2005/2006 to 2009/10), from a total of 26,560 projects, 9,421 or 10.48% of the projects were operational. In the third period, GTP-I (2010/2011 to 2014/2015) registered 25,942 projects, of which only 9.76%

(10,340) were operational projects. The fourth period, during GTP-II (2015/2016 to 2019/2020), registered a total of 17,114 projects, of which only 5.07% of the projects were operational during the period, which is the maximum compared to all five-year development plans. Finally, the last period is the beginning of the current TYDP (2020/2021 to 2029/2030), registering a total of 13,885 projects, of which 8.05% (1454 projects) are operational. This shows that the implementation rate of the projects is higher during GTP-II and has shown improvement across all plans over time but is still very low compared to the number of licensed projects in all plan periods.

Figure 2: Private sector investment inflow across development plans



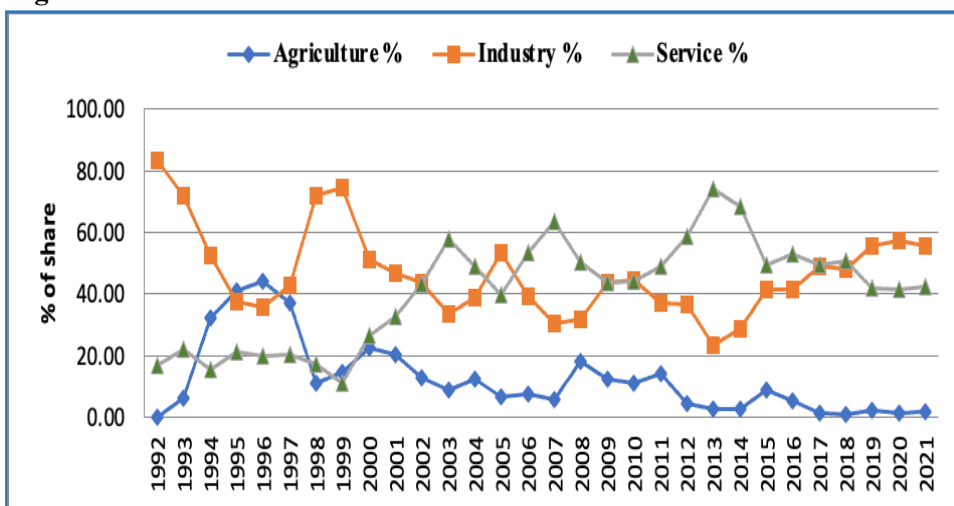
Source: EIC, data accessed on September 2021

3.1.2. Performance of Private Investment Across the Main Sector and Subsectors

Private sector investment inflow contributes to the development endeavor of the country as peroxided by the amount of capital invested among the main subsector of the economy over the last thirty-one years (1991/1992 to mid-2021). Out of 43,363 operational investment projects, 21,984 projects (50.70.04%) are service sector investments, 18,556 projects (42.79%) are industry projects, and the remaining 2,823 projects (6.51%) are agriculture sector investment projects (EIC, 2021). This shows that the majority of private

sector investment has been made mainly in the non-productive sector of the economy over the last three decades.

Figure 3: Private sector investment inflow subsectors



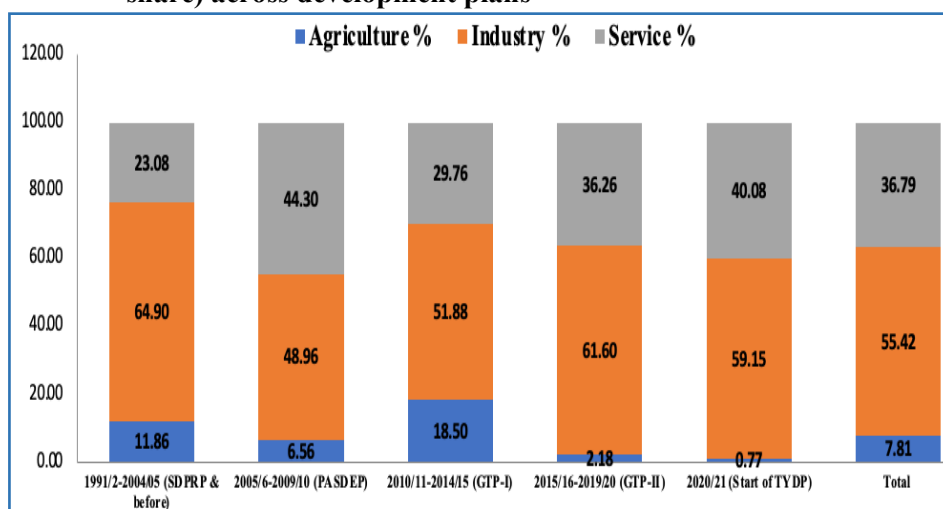
Source: EIC, data accessed on September 2021

Figure 3 shows the trends in the operational number of project shares across the main sectors of the economy from 1991/1992 to mid-2021. The total number of operational projects in the service subsector led from 2005/2006 to 2017/2018 and subsequently declined from 2018 to 2021. The industry subsector took the lead starting in 2018 and showed incremental trends from 2013 onwards. However, the agricultural subsector share illustrates declining trends over time, from 1996 to mid-2021. This shows that the majority of operational private investment projects are from the service or industry sectors, with lower investment projects in the agriculture sector over recent years. This might be policy support starting with the GTP-I and GTP-II plans, which have placed much emphasis on the manufacturing industry and hence resulted in good progress in shifting private investment inflow from the service sector to the industry. However, balanced policy support for the productive sector between the manufacturing and agriculture sectors is crucial in the years to come.

Figure 4 below shows the sectoral distribution of the invested capital share of investment projects across the successive development plans. Out of a total of 617.3 billion birr in capital investment made over the last three decades, the industry sector took the lead share with 342.1 billion birr (55.42%),

followed by service with 227.1 billion birr (36.79%) and the agriculture sector with 38.2 billion birr (7.81%), with a leading similar sector rank in all development plans showing lower investment inflow to the agriculture sector over the last three decades. This partly demonstrates the effectiveness of GTP-I and GTP-II policy support to redirect private sector investment toward productive sectors (industry). As a result, most private sector investment seems to be channeled towards the industry sector over the next ten years. Although the performance of the industry has been impressive during the GTP-II, the figure suggests substantial declining trends of agricultural investment with increment trends of an operational project in the service sector during the periods. The result suggests that there are some promising signals that the industrial sector might have begun to emerge with no or little agriculture sector investment, which indicates the less nascent structural change in the productive sector of the economy.

Figure 4: Sectoral breakdown of investment projects (capital invested share) across development plans



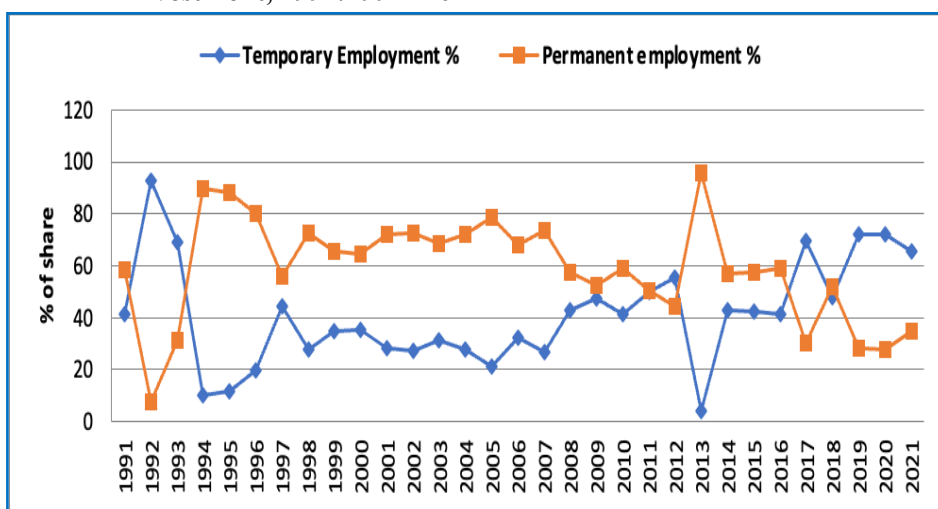
Source: EIC, data accessed on September 2021

The creation of employment opportunities by private sector investment projects has increased demand for temporary or casual work. However, permanent employment opportunities have declined in recent years. Private sector investment projects, which started operations, created a total of 941,496 (23.9%) permanent employment and 2,997,196 (76.1%) temporary job opportunities from

1991/1992 to mid-2021. Looking at the share of employment in the major sectors of the economy (i.e. agriculture, industry, and service), out of the total employment opportunities, 57.27% (225,576 jobs) was created by the service sector, 24% (945,671 jobs) by industry, and the remaining 737,261 employment jobs, or 18.72%, was created by the agriculture sector (EIC, 2021). This shows that the majority of employment opportunities are created by the service sector, while industry and agriculture have contributed less over the last three decades, which shows the infancy stage of the productive sector of the country.

Figure 5 shows the trends in the share of permanent and temporary employment opportunities created by private sector investment projects over the last three decades. The results show a declining pattern in the share of permanent employees from 1994 to mid-2021, except for an increase in 2013, while temporary employees show increasing trends (the highest in 1992 and lowest in 2013), which is contrary to the government plan. The most relevant type of employment is permanent, since human capital skills and technological know-how are provided by permanent rather than temporary workers, and therefore due attention and incentive schemes should be given to private sector investors to opt for permanent forms of employment rather than temporary employment in the years to come.

Figure 5: Permanent and temporary employment jobs by private sector investment, 1991/1992 -2021

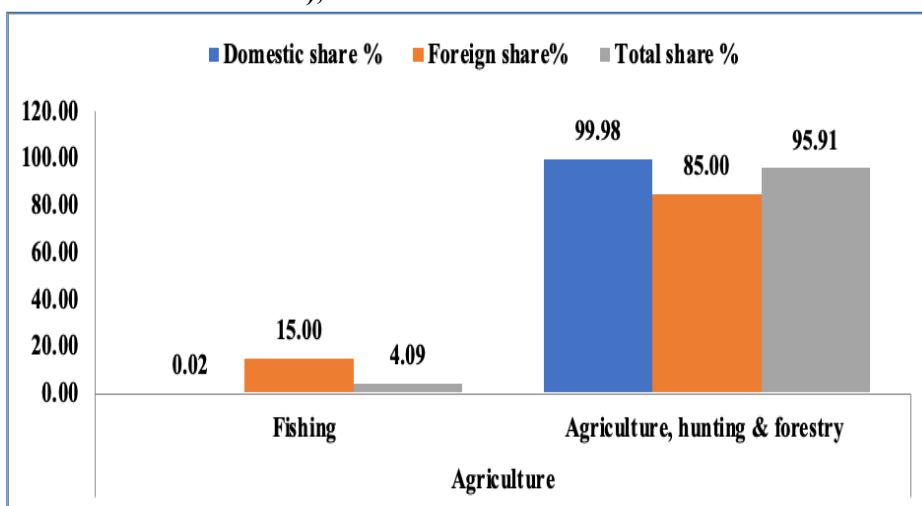


Source: EIC, data accessed on September 2021

Based on the EIC data from the past three decades, the sub-sequent section examines in detail private sector investment flows across the main sub-sector of the economy.

Figure 6 shows that the largest agriculture sub-sector investment is found in the agriculture, hunting, and forestry subsector (95.91%) and is distantly followed by the fishing subsector for both domestic and foreign investments over 1991/2 to mid-2021. The result suggests that there is little or no private sector investment (domestic and foreign) in the fishing sub-sector, which is one of the comparative advantages of exploitable fish potential in response to the development of various dams, including the Great Renaissance Dam (GERD) of Ethiopia.

Figure 6: Leading sector in the agriculture subsectors (total capital invested share), 1991/1992 -2021

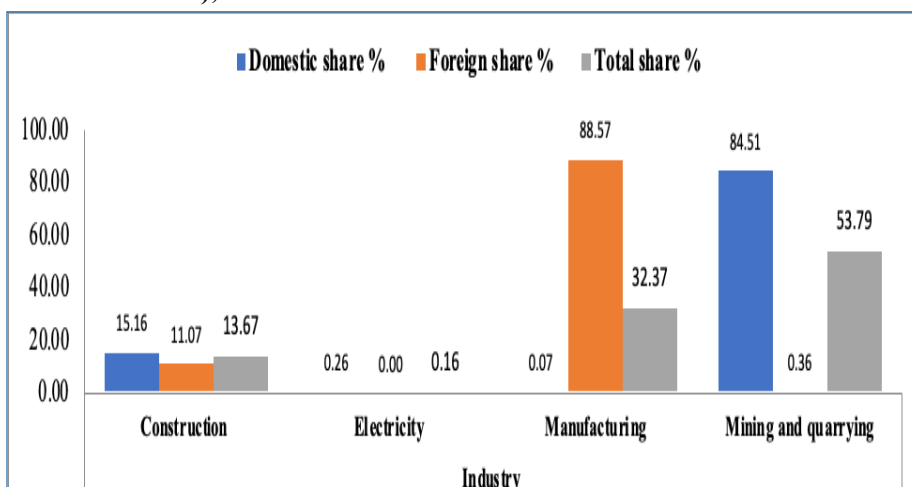


Source: EIA, data accessed on September 2021

The private sector investment sectoral share of capital invested within the industry sector from 1991/1992 to mid-2021 is depicted in Figure 7. The total capital invested by foreign investors in the manufacturing subsector took the leading share (85.57%), followed by the construction subsector (11.09%), whereas the remaining few foreign investors engaged in electricity, mining, and quarrying subsectors. However, the total capital invested by domestic investors took the lead in mining and quarrying (84.51%), followed by the construction

subsector, while the remaining few domestic investors engaged in electricity and manufacturing subsectors. This suggests that domestic private investors' engagement in the manufacturing subsector remained less satisfactory despite GTP I and GTP II policy attention and incentives given to redirect the private sector toward the manufacturing sector since the sub-sector would spearhead and transform other industrial sectors of the economy. This might be because domestic private investors lack industrial knowledge, technical and managerial skills, and experience in operating large manufacturing industries. Therefore, the participation of domestic private investors in the manufacturing subsector has been limited in recent years.

Figure 7: Leading sector in the industry subsectors (total capital invested share), 1991/1992 - 2021

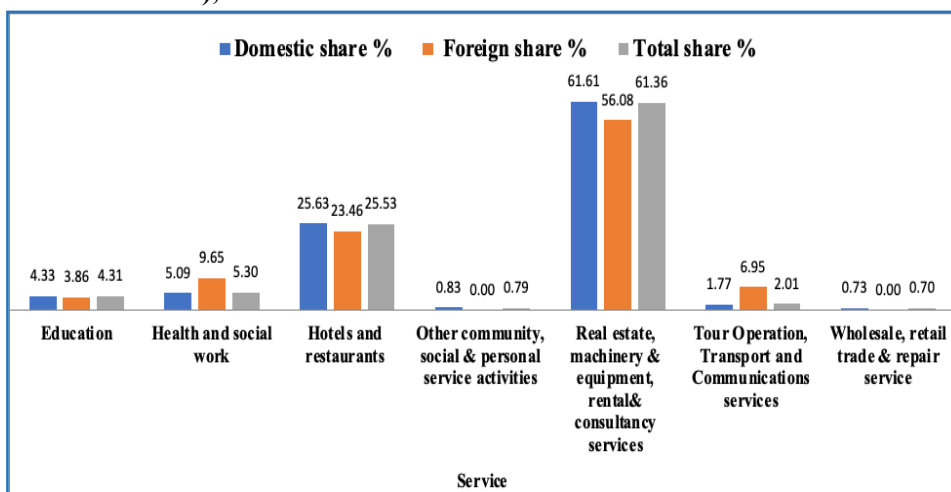


Source: EIC, data accessed on September 2021

The sectoral share of capital invested by private sector investment within the service sector from 1991/1992 to mid-2021 is depicted in Figure 8. The leading two service subsectors in terms of invested capital in operational projects by both foreign and domestic investors are real estate, which includes machinery and equipment, rental and consultancy services (61.36%), and hotels and restaurants (25.53%). The other three subsectors have a share of 0.7 to 5.3 percentage points. This indicates that private sector investment (both domestic and foreign) has been lopsided more towards a few service subsectors, which might be due to the lower level of start-up capital requirement, technical and

managerial capability, the lower payback period of capital return, and associated risks compared to those in the service sector. In addition, the concentration of the private sector on a few service subsectors might be due to the short-term profit maximization motives of firms.

Figure 8: Leading sector in the service subsectors (total capital invested share), 1991/1992 -2021



Source: EIC, data accessed on September 2021

3.2. Sectoral Composition of Private Sector Investment

The data obtained from the EIC covers private capital investment in major economic activities over the last three decades (1991/1992-mid-2021) in Ethiopia. The data for this study were organized around three major subsectors of the economy: agriculture, industry (manufacturing), and services. The data was further examined for each subcomponent of the sectors in order to unpack, characterize, and evaluate the country's private sector investment over time.

3.2.1. Capital Investment by Private Sector on the Subsector of the Economy

The service sector was the most important subsector to attract capital investment over the last three decades (1991/1992-mid-2021), followed by the manufacturing sector. Among the various major service sector investments, capital invested in real estate, machinery and equipment, rental and consultancy services stand first, followed by hotels and restaurants. The average capital invested in mining and quarrying is the leading industry subsector due to its

huge investment requirements compared to other investment in the industrial sector. While the agricultural sector has been considered the leading sector toward economic growth and development and backed by all the development policies thus far, the average capital investment in the sector is by far smaller than investment in subcomponents of the service sector such as hotels and rent. Although it is not possible to draw any implication at this level, it clearly shows a divergence between the policy directives and what has exactly been happening on the ground (Table 1).

Table 1: Average capital investment by subsector in billion birr (1991/1992-mid-2021)

Subsectors Sectors	Capital (in billion birr)		
	Domestic	Foreign	Total
Agriculture, hunting & forestry	35.1	11.1	46.2
Fishing	0.0	2.0	2
Agriculture total	35.1	13.1	48.2
Manufacturing	0.2	110.6	110.8
Construction	32.9	13.8	46.7
Mining and quarrying	183.6	0.5	184.1
Electricity	0.6	0.0	0.6
Industry total	217.2	124.9	342.1
Education	9.4	0.4	9.8
Health and social work	11.1	1.0	12.1
Hotels and restaurants	55.6	2.4	58
Other community, social and personal service activities	1.8		1.8
Real estate, machinery & equipment, rental & consultancy services	133.6	5.7	139.3
Tour Operation, Transport and Communications services	3.8	0.7	4.5
Wholesale, retail trade and repair service	1.6		1.6
Service total	216.9	10.2	227.1
Total	469.2	148.2	617.4

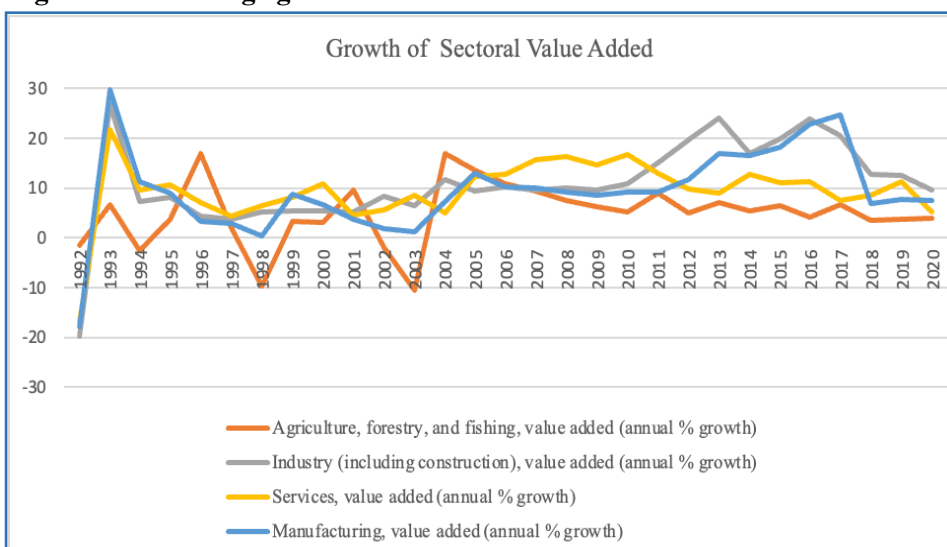
Source: EIC data accessed on September, 2021

The results in Table 1 above and Figure 9 below also provide a glimpse of the resource allocation of the country over the last three decades. Even in the service sector, the most important sectors from the societal perspective, such as education and health, have been given less priority to invest in. Generally, private sector investment in Ethiopia seems more focused on less risky and highreturn investment sectors than high impact and long-term societal welfare.

3.2.2. Evolution of Sectoral Value Added

The trend of annual growth of sectoral value added is mixed. Immediately after the regime change (1992), all the sectors showed a boom except the agricultural sector. Of course, the economic recovery effort by the current government could be the major pushing factor for the sharp rise. Although there was a consistent and almost identical change in value added growth during the 1994-2004 period, for the industrial service and manufacturing sectors, the agricultural sector exhibited larger swings. The unhealthy fluctuation in the agricultural sector's value added could be linked to policies such as agricultural development-led industrialization, which were resource shifts and extensive but sporadic interventions in the sector because of market liberalization and privatization.

Figure 9: Percentage growth of sectoral value added



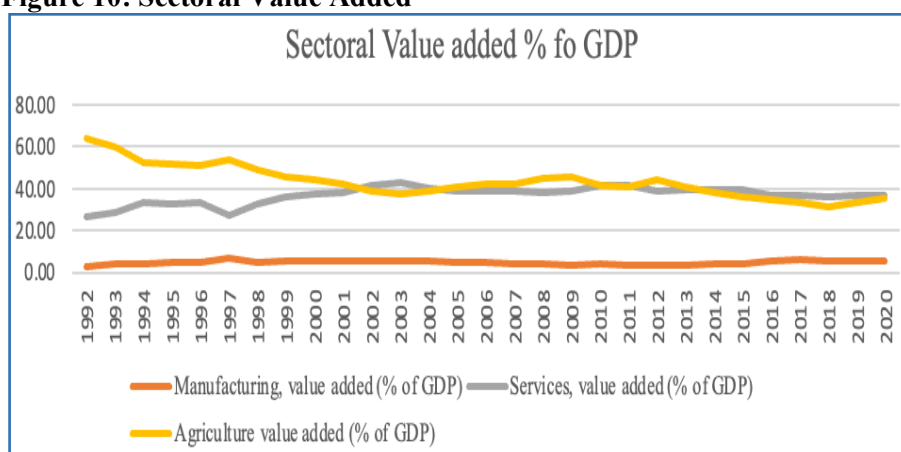
Source: Own computation (NBE and WB data 2020)

Figure 9 above shows that after 2005, the change in agricultural sector value added declined gradually, and the pattern depicted trends similar to those of the service sector. However, the industrial sector overtook the service sector starting in 2011 onward. The pictorial view depicted in Figure 9 is consistent with policy directives such as GTP I and GTP II, where much focus is given to enhancing value-added activities in the manufacturing sector. Nonetheless, the value-added growth in the agricultural sector remained stagnant, while it still contributed to the lion's share of the GDP of the country. Moreover, in recent years (starting in 2017), the value-added growth of all sectors has exhibited declining and mixed patterns.

3.2.3. Evolution of GDP Composition

In this subsection, the manufacturing sector is given due attention, as the relative development of this section is sluggish, in contrast to the government plan. The sectoral distribution of growth of each sector in percentage shows heterogeneity over time (Figure 9). However, the percentage contribution of the main sector's value addition tells a very different story (Figure 10). The manufacturing sector's contribution to the overall value added (% GDP) is stagnant throughout the period covered. On the other hand, the service sector has been competent with the agricultural sector, which is against the structural pathways of the economy, in which the share of the agricultural sector was expected to decline while the manufacturing sector competed with the service sector.

Figure 10: Sectoral Value Added



Source: Own computation (NBE and WB data 2020)

The converging pattern of the agricultural and service sectors over the last three decades clearly shows that the economy is burdened with pure consumption. Unless the consumption demand from the service sector (demand) is backed by equivalent output (supply), it becomes distortionary and consequently economically unstable.

3.3. Long-Run and Short-Run Deriving Forces of Private Investment

The advantage of the ARDL approach over other multivariate time series techniques is that estimation of the short and long-run coefficients does not require any form of prior stationarity of the right-hand side variables (Pesaran *et al.*, 2001). However, there are a series of steps to be followed before determining the final model specification. Accordingly, prior to running the ARDL model specified, the parsimonious lag for each series was determined using the AIC optimum lag length determination criteria. Accordingly, ARDL (3 1 1 1 0 0 11 0) was found to be the appropriate specification. Furthermore, the robustness of the model was tested using the Ramsay regression specification error test for variables, and the model was found to be the most robust.

Given the limited number of data points, the ARDL model is fitted using the Akaike information criterion (AIC) to capture the long-run effect of the regressors chosen. In addition, the consistency of the long-run relationship was tested using the *Pesaran/Shin/Smith (2001) ARDL Bounds Test approach*, and the result was found to be significant ($F=7.494$), which is much higher than the critical values at the 5% significance level (I-1 critical value = 3.12). This test result implies that we can confidently reject the null hypothesis, meaning that there is a significant long-run relationship between private investment and the regressors.

The estimated ARDL model revealed that out of eight explanatory variables, four variables have a significant long-run relationship with private investment. In the long run, the real effective exchange rate (REER), government expenditure (GOVEX), credit provided to the private sector (CREDIT), and real interest rate (RIR) have a positive significant effect on private investment in Ethiopia (Table 2).

Table 2: Estimated long and short-run coefficients using the ARDL (3 1 1 1 0 0 11 0 1)

Variables	Coefficient	Std. Err.
Long run dynamics		
TPR (L1)	-1.967***	0.404
RGDP	0.001	0.004
UEMPT	-2.086	2.903
REER	0.246**	0.083
GOVEXP	0.945*	0.437
TOT	0.019	0.049
CREDIT	0.121**	0.039
INFL	-0.162	0.108
RIR	0.276*	0.134
Short run Coefficients		
TPI		
L1.	0.491	0.298
L2.	0.493*	0.264
□lnRGDP (L1)	0.049	0.002
□ln UNEMP(L1)	-9.099	10.16
□lnREER (L1))	0.484*	0.264
□lnCREDIT□(L1)	1.127**	0.360
□lnINFI□(L1)	0.193	1.617
_cons	0.670	0.425

Note: ***, ** and * are significant at the 1%, 5% and 10% levels, respectively

Source: Model Result

The real effective exchange rate is found to be significant at the 10% significance level. A country's real effective exchange rate is a measure of the competitiveness of domestic products in the international market. A one percent increase in the competitiveness index of the country results in a 0.25 increase in private sector investment. Hence it is important to look at the change (improvement) in real effective exchange while dealing with exchange rate policies.

Theoretically, government expenditure crowds out private investment in the short term but crowds in the effect of private investment in the long run (Laopodis, 2001). Consistently, the long-run coefficient estimate of government expenditure revealed that there is a positive and significant causal relationship between government expenditure and private investment. This implies that government expenditures on infrastructure developments (such as transport, energy, and social services) will not have instantaneously stimulating effects and will not create a shortage of loadable funds for private sector investment (Ayeni, 2020; WBa, 2016). Therefore, the long-run result is theoretically, empirically, and practically consistent.

Credit is proved to be a source of capital to boost private investment in an economy. In line with the results reported by Solomon (2021), the long-run estimates of credit offered to private investment revealed that there is a positive and significant effect. A 1% increase in credit increases private investment by about 0.12%. This result calls for more attention towards the provision of working capital in order to realize the potential of private sector investment contribution to the country's economy.

The real exchange rate is found to have a positive and significant effect on private investment. Since the real interest rate is the difference between inflation and the bank interest rate, its value is negatively worsening over time due to the fact that inflation is usually higher than the bank interest rate. Therefore, the result of the study is in line with the reality on the ground. The implication is that the higher the real exchange rate in its absolute value, the better for private investment. This means that investors prefer to reinvest their profits and savings rather than deposit them in a bank. However, it is very crucial to cut a balance between the savings of most of the society where the marginal propensity to consume is too high. An increase in the real interest rate discourages this segment of society from saving and investing.

Once the long-run cointegrating model has been estimated, the third step is to model the short-run dynamic parameters within the ARDL framework. Thus, the lagged values of all level variables (a linear combination is denoted by the error-correction term, ECM_{t-1}) are retained in the ARDL model. Table 2 presents the results of the estimated error-correction model (ECM) of the private sector investment model using the ARDL technique. The result shows the

lagged value of total investment (L2), real effective exchange rate (REER), and credit have a positive effect on private investment.

The autoregressive short-run effect of private investment was found to be significant, implying that there is a positive spillover effect of last year's investment on the present. This result is in line with the rational expectation theory, where investors are rational and do have information about the industry. Hence, the more vibrant industry in the last period stimulates investment in the current period.

Consistent with Ayeni (2020), the real effective exchange rate is found to have a positive and significant effect on private investment in the short run. This result is consistent with economic theory, which implies a real effective exchange rate increases the overall competitiveness and hence stimulates private investment (Romer, 1996). Exchange rate policies are important to bring instantaneous changes in private investment as well as sustain and stimulate economic activity in the long term. Similarly, the short-run result shows credit has a positive and significant effect on private investment in the short run, suggesting that rectifying financial services will boost private investment in the upcoming years.

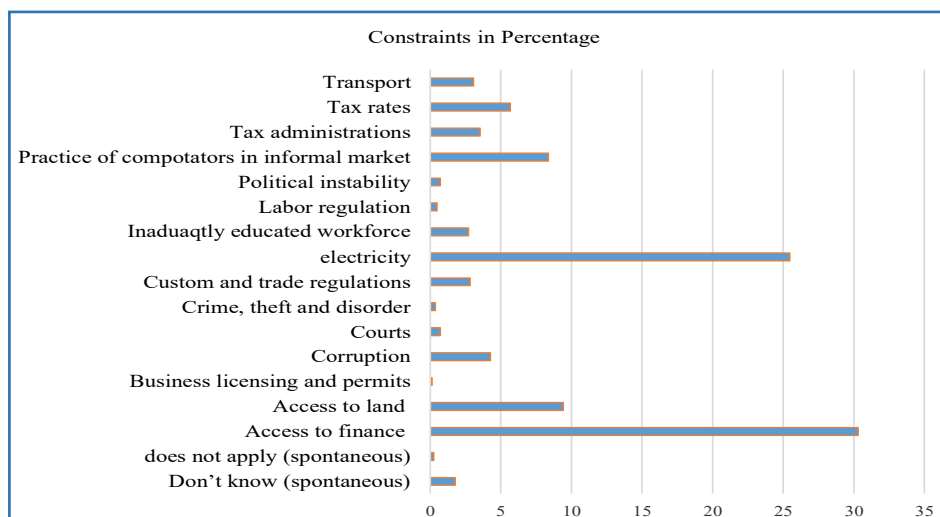
3.4. Challenges and Constraints of Private Sector Investment in Ethiopia

This section examines the main challenges and constraints of private sector development in Ethiopia. A series of economic reforms have burnished and promoted the country's profile among the international private sector keen to tap Ethiopia's competitive labor force, emerging domestic market, and regional trade access (FDRE, 2020). The government aims to expand the role of private sector investment by providing various policies and strategies to support the development of industrial parks to encourage FDI inflow to the country. In response, the country's exports, job opportunities, and transfer of knowledge and technology have been improving over time (WB, 2021). However, the government invested heavily in industrial parks to be transferred to private sector investors and attempted to address various constraints and challenges that would limit both competitiveness and resilience to various shocks in private sector investment. The result of various empirical studies shows that the private

sector faces key challenges which prevent it from playing a much greater role in driving economic growth and job creation (Kifle and Atilaw, 2018). In addition, the ongoing COVID-19 pandemic and political unrest, which are causing instability in different parts of the country, are adversely affecting private sector investment, with direct impacts on consumer demand decline, contracted product markets, the blocking of foreign revenue and importing valuable inputs that have access to finance and are vital to private sector development (FDRE, 2020). Therefore, in exploring the contemporary challenges and constraints of private sector investment in Ethiopia, this study explored different datasets, namely: the Enterprise Survey (2015), Primary Manufacturing Survey (2020), and Phone Survey Data (2020/2021). Based on these survey results and from the critical empirical reviews of previous studies, the main constraints and challenges of private sector development in Ethiopia identified by the present study are as follows:

Limited access to finance: As shown in Figure 11, the enterprise survey of WB (2015) showed that from the 848 enterprise survey respondents, 30.31% of the respondents reported that access to finance was the main constraint encountered during the establishment of private sector investment in Ethiopia. Similarly, access to financing was also found to be a leading constraint of private sector investment in a more recent primary manufacturing survey of the WB (2020). Inefficient financial markets increase the reliance on internal funds or informal sources by connecting firms that are creditworthy to a broad range of lenders and investors. A firm's ability to access financial markets to undertake investments and other operational requirements appears to be a prominent obstacle. The sources of a firm's financing and the features of its financial transactions may indicate excessive dependence on internal funds and potentially inefficient financial intermediation. Ethiopia's government exerts a variety of control mechanisms over the banking sector that constrain firms' access to finance.

Figure 11: Constraints of private sector investment during the establishment of businesses

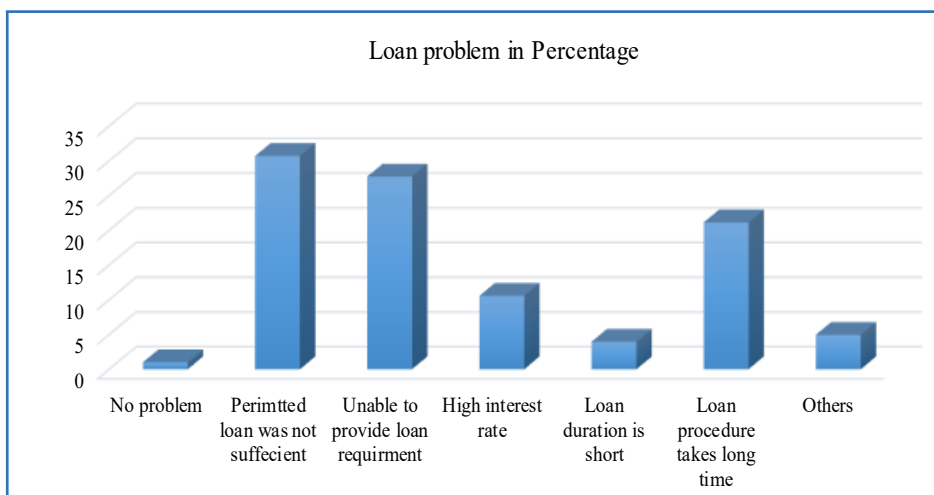


Source: Author's estimate from Enterprise survey (2015).

As shown in Figure 11, the main problem related to Ethiopian enterprises' accessing finance was related to the loan problem. Based on the estimated results obtained using primary manufacturing survey (2020) data, approximately 51.13 respondents reported that they faced loan problems during the establishment of the manufacturing industry. The loan-related problems include insufficient permitted loans; inability to fulfill loan requirements; high interest rates; short loan durations; bureaucracies; and long loan procedures. This finding identified a low percentage of firms financed by banks in Ethiopia. Since commercial banks generally serve Ethiopia's largest firms and regionally focused microfinance institutions tend to micro-scale enterprises, the needs of the "missing middle" of small and medium-sized enterprises largely go unmet. This was also reported by Dalberg (2019) and FDRE (2020). For instance, starting in 2014, Ethiopia showed that mixed signals of constrained access to finance characterized by a rise in the saving rate, increasing the supply of funds for lending, and as a result, private bank lending to private sector investment has risen by 22 percent annually. However, survey results revealed that the bulk of investments continue to be self-financed or served by the black market. Although improvement in the financial landscape has made significant progress

in the development of private sector investment, finance remains a notable weakness and has been characterized by low domestic savings mobilization, underdevelopment of capital markets, and insufficient credit to key sectors (Tyson, 2021).

Figure 12: Reasons for not solving the loan problems



Source: Authors' estimation by using primary manufacturing survey (2020)

Lack of Physical Infrastructure: This includes electricity, transport, and water supply, which are prerequisites for competitiveness and growth in private sector investment. The quality of physical infrastructure efficiently connects private businesses to markets for inputs, products, and technologies; reduces the cost of production; and enhances the competitiveness of businesses in local and international markets. As shown in Figure 11, according to the enterprise survey of the WB (2015), approximately 25.4% of interviewed private sector investors replied that electricity is the second constraint that hinders the establishment of private sector investments. Furthermore, according to a primary manufacturing survey of WB (2020), approximately 7.15% of interviewees reported that they faced a shortage of electricity and water supply in the manufacturing industries, which hindered the full capacity operation of the businesses. An inadequate electricity supply can increase costs, disrupt production, and reduce the profitability of businesses. A variety of indicators point to unreliable access to electricity as a constraint on economic activity. According to Abdisa (2018),

frequent and prolonged electricity power outages harm employment, productivity, and export earnings in all private sector developments. Specifically, electric power distribution and generation are the binding constraints on private sector investments in Ethiopia. The distribution of electric power either remains incomplete or has been degraded due to poor maintenance, which results in low availability and frequent outages, which interrupt production and raise costs for firms that rely on a steady, predictable power supply. Ethiopia has embarked on an expansion of power generation capacity with projects scheduled for completion in the next few years, but the obsolescence of transmission and distribution infrastructure continues to compromise reliable supply.

Transport is another physical infrastructure that hinders the development of private sector investment. Based on the enterprise survey of the WB (2015), approximately 3.07% of Ethiopian firms report that transportation is one of the constraints for private sector investors. Ethiopia's current state of transport and logistics performance imposes an additional layer of costs to firms seeking to export and generate foreign exchange rates. The inefficiency of transport services imposes additional costs on firms and may act as barriers to private sector investment. Moreover, based on the World Bank's Logistics Performance Index, which considered infrastructure, timeliness, customs, and logistics quality, Ethiopia is ranked last compared to Kenya, Rwanda, and Uganda. Much of this index results in poor road quality and connectivity (WB, 2021). Ethiopia's road network also lags far behind its comparators, with the average rail density of its comparators exceeding Ethiopia by more than twelve times. According to Nakamura *et al.* (2019) and Iimi *et al.* (2019), Ethiopia's export transit has taken 42 days, far exceeding Rwanda and Uganda, and is twice as long as Kenya. Underlying these delays is the long inland distance to the Djibouti port, which delays the document preparation for port handling and customs clearance processes, which are also longer and costlier. Consequently, these notable constraints are due to the long bureaucratic process involved and the existing legal arrangement among constraints that hinder the private sector.

Ethiopia has abundant water and sanitation resources. Nevertheless, much of Ethiopia's private sector investments face challenges in terms of water supply and access to safe drinking water. For many manufacturing industries, water is also an important input in the manufacturing process. Interruptions in

the water supply can have serious adverse effects on firms' operations. In the absence of absolute scarcity in much of the country, the technical cost of withdrawals primarily drives the price of provision (WB, 2021). In surveys of the manufacturing sector, water insufficiency does not appear to be a significant constraint when compared to other potential issues in terms of percentage reports.

Access to land: According to the enterprise survey data of WB (2015) in Figure 11, of the interviewed private sector investors, approximately 9.4% of the respondents replied that access to land discouraged the private sector investment. Access to land was challenged by inadequate support from the government side, followed by poor implementation and enforcement of policy at all levels and inadequate access to land. In Ethiopia, reforms to land policies are related to land certification campaigns that introduced land use rights through long-term leases, as well as permission to rent, transfer of usage rights, and bequests.

Land continues to account for the bulk of the government's dispute resolution activities and processes, taking a long time and adding to the cost of transferring land between parties and the reliability and transparency of its administrative processes. The government should pay compensation if the land is given for private sector investment as a form of leases, but often complains that the compensation paid has been reported to be unfair and inadequate. As a result, it would be a source of conflict and instability (Stebek, 2015). Specifically, the Ethiopian government's development of industrial parks throughout the nation has recently solved land for large, foreign-owned factories and other manufacturing industries to improve land constraints facing private investors in the country (FDRE, 2020). However, it is not sufficient for domestic private sector investors and those who are engaged in micro and medium-sized enterprises. The study identified difficulties in improving tenure security in order to facilitate the emergence and consolidation of a strong private sector investment. In connection to this, Stebek (2015) notes that Ethiopian land governance faces challenges in the availability, transferability, and affordability of land access for business activities.

The practice of the informal market: Formal private businesses exist and operate inside the bounds of government regulations. The effect of practices in the informal market influenced the competitiveness of formal firms. According to the estimated result of the enterprise survey data of WB (2015) (Figure 11), approximately 8.37 percent of respondents reported that informal market practice adversely affects formal private business. The practice of informal marketing activities and inadequate regulatory tax systems may affect the development of formal private businesses. Thus, these adversely influence market opportunities for formal businesses. Formal firms can impose additional costs of production compared with a business engaged informally and could not compete in the market. Furthermore, financial inefficiencies in the labor force from formal firms may have an impact on business growth. Consequently, it creates more opportunities for informal business. According to Amha (2019), firms from the formal sector do not develop faster than firms from the informal sector.

Tax-related issues: Tax rates and a poor administrative system are the main obstacles hindering the development of private sector investment in Ethiopia. According to the World Enterprise Survey of WB (2015) result, the main reasons were high tax rates (5.66%) and poor tax administration (3.54%) (Figure 11). The result attested that investors were challenged by inadequate support from the government side related to tax rates and tax administration. Moreover, poor implementation and enforcement of the policy at all levels were also found to be a challenge negatively influencing private sector investment. As a result, good governance in taxation is a critical issue in creating a conducive business environment. Formal businesses pay taxes and are supposed to comply with regulations, and tax administration and regulations safeguard the general public's interest while remaining transparent and not imposing the administration process on private sector investment. Gizachew *et al.* (2021) and Nikus (2021) also confirmed that the reformation of tax administration and regulations should be undertaken to improve private sector investment in the productive sector of the economy.

Corruption: The finding showed that corruption is also the main challenge and constraint on private sector investments in Ethiopia. Ensuring accountability is

critical to the success of private-sector investor operations. When these rules are obscured or bent due to corruption, firms may limit their full capacity of operation. The result of the enterprise survey of the WB (2015) shows only approximately 4.25% of the respondents replied that corruption is an obstacle to the establishment of the private sector. Private investment investors are requested to pay a bribe to obtain selected services when they request a construction permit while trying to secure a government contract or during meetings with tax officials. This act creates an unfavorable business environment by undermining operational efficiency and raising the cost of production. Corruption and bribes are common and quite high and add to the bureaucratic cost of obtaining the required permits and licenses. This can be an obstacle to the development of private sector investments. This is due to lack of institutional capacity and a poor system. Based on this finding, the present analysis flags corruption as problematic but not a binding constraint on private sector investment in Ethiopia.

Inadequately educated workforce: Despite improvements in the overall educational coverage over recent years, results pointed out that a lack of adequately qualified educational professionals in the labor market affected the private sector investment in Ethiopia. There has been a significant improvement in formal education in Ethiopia. As a result, secondary education enrollment has steadily increased to around 40% (WB, 2020). Meanwhile, the young workforce accounts for a growing portion of human capital. The World Bank Enterprise survey (2015) result shows 2.71% of the responses were related to the problem of the quality of the educated workforce (see in detail Figure 11). The respondents reported that the supply of labor from college and university graduates lacks the required technical knowledge and skills. Therefore, private sector investors remain dissatisfied with the availability of quality-educated workers in the labor market. According to MoE (2019), most graduates lack soft skills such as teamwork, creativity, and initiative. These problems discourage private businesses' ability to innovate and grow, which is basically due to weak linkages between industry and universities.

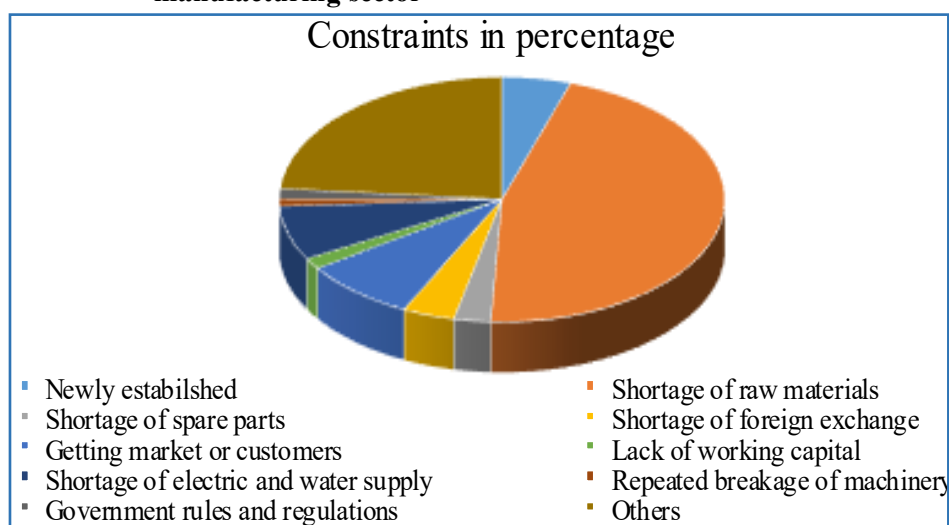
Custom and trade regulations: Customs and trade regulations include issues related to policies and conditions, profit taxation, protection of property rights,

and business regulation. They are also the main challenges and constraints on private sector investments in Ethiopia. Involvement in international trade permits private sector investment to expand, raise standards for efficiency, import materials at lower cost, and acquire updated and better technologies. However, trading requires firms to deal with customs and trade regulations and it is necessary to obtain export and import authorizations. Customs and trade-related constraints can often delay the timely delivery of goods and services to the international market. According to the World Bank (2021), compliance costs for imports in Ethiopia are more than double compared to sub-Saharan Africa (SSA). However, exports are about the same as in SSA. Border compliance costs are much lower than SSA. Overlapping institutional setups and a lack of coordination create conflicting authorities across different government structures and have brought complaints from private businesses that rely on the well-coordinated administration of regulations and procedures. From the World Bank's enterprise survey results, approximately 2.83% of private-sector investors replied that they faced obstacles to customs and trade regulations (see Figure 11). Efficient customs and trade regulations enable businesses to export and import goods directly. Delays in clearing customs for exports and imports create additional costs for the firm. These can interrupt production, interfere sales, and affect supplies or merchandise.

Shortage of foreign exchange: Based on survey results of WB (2020), the shortage of foreign exchange was one of the obstacles that hindered the full operation of manufacturing industries. As shown in Figure 13, approximately 3.76% of interviewers reported that shortage of foreign exchange is one of the constraints that adversely affects the operation of manufacturing industries. The survey results revealed that the constraint related to shortage of foreign currency has pushed import-reliant businesses to break production and even close their doors due to stock-out products. The manufacturing sector mainly imports most raw materials through international trade. Burdensome regulations and span systems of tracking, certifications, and licensing add further costs, such as lengthy stoppages of operations and frequent business closes. Consequently, the shortage of foreign exchange adversely affects firm activity, goals, and factors of production. This shows that government foreign exchange services do not keep pace with the demand for imports in private sector investors in Ethiopia.

The time and opportunity costs associated with securing foreign exchange create additional costs for firms. Domestic private investors are obliged to purchase foreign exchange from the black market by incurring higher costs. Additional reports reveal that firms exert greater pressure on government offices to obtain hard currency, whether through lobbying, bribes, or looking at the black market. Not surprisingly, firms operate within government-designated priority sectors, and foreign-owned firms have independent access to foreign currency. One of the causes of the shortage of hard currency in Ethiopia is the gradual overvaluation of the Ethiopian birr against the U.S. dollar.

Figure 13: First major problems prevented operating full year in the manufacturing sector



Source: Authors' estimation by using primary manufacturing survey (2020)

Problems during the establishment of the manufacturing industry: As shown in Table 3, survey results of 3,067 primary manufacturing sectors of the WB (2020), due to issues related to newly established businesses, is one of the problems in the manufacturing sector. Approximately 5% of interviewed investors reported problems related to newly established businesses in which a shortage of supply of raw materials, spare parts, market, working capital, machine breakage, inconvenient working environment, and electricity were the main constraints (Table 3).

Table 3: Major problems during the establishment of business by percentages

Sources of problem	First	Second.	Third
Shortage of supply of raw materials	52.33	11.14	7.11
Shortage of spare parts	2.97	9.31	3.26
Getting market/customers	9.26	21.07	6.39
Shortage of working capital	4.53	11.87	7.26
Frequent machine breakage	1.01	4.82	3.97
Inconvenient working place	2.84	4.49	5.32
Problems with workers	0.55	1.79	2.74
Government rules and regulation	1.66	3.98	5.04
Shortage of power	7.50	17.82	25.21
No problems faced	12.71	8.69	19.69
Others	4.63	5.04	14.01

Source: Authors' estimation by using primary manufacturing survey (2020)

The identified first-rank problems of private sector investors related to the establishment of manufacturing industries are indicated in Table 3. Approximately 52.33% of the respondents replied that they were facing problems with a shortage of raw material supply, and 9.26% reported problems related to a lack of markets and customers. In the second ranking of problems, 21.07% and 17.82% of problems related to the market/customers and a shortage of electricity were reported by investors. In the third-level problems, a shortage of electricity accounted for a high percentage, which accounted for 25.21% of the respondents. In this study, there were different challenges that the manufacturing sectors faced during establishment time. However, the major challenges of private sector investors in the manufacturing sector in all ranks of the problem, approximately the highest percent of sample investors, were that they faced problems with electricity.

Table 4: Major problems that prevent operating with full capacity in percentages

Types of problems	1 st	2 nd	3 rd
No problem	4.81	9.47	7.69
Shortage of supply of raw materials	56.40	10.78	3.87
Shortage of spare parts	2.73	9.83	7.43
Lack of getting market/customers	9.47	23.04	9.93
Shortage of working capital	4.09	11.38	3.91
Repeated breakage of machinery	1.29	5.01	3.12
Problems with workers	0.76	2.59	5.80
Government rules and regulation	2.08	3.94	23.82
Shortage of power	8.94	17.59	15.78
Others	9.43	6.37	18.64

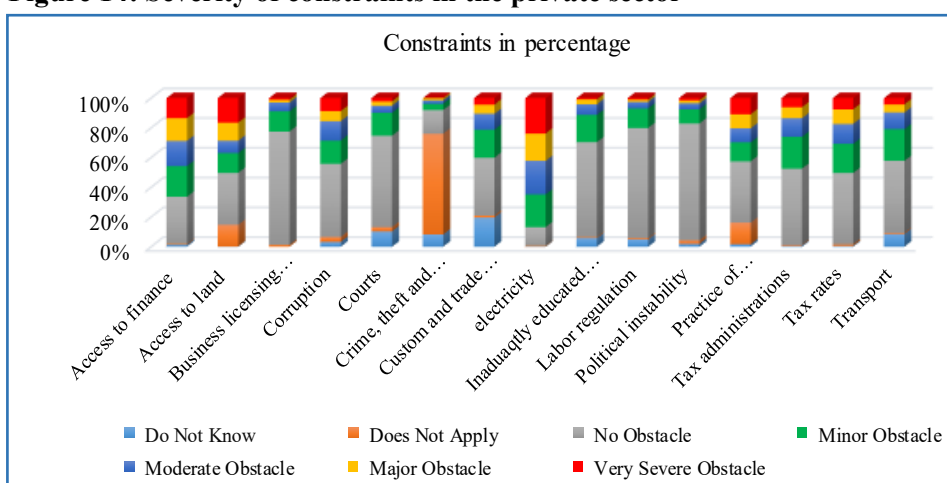
Source: Authors' estimation by using Primary Manufacturing Survey (2020)

As depicted in Table 4, the major problems of the private sector in the manufacturing industries that were not operating at full capacity were the shortage of supply of raw materials (56.4%) and lack of market and customers (9.47%), both of which were ranked to be the first. In the second rank, the two top problems were lack of market/customers (23.04%) and shortage of power (17.59%). In the third level, government rules and regulations (23.82) and a shortage of power (15.64) were the main problems in manufacturing. In addition to the specified problems in the third rank, other unobserved constraints accounted for 18.64 percent of the total. This might be related to corruption, bureaucracy, and other problems during the production process.

Other Constraints: Based on the results of the primary manufacturing survey of WB (2020), the remaining obstacles that prevented the full operation of manufacturing industries were shortage of raw materials, shortage of spare parts, shortage of market or customers, lack of working capital, repeated breakage of machinery, government rules and regulations, and others. However, the extent of constraints is quite different across the sectors. For example, as shown in Figure 3, approximately 45.82 percent of respondents reported that a shortage of raw materials was the major problem preventing manufacturing industries from operating at full capacity, while repeated machinery breakdown and a lack of working capital were the least problems.

As shown in Figure 14, the other constraints include political instability, problems related to legal matters, labor regulation, crime, theft, and disorder, as well as business licensing and permits. Private sector investment could become the target of theft, robbery, damage, or burning due to political disruption associated with social unrest. Such constraints are nonbinding constraints that also pose costs to private sector investment. Thus, private sector investors are forced to divert their initial investment resources from productive uses into other less risky business areas to reduce the risk and cover security-related costs; hence, the practice negatively affects the growth of private sector investment.

Figure 14: Severity of constraints in the private sector



Source: Author's estimated from Enterprise survey (2015)

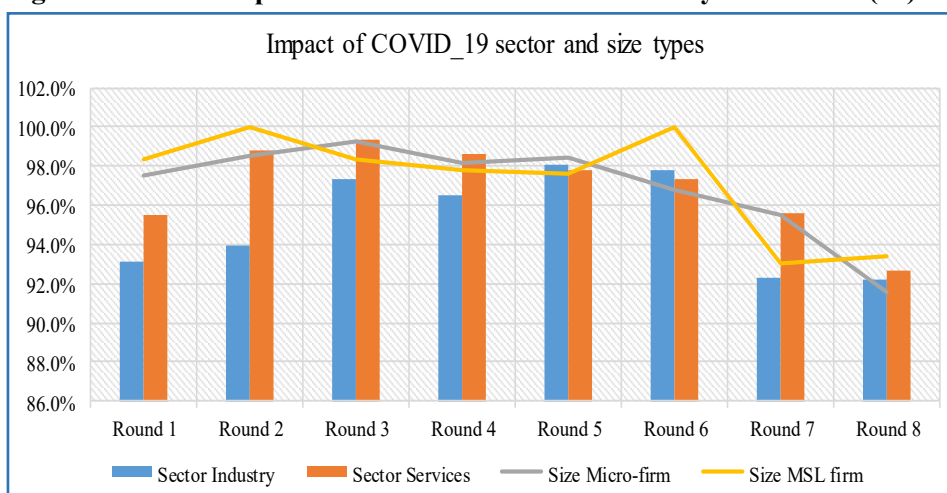
As depicted in Figure 14, the severity of different obstacles that hinder the development of private sector investment is presented. Similarly, most investors reported electricity, access to finance, and access to land as severe obstacle categories. Most of the investors also reported access to finance and electricity under the category of major obstacles.

The Effect of the COVID-19 pandemic: Like the rest of the world, Ethiopia has been experiencing unprecedented social and economic impacts since March 2020. The COVID-19 adverse effect of private sector investment has been substantial and reported to be more severe over the 8-round phone survey of the WB (2021). The economic impact of COVID-19 includes the increased price of

basic foods, rising unemployment, a slowdown in growth, and an increase in poverty. An underdeveloped private sector investment would limit the country's trade competitiveness and resilience to shocks (World Bank, 2021). The government has been providing support to expand the role of private sector investment to make Ethiopia's growth momentum more sustainable. To this end, the government's effort to attract FDI from different countries to invest in the manufacturing sector by building industrial parks in different parts of the country is worthwhile.

As shown in Figure 15 below, the assessment of the effect of COVID-19 on both industry and service sub-sectors was collected in 8 rounds with 4-week intervals by the WB (2021). However, the severity of the shock is quite different across sectors and sizes of enterprises. The result shows the effect of COVID-19 on the service sector is quite severe compared to the industry sector, and the effect increases starting from the first round up to the third round for both sectors. However, the effects in rounds 5 and 6 were similar and slightly declined compared to the previous round. In rounds 7 and 8, the adverse effect declines, which might be related to the Ethiopian government reopening education and other sectors; consequently, it would have a positive effect on the recovery of those firms. In addition, the government of Ethiopia had a plan to support some surveyed firms affected by COVID-19, although not sufficient.

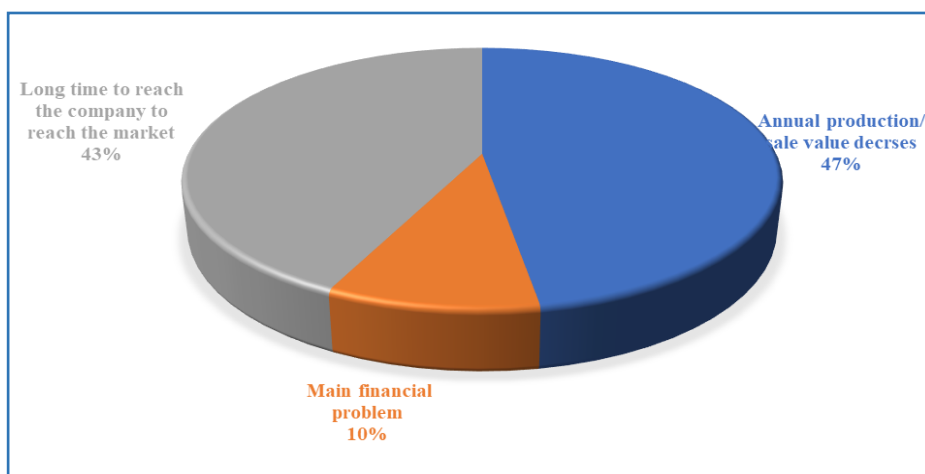
Figure 15: Share of private sector investment affected by COVID-19 (%)



Source: Author's estimation by using Phone Survey Data: Monitoring COVID-19 Impact on Firms (2020/21)

The effect of shocks is also different across the sizes of firms. For instance, as shown in Figure 15, the variability of shocks was very high for MSL firms compared to micro firms. Micro firms were slightly affected by COVID-19 during the onset of the pandemic, but the effect gradually increased and then smoothly declined at a decreasing rate. This is because private sector investment focused on the service sector and domestic market, where recovery was high and quick in the last round of the survey (8th round). According to the Primary Manufacturing Survey (2020), 84.64 percent of the interviewed private sector investors reported that COVID-19 adversely affected their business. As shown in Figure 16, the COVID-19 decrease in annual production sales (47%), creates a long time to reach the market (43%), and creates a financial problem (10%). Due to the adverse effect of COVID-19, 5.48% of interviewed manufacturing industries received support from the Ethiopian government, although not sufficient.

Figure 16: COVID-19 affected manufacturing industries

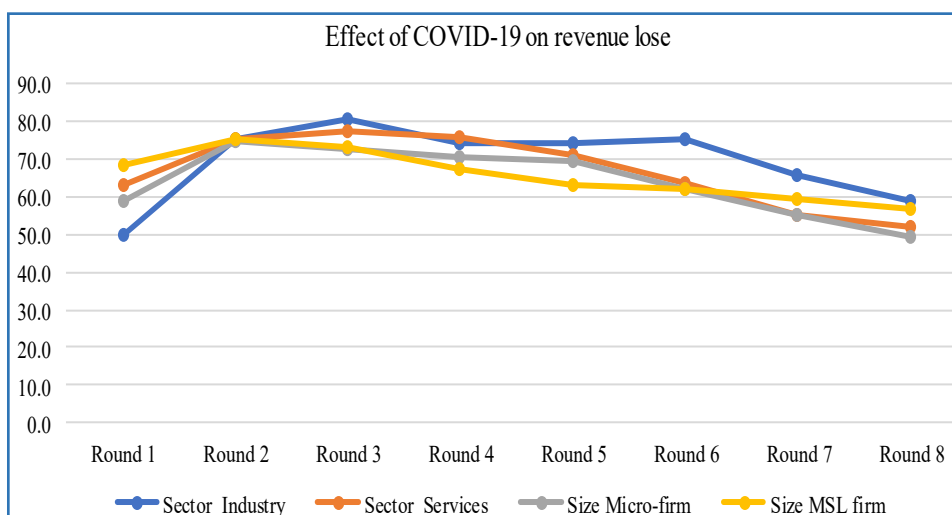


Source: Authors' estimation by using primary manufacturing survey (2020)

Furthermore, based on the phone survey data on firms, the revenue of firms was adversely affected by the pandemic. For instance, starting from the COVID-19 pandemic, the loss of revenue in the industry sector was relatively less than the loss of revenue in the service sector. However, over time, in the second round, the effect of COVID-19 on business revenue was more severe than that of the industry sector, although the variability looks smooth across 8

rounds. With regard to the size of firms, at the onset of COVID-19, the loss of revenue was high for MSL firms compared with micro firms. Starting from survey round 2 to survey round 6, the effect of the pandemic on micro firms is relatively less on MSL firms. The result shows that gradually, the effect of the crises became almost similar in the last survey round. This finding was also supported by other scholars. According to the Jobs Creation Commission of Ethiopia (2020), the most affected sectors in Ethiopia are the manufacturing and the construction sectors, linked to international markets and global demand; services in urban areas; tourism (hotels and restaurants); transport and warehousing; and personal services. Specifically, micro and small-scale enterprises in supply chains in construction, agricultural and horticultural exports, manufacturing, agro-industry, hospitality, tourism, retail, and farmers/pastoralists in areas at risk of increasing food insecurity are seriously affected by the pandemic (USAID 2020; UN Women African, 2021).

Figure 17: Monthly revenue lost because of COVID (last completed month)



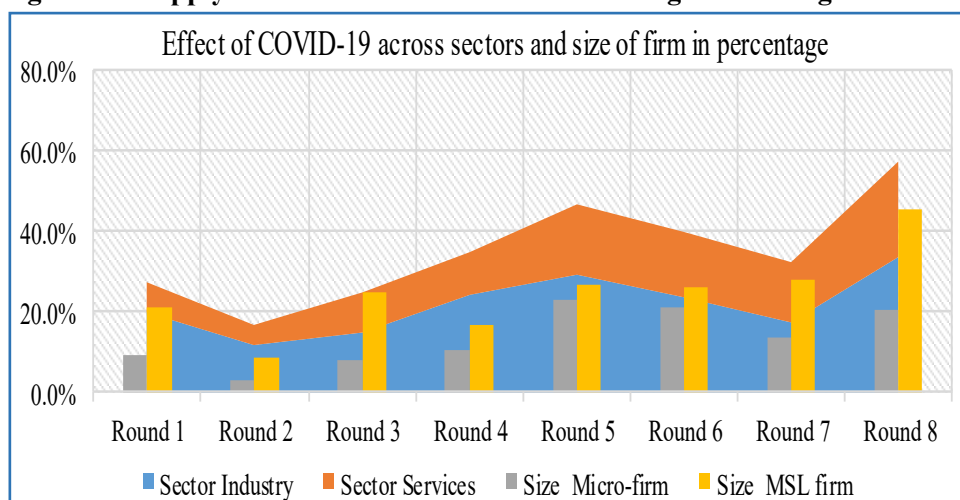
Source: Author's estimation by using *Phone Survey Data* (2020/2021).

Due to COVID-19, private sector investment is adversely affected by the following issues:

The decline of raw materials and intermediate goods: The decline of imported goods due to COVID-19 negatively affected the supply of raw

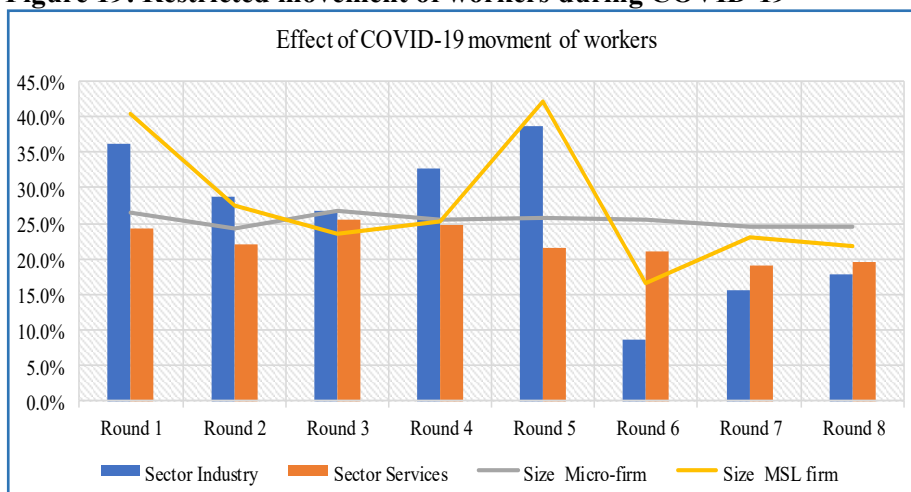
materials and intermediate goods for industry and service sectors and micro as well as MSL firms. Specifically, as shown in Figure 18, during COVID-19, the shortage of raw materials and intermediate goods in the service sector and MSL-firm was high. However, the effects over 8 rounds and across sectors were different. In terms of the size of firms, the supply of raw materials and intermediate goods for MSL increased across 8 rounds.

Figure 18: Supply of raw materials and intermediate goods during COVID-19



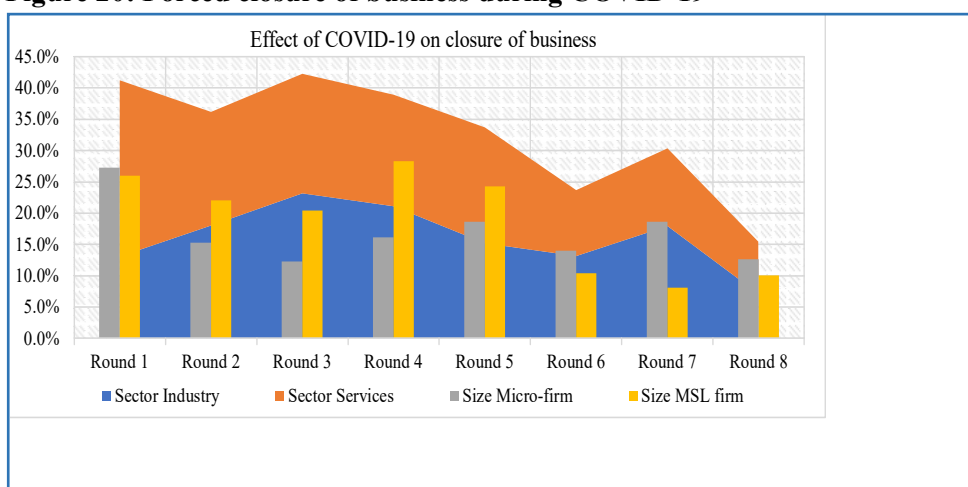
Source: Author's estimation by using Phone Survey Data (2020/2021).

Restricted movement of workers: COVID-19 also affects the manufacturing industry in industrial parks and companies due to restrictions on the movement of workers adopted by the Ethiopian government during the outbreak of the COVID-19 pandemic. Its effect on private sector investment has been different across sectors and the size of firms. Figure 19 shows that at the beginning of the pandemic, the restriction of movement of workers was high in the first round but gradually declined. Due to this effect, the industry sector and LMS firms were highly affected compared with the service sector and micro firms, respectively. This is because industry and large firms have had more labor workers. Gradually, the restricted movement of workers starts from five rounds onwards. Despite the difference in magnitude across sectors, the private sectors have been affected, with respondents of firms less affected by the labor force than before.

Figure 19: Restricted movement of workers during COVID-19

Source: Author's estimation by using *Phone Survey Data* (2020/2021).

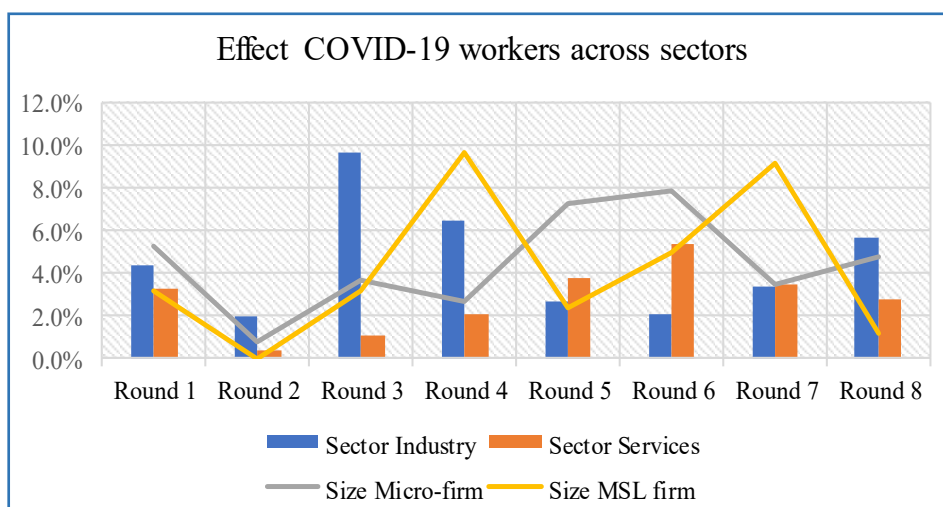
Forced closure of business: Due to the COVID-19 and the state of emergency declared by the government of Ethiopia, private sector investment forced the closure of businesses. This industry and service sector investment were adversely affected over eight rounds differently across sectors and gradually declined. The effect of COVID-19 is also different across the sizes of firms. The onset of COVID-19 and the closure of businesses were high for the service sector, although the effect was gradually lower than that of MLS firms.

Figure 20: Forced closure of business during COVID-19

Source: Author's estimation by using *Phone Survey Data* (2020/2021).

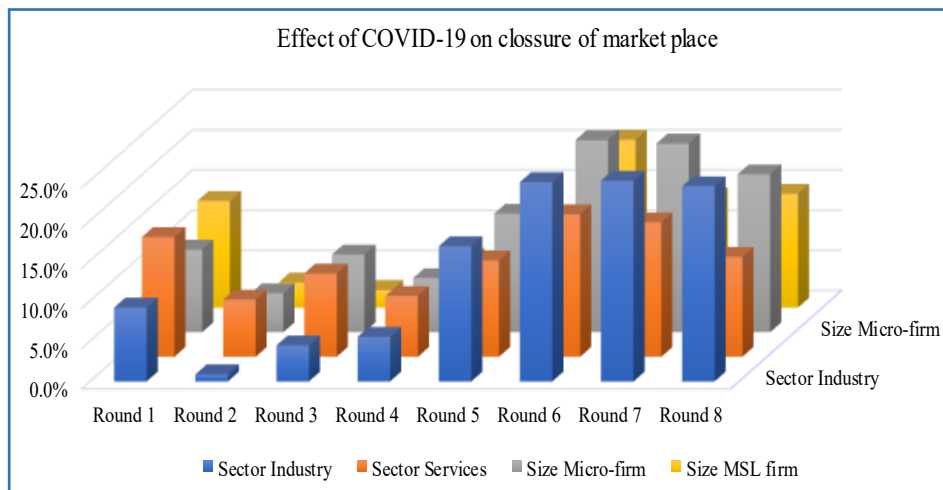
Worker's absence from the workplace: As depicted in Figure 21, during the onset of the pandemic, the percentage of respondents who had been paid but did not normally work was high in the first round; however, it declined over time. At the start of the pandemic, the government was the main source of assistance, accounting for roughly 71% of total assistance. However, the role of government-provided assistance declined in December 2020 and afterwards. When compared to rural areas, the percentage of paid but not normally work was far higher in urban areas. Respondents working in urban areas were more vulnerable than those working in rural areas during the pandemic.

Figure 21: Workers' absence from the workplace during COVID-19



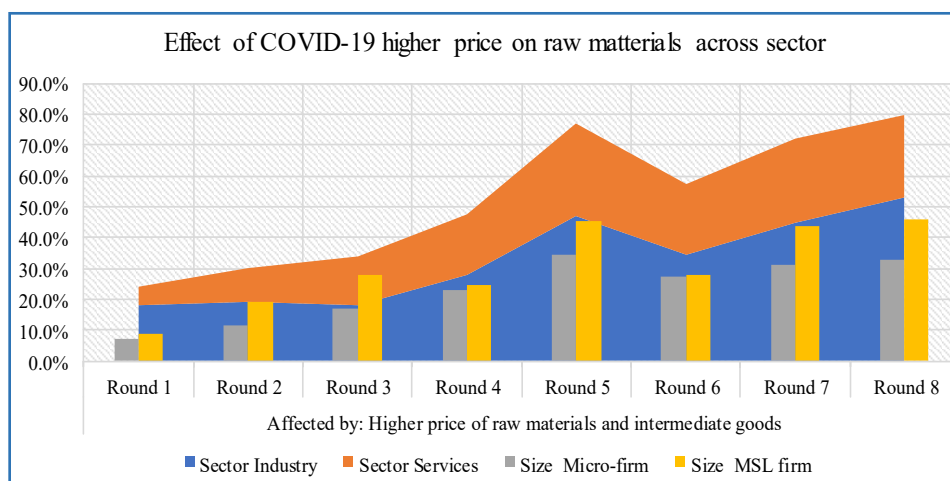
Source: Author's estimation by using High-Frequency Survey with Firms (2020/2021).

Closure of market places/shops: At the national level, studies report that since the outbreak of the pandemic, private sector investment has shrunk across the industry and service sectors. The effect of the pandemic was more serious in the last rounds of the survey in all sectors (Figure 22).

Figure 22: Closure of marketplaces/shops during COVID-19

Source: Author's estimation by using High-Frequency Survey with Firms (2020/2021).

The higher price of raw materials and intermediate goods: As shown in Figure 23, the effect of the COVID-19 pandemic on the price of raw materials and intermediates was relatively low during the onset of COVID-19. However, the effect will become increasingly apparent in the next rounds in both industry and service sectors and across firms. In round 1, the effect was low in the service sector compared with the industry sector.

Figure 23: Higher price of raw materials and intermediate goods during COVID-19

Source: Author's estimation by using High-Frequency Survey with Firms (2020/2021).

Generally, limited worker mobility and economic insecurity reduce the market performance of firms and adversely affect business performance. COVID-19 has particularly affected service and construction jobs, which have seen a drop in the labor force in these sectors by 61% (UN-Ethiopia 2020; Halvorsen, 2021). Pandemic-driven job losses are estimated at as many as 2.5 million people in Ethiopia (African Economic Outlook, 2021).

4. Conclusion and Recommendations

The study assessed the structure and performance of private sector development and identified the key constraints and challenges, and explored its contribution to the economy using secondary data and evidence from the past three decades. A time-series ARDL model was employed to analyze the long- and short-run driving forces of private sector investment. The study analyzed various policy measures designed by the government in response to promoting private sector investment in the country. The result shows an increment trends of the private investment projects (domestic and foreign) has been observed over recent years. However, the majority of investment is owned by domestic rather than foreign investors. Besides, the implementation rate of projects has been very low across all plans and has particularly declined in recent years. During the last three decades, private sector investment capital flow has been mainly made in the service sector with minimal investment flow in the agriculture sector, but there are some promising signals in the industrial sector which have begun to emerge over recent years (since 2018).

The top three leading sub-sectors in terms of capital inflow (both domestic and foreign) made by the private sector over the last three decades are real estate (machinery and equipment, rental and consultancy services) from services, mining, and quarrying from industry, and agriculture and hunting and forestry from the agriculture sector. Similarly, in terms of employment creation, the service sector remains the major contributor, followed by industry and agriculture in their respective orders. However, the trend of permanent employment share declined over time. Ethiopia's domestic private sector investors mainly concentrated on real estate and its associated services (from services), mining and quarrying (from industry), and with less participation in agriculture, hunting, and forestry (from agriculture) subsectors over the last three decades. This implies that the domestic private sector has not yet vigorously entered productive sectors (agriculture and manufacturing) of the economy. Most domestic private sector investment is concentrated in the service sector, primarily due to a lack of industry knowledge, limited access to input markets, technical and managerial skills, experience in operating large manufacturing industries, and the short-term profit maximization motives of firms. Hence, the private sector plays a less satisfactory role in the employment

generation, export growth, and output growth of the country. In response to policy support during GTP I and II, impressive progress in shifting private investment inflows from the service sector to the manufacturing sub-sector, less participation of FDI, and no or little agriculture sector investment has been made in recent years indicating less nascent structural change in the productive sector of the economy. This suggests scaling up the policy support given to the manufacturing sector during GTP I and II to the agriculture sector with more balanced policy support between the manufacturing and agriculture sectors is crucial during the current TYDP periods.

Private sector investment in the productive sector (industry and agriculture sectors) has had a trickled down effect of increasing industrial competitiveness and hastening structural transformation and is thus, inextricably linked with a reduction in poverty and the unemployment in the economy. To this end, the government has to provide broad policy support for the productive sector in general (agriculture and industry sectors) and particularly special support for some subsectors that the economy needs most (such as the manufacturing sector). The government should also scale up the policy support given to the manufacturing industry during GTP I and GTP II to the agriculture sector during TYDP periods. For the productive sector to play the expected transformative role in the economy, the government has to introduce various incentive schemes (for both domestic and foreign investors) to be able to provide quality goods and services and maintain international export standards. The incentive schemes could target tax incentives, export promotion, employment/skills training, incentives for creating permanent employment opportunities, and incentives for the adaptation and transfer of foreign technologies (to domestic firms).

The study found that the main constraints and challenges hindering private sector investment include inadequate physical infrastructure (that is, electricity, transport and logistics, and water supply services), lack of input markets (that is, restricted access to financial services, limited access to land, lack of a technically skilled labor force), weak institutional framework (that is, ineffective regulatory environments, malpractice in the informal market, corruption, custom, trade, and tax-related issues), political instability that leads to social unrest, and the prevalence of the COVID-19 pandemic. The results suggest that manufacturing firms have been hit the hardest by the pandemic in

several ways which include the reduction of demand, the shortage of raw materials and intermediate goods, restricted movement of workers, and absence from the workplace due to prolonged containment measures, which led to the forced closure of businesses and the market place. Therefore, the government should also quickly address the constraints to improving private sector development through designing various short and long-term strategies to allow a much greater role for the private sector in driving economic growth and job creation in Ethiopia.

For the private sector to play the expected transformation role in the economy, the government should undertake the following main activities: create enabling business environment through providing a range of incentive schemes in the priority sector of the economy; resolve the bottlenecks through better functioning of input market (labor, land and capital) through undertaking reforms in the financial sector, enhancing coordination within and between different layers of the government, and improving skillfully human resource shortages through continual capacity building training; providing quality physical infrastructures and supplying modern, affordable and sustainable energy, providing and facilitating required raw materials and machineries, strengthening inclusive Public-Private-Partnerships by providing preferential support for accessing raw material inputs, technologies, and financial services, and creating enabling business environment in the industrial parks; and ensuring consistent management strategies to minimize corruption, minimizing the violent uprisings by strengthening ways for ensuring peace and stability and build up the confidence of private sectors, and minimizing bureaucratic inefficiencies in the government and financial institutions; and providing all-round support to protect the private sector investment from the adverse effect of COVID-19 pandemic through developing short and long-terms adaptation and recovery interim plans which might include a range of economic incentives such as extension of the period of tax exemptions and loan deferrals, reduction of tax, deferment, and improved loan conditions based on the severity of the impacts.

Probably, you can summarize the above idea as:

To enable the private sector to play the expected transformational role in the economy, the government should focus on the following main activities: creating an enabling business environment through a variety of incentive schemes in priority sectors of the economy; resolving bottlenecks through better

functioning of the input markets (labor, land, and capital) through financial sector reforms; and strengthening inclusive public-private partnerships.

According to the ARDL model results, the real effective exchange rate and credit have positive and significant effect on private investment both in the short and long run. This result implies exchange rate fluctuation and accessibility of financial services are time-unbound constraints of private sector investment, and hence, financial sector reform should be undertaken in view of leveraging private sector investment in the upcoming years.

Government expenditure has a significant positive effect in the long run, but not in the short run. This is a good indicator that government expenditure will augment private sector investment in the future. However, such government spending should prioritize capital investment (such as physical infrastructure and park development), which takes time to bear fruit. Therefore, it is helpful to focus on high-impact physical infrastructure and the development of parks to stimulate private sector investment in Ethiopia.

Real interest rates have a significant positive effect in the long run, but not in the short run. This is a good flag that an increase in real interest rates encourages saving, and thereby, private investment. The effect of real interest rate can be seen from two directions: the depositor perspective and the borrower perspective. The policy measure that aims to improve real interest rates should maintain the tradeoff between saving and investment. To this end, the government should adjust the real interest rate in a way that encourages saving and private sector investment in the years to come.

Consistent improvement in the real effective exchange rate of the country improves private sector investment. This is because an improved real effective exchange rate means private investors have a consistent market and thereby improve their competitiveness in the international market. This is also an indicator of consistent market demand for domestic products in international markets, which is an incentive for private investors. Therefore, it is imperative to focus on the production of exportable goods and services. This can be achieved through encouraging investment in the high-value export-led manufacturing sector, which is crucial to reversing the significant negative effect of currency devaluation and strengthening overseas purchasing power in the years to come. To this end, the government should provide various economic incentives for domestic investors engaged in productive sectors that will help produce excess supply to improve the trade balance of the country.

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