A comparative case study of private investment and economic development in Ethiopia and Tanzania, 1986-1996

Kasahun Reta Woldemariam
Clark Atlanta University

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ABSTRACT

INTERNATIONAL AFFAIRS AND DEVELOPMENT

WOLDEMARIAM, KASAHUN R. B. S. BUFFALO STATE COLLEGE, 1995

A COMPARATIVE CASE STUDY OF PRIVATE INVESTMENT AND ECONOMIC DEVELOPMENT IN ETHIOPIA AND TANZANIA, 1986-1996

Advisor: Ciyata Coleman, Ph. D

Thesis dated July 2000

This study examined the contribution of foreign direct investment to economic development in Ethiopia and Tanzania from 1986 to 1996. Data for this study were obtained from the Ethiopian Investment Authority in Addis Ababa, Ethiopia, and the Tanzanian Investment Promotion Centre in Dar es Salaam, Tanzania. Other publications including the World Bank, the International Monetary Fund, and the United Nations Human Development Programme were also consulted.

Using exploratory research method, this undertaking compared and contrasted foreign investment flows and the conditions under which the transfer of capital and technology help achieve the development objectives of the two countries. It also analyzed the investment policies and the role of the state in the transformation of the economies of Ethiopia and Tanzania.

The results of the study suggest that the expectation that foreign technology and capital are necessary to transform the economies of Ethiopia and Tanzania is not fully confirmed. Moreover, the results of the study suggest that the investment policies were not reflective of the countries’ unique economic conditions. Additionally, the transformation of these economies from underdevelopment to development may be enhanced by strengthening the capacity of the state to build the human capital stock, provide reliable communication systems, and regulate anti-competitive practices.
A COMPARATIVE CASE STUDY OF PRIVATE INVESTMENT
AND ECONOMIC DEVELOPMENT IN ETHIOPIA AND TANZANIA, 1986-1996

A THESIS
SUBMITTED TO THE FACULTY OF CLARK ATLANTA UNIVERSITY
IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR
THE MASTER OF ARTS DEGREE

BY
KASAHUN RETA WOLDEMARIAM

DEPARTMENT OF INTERNATIONAL AFFAIRS AND DEVELOPMENT

ATLANTA, GEORGIA
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CONTENTS

ACKNOWLEDGMENTS ................................................................. ii

LIST OF TABLES ................................................................. v

ABBREVIATIONS ................................................................. vi

CHAPTER

I. INTRODUCTION ................................................................. 1

   A. Perspectives on the Sources of Underdevelopment in Africa ....... 1

   B. Background on Ethiopia and Tanzania .............................. 6

Statement of the Problem .................................................. 9

Purpose of the Study ......................................................... 11

The Importance of the Study .............................................. 11

Research Questions ........................................................... 13

Hypotheses ...................................................................... 14

Definition of Terms .......................................................... 15

Limitations .................................................................... 17

Research Methodology ...................................................... 18

II. LITERATURE REVIEW ....................................................... 19

Central Planning As a Development Model ............................ 20

Market Economy as a Development Model .............................. 26

   A. The Role of the State in a Free-Market Economic System ....... 28

   B. Broad-Based Agricultural Development Strategy ................. 34

Capital Accumulation and Economic Growth ......................... 38
CONTENTS (Continued)

Technology Transfer and Economic Development .......................... 44

III. INVESTMENT POLICY AND ECONOMIC DEVELOPMENT ............. 49
   A. Investment Policy of Tanzania ........................................ 52
   B. Investment Policy of Ethiopia ........................................ 55

Comparison of Investment Policies and Investment Inflows ............ 59

Determinants of Foreign Investment Flows ................................. 62

Implications of Investment and Development Policies .................. 66
   A. Comparison of Human Development in Tanzania and Ethiopia .... 67
   B. Investment and Employment Creation in Ethiopia .................. 71
   C. Private Investment and Employment Creation in Ethiopia and Tanzania ........................................ 73

IV. CONCLUSION ................................................................. 77

BIBLIOGRAPHY ..................................................................... 83
LIST OF TABLES

<table>
<thead>
<tr>
<th>Table</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Foreign Direct Investment, Import, and Export from 1986-1996</td>
<td>.60</td>
</tr>
<tr>
<td>2. Human Development Indicators</td>
<td>.68</td>
</tr>
<tr>
<td>4. Private Investment That Have Started Production/Services In Ethiopia, July 1992 - April 1998</td>
<td>.73</td>
</tr>
<tr>
<td>5. Summary of Approved Local and Foreign Projects In Tanzania (September 1990 - March 1998)</td>
<td>.75</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Full Form</td>
</tr>
<tr>
<td>--------------</td>
<td>-----------</td>
</tr>
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<td>CBC</td>
<td>Congressional Black Caucus</td>
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<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>HS</td>
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</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>ISI</td>
<td>Import Substitution Industrialization</td>
</tr>
<tr>
<td>SN</td>
<td>Sanitation</td>
</tr>
<tr>
<td>SW</td>
<td>Safe Water</td>
</tr>
<tr>
<td>TANU</td>
<td>Tanganyika African National Union</td>
</tr>
<tr>
<td>TCI</td>
<td>Tanzanian Investment Certificate</td>
</tr>
<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade And Development</td>
</tr>
<tr>
<td>UNIDO</td>
<td>United Nations Industrial Development Organization</td>
</tr>
</tbody>
</table>
CHAPTER I
INTRODUCTION

This study is about the two "economies in transition" in Africa: Ethiopia and Tanzania. It explores the development models, central planning and free-market economy, that have been adapted by the two countries. In addition, this undertaking examines the role of the state and foreign private capital in the transformation of the economies of Tanzania and Ethiopia. It also compares and contrasts the investment policies of Tanzania and Ethiopia.

The paper is divided into four chapters. The introduction chapter includes background, purpose and importance of the study, research questions, hypotheses, definitions, and limitations of the study. Chapter II is devoted to literature review with particular focus on the role of the state and the development policies pursued by Tanzania and Ethiopia. This Chapter also examines the extent to which the flow of foreign capital and technology contributes to economic growth in Ethiopia and Tanzania and whether or not the transfer of technology closes the digital gap. In Chapter III, the investment policies of Ethiopia and Tanzania are analyzed. In Chapter IV, some concluding remarks are made.

A. Perspectives on the Sources of Underdevelopment in Africa

There are mainly two schools of thought with opposing views regarding the sources of underdevelopment in Africa. One school of thought holds that colonialism has disrupted social, economic, and political transformations in Africa. Shortages of capital and technological backwardness that is pervasive in Africa are, therefore, results of
imperial intrusion. The other popular view regarding the sources of underdevelopment holds that internal factors are largely to blame for the current social, economic, and political disarrays in Africa.

How the imperial powers and Africans perceived their natural environment was an important factor that led to the colonization of Africa. For Africans, nature and mankind co-existed in harmony. Any change or disturbance to nature would cause imbalance and disharmony. For Western nations, nature was to serve mankind. Obstacles for growth and advancement were only temporary and would eventually be under control.

The differences in the perceptions of the natural environment have been manifested in actions, inventions, and innovations. As Michael Adas observed, "Africans built roads that twisted and turned around trees rather than cutting a straight path." Europeans, on the other hand, attempted to master the laws of nature and challenged the limits of space and time. They built canals, warships, railways, and airplanes to transcend the boundaries of their immediate natural environment. Adas also noted:

"... the assumption that it was desirable for humans to master nature and that the scientifically minded and innovative Europeans were best at doing so led many authors to the conviction that it was the destiny and duty of the Europeans to extend into and develop regions occupied...[by] half-child, half-human [but] wholly savages."

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1 For further information, see Walter Rodney, *How Europe Underdeveloped Africa* (Washington, DC: Howard University Press, 1982).


4 Ibid.
Some took a counter-position to the convictions stated above and argued that the mission of the West in Africa was driven by pure economic interests including the exploitation of natural and human resources and the search for market outlets for their surplus capital. Rosa Luxemburg argued that "[c]apitalism needs non-capitalist social strata as a market for its surplus value, as a source of supply for its means of production and as a reservoir of labour power for its wage system."  

Raymond Betts stated that with European exploration into the hinterland of Africa, "[t]he Dark Continent, it would appear, was suddenly suffused with light." The actions, inventions, and rationality, or binding to the laws of nature and its ruthlessness perpetuated the gap in capital accumulation and technological advancement between the West and the colonies in Africa.

The West is technologically advanced with enormous surplus capital. The Third World lacks technology and capital to transform its economies from underdevelopment to development. Bernice Scott also argued that "Europeans, by virtue of greed . . . and economic necessity, had ventured across the sea, and for almost one hundred years, had been exploiting the human and natural resources of Africa." In addition, as Paul Baran maintained, the search for market outlets and natural and human resources manifested in

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the disruption of domestic capital accumulation and indigenous technological advancements in Africa. The economic motives of the colonial powers forced Africans to produce exportable crops. The present economic crisis in Africa, according to Baran, is attributable to the workings of the colonial powers "that were nothing but self-seeking and engaged in activities that were nothing but predatory." 

The late Mwalimu Julius Nyerere, delivering the Tanganyika African National Union Creed — the Arusha Declaration — noted that it was internal weaknesses that brought external forces of underdevelopment. For Nyerere, the internal weaknesses have contributed to colonial subjugation which, in turn, resulted in the disruption of economic activities and technological advancements in Africa. He stated: "[i]t is our weakness that has led to our being oppressed, exploited and disregarded. We now intend to bring about a revolution which will ensure that we are never again victims of these things." 

The revolution, however, "was symbolic rather than real, as it involved the replacement of white rulers by black ones without a significant improvement in the well-being of the people" which made it difficult to identify adversaries from allies. Some maintained that Africa's decadence has been engendered by the transformation of

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9Ibid, 142.


political power into the hands of "conceptually incarcerated" evolves (as has been applied to scholars working in the Euro-centric tradition) that "identify more with powerful interests in the core and less with the people of their own countries." The colonial powers, according to Arthur Gavshon,

\[\ldots\] put away their nineteenth-century presumptions [and] that direct political control was needed to preserve access to the resources and markets of their colonial territories \ldots [for] they had groomed heirs to take over, heirs ready and willing to settle for the shadow rather than the substance of true independence.\[14\]

Furthermore, David Birmingham observed that post-independence leaders are mirror images of colonial rulers, governing by force and fiat and taking their subjects further away from prosperity.\[15\] Jean-Francois Bayart also asserted:

Africans are not passive victims of external forces \ldots They are always engaged in the process of 'extroversion,' in which they have sought to draw on resources or alliances available in the external environment in furtherance of their continuing internal competitions and conflicts.\[16\]

Evidently, Bayart was referring to African leaders as perpetuating economic underdevelopment in the region. For the president of Uganda, Yoweri Museveni, however, Africa's economic underdevelopment is attributable to cultural backwardness and political divisions along ethnic lines. He stated that the solution for Africa is to


create a United States of Africa, suppress the rise of competitive political parties, and find ways for Africans to become "Asianized."^{17}

From this introductory discussion, it can be inferred that the social, economic, and political underdevelopment in many parts of Africa was caused by internal and external factors. At the national level, the development strategies of African countries were either too ambitious or lacked strategic vision. The development policies pursued by African governments had to take into account the international environment as well.

B. Background on Ethiopia and Tanzania

The two countries were governed by socialist regimes (Ethiopia from 1974 until 1991 and Tanzania from 1964 until 1985). Ethiopia is among the few countries in the world that successfully, for the most part, challenged European colonial incursion during the Scramble for Africa and the First and Second World Wars. From early October 1935 until January 1941, Ethiopia was occupied by the Italian forces that were mainly restricted in the provincial capital cities of central and northern Ethiopia. Given the short period of Italian occupation of Ethiopia and the persistent clashes between Ethiopian and Italian forces, it is difficult to claim that Ethiopia was under colonial subjugation.

From 1942 until 1974, Ethiopia was ruled by Emperor Haile Selassie. During this period, Ethiopia was a politically, socially, and economically stable country with a few exceptions dealing with Ethio-Eritrean integration and the Ethio-Somali border conflicts. To say that Ethiopia under Emperor Haile Selassie was politically, socially, and economically stable is not to suggest that the country was progressing towards development. In the early 1970s, Ethiopia was faced with one of the worst droughts in its history in which thousands of people died of starvation. Lack of response by the central

government to the starvation in northern Ethiopia precipitated violent demonstrations in the provincial cities of Gonder, Gojam, Addis Ababa, and in other parts of Ethiopia. Consequently, in February 1974, the armed forces overthrew Emperor Haile Selassie and remained in power until August 1991.

The colonial experience of Tanzania is, to a large extent, different from Ethiopia. Tanzania was colonized by Germany from 1885 until 1919. From 1919 until 1961, Tanganyika was under British "protectorate." In 1964, Zanzibar became integrated with mainland Tanganyika to form the United Republic of Tanzania. Unlike the federal arrangement of Eritrea's integration with Ethiopia, the integration of Zanzibar with Tanganyika was designed to provide partial autonomy to Zanzibar and to ensure the separation of political power between mainland Tanzania and Zanzibar. To that end, the president of Zanzibar is the vice president of the United Republic of Tanzania. Three years after the formation of the United Republic of Tanzania, the Arusha Declaration was passed. It established a socialist development program and nationalized domestic and foreign properties. Like the government of Tanzania, the military government of Ethiopia declared socialism as the country's development path and nationalized domestic and foreign private properties.

The development objectives of both governments were to promote collective social and political consciousness and to foster self-reliance and industrialization anchored on collective farming (Ujamaa villages in Tanzania and Sefera in Ethiopia). Private properties were nationalized and policies for universal access to education, health, and other social services were enacted. Ethiopia and Tanzania made great strides in providing universal access but achieved neither industrialization nor food security.

The declining rate of food production in both countries was partly caused by the drought in Ethiopia in the early 1970s and in Tanzania in the mid-1970s, and partly by
the absence of farming techniques that are environmentally sound. This was exacerbated by the diversion of scarce financial resources from investments in the rural and urban economic sectors to the purchase of arms. For example, in 1986, the military expenditures for Ethiopia and Tanzania as percentages of Gross National Product were 8.6% and 3.3%, respectively. In other words, in 1986 the military government of Ethiopia spent over a billion dollars and the government of Tanzania spent $110 million for the purchase of arms.18

The oil-shocks of 1973 and 1979 were also other compounding factors for economic decline in Ethiopia and Tanzania. When the two countries were scorched by drought, Middle Eastern and North African oil-rich countries decided to increase their prices. The second oil-price increase occurred when the government of Ethiopia was confronted by secessionist and irredentist groups including the Eritrean and the Oromo Liberation Fronts and the Somalia government. Tanzania had to fight a war against the government of Idi Amin Dada of Uganda whose human rights violations forced many to seek refuge in Tanzania and other neighboring countries.

These internal and external factors profoundly affected savings, investments, and domestic capital formations that are crucial for economic growth. The development policies pursued by both countries, particularly the nationalization of domestic and foreign private properties, were evidently designed to undermine the rise of bourgeois classes. Policy-makers in Ethiopia and Tanzania took the view that central or command economic systems meant not only putting up barriers to foreign private sectors but to domestic private sectors as well. Both, in their view, had the same capitalist motive — exploiting the working class.

Beginning in the late 1980s, the governments of Tanzania and Ethiopia took the view that capital is a necessary precondition for economic growth. As a result, Ethiopia and Tanzania adopted a free-market economic policy and created the condition for domestic and foreign private sector participation in their economies. However, given the weaknesses of the domestic private sectors in both countries, the adoption of a free-market economy by the two countries has become as much contested as their previous development model.

**Statement of the Problem**

A report by the United Nations Conference on Trade And Development (UNCTAD) pointed out that “African nations are still faced with a number of obstacles that are impeding industrial expansion.”\(^1\) The report further stated that "[t]he way to accelerate industrialization is to actively encourage foreign direct investment programmes."\(^2\) The former United States Ambassador to the United Nations, Andrew Young, supported the views expressed by UNCTAD.

Mindful of the shortages of capital and technology in many parts of Africa including our countries of focus, Young stated that foreign investment is the only means to tackle economic crisis in Africa.\(^3\) A Tanzanian representative, speaking on behalf of the Group of 77, said that the "emphasis on private capital flows was a fallacious argument, since very little of such flows was going to the countries that needed them."

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\(^{2}\) Ibid.

\(^{3}\) Andrew Young, speech delivered at the National Summit on Africa (Georgia: 9 May 1998).
most."22 His statement presupposes the importance of capital for economic development and the opening up of markets of the developing countries for foreign investment. In the views of Friedrich List, however, economic liberalization "would enable the strongest nations to dominate the trade and industry of weaker countries and reduce them to a condition of slavery."23 Even if the preconditions are met and foreign capital and technology transfer takes place, some observers and policy-makers are not convinced about the benefits of free-market economy to underdeveloped countries. Two prominent leaders, Prime Minister Mahathir Mohammed of Malaysia and the late Mwalimu Julius Nyerere of Tanzania, were not optimistic about the free-market economy as a suitable model for developing countries. At the Asia Pacific Economic Cooperation Forum, Prime Minister Mahathir Mohammed stated:

> The creed of the market is to surrender your independence to those who know best and you will prosper... Thus the swing from the government knows all... to the market can do no wrong... is now as extreme as communism and socialism of yesteryear. 24

Indeed, the Congressional Black Caucus (CBC) and twenty-two religious and secular organizations went as far as to issue a statement calling on the leaders of the Group of Seven (Denver Summit) to "consult with Africans before making policy decisions which affect African nations." While praising the efforts of the Group of Seven for paying particular attention to Africa, the CBC and the religious and secular groups

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24Mahathir Mohammed, speech delivered at the Asia Pacific Economic Cooperation Forum (Vancouver: Canada, November 1997).
expressed their concern that the "Denver Summit of Eight [may] become a modern-day Berlin Conference."²⁵

Additionally, Mwalimu Nyerere, addressing delegates at the National Summit on Africa in 1998, noted that foreign investment has to come in the same package with respect for humanity and sovereignty.²⁶ Given these statements by advocates and critics of market economy, it is evident that there is a need for exploring the extent to which the inflows of capital and technology accelerate the economies of Ethiopia and Tanzania.

**Purpose of the Study**

The purpose of the study is to examine the role of the state and foreign private investment in the economic transformation of Tanzania and Ethiopia. The transfer of capital and technology into the economies of Tanzania and Ethiopia is subject to the development and investment policies formulated and implemented by the governments of each country. Therefore, the research also compares and contrasts the investment policies of the two countries and seeks to identify the factors that would improve their chances of successful transition from underdevelopment to development.

**The Importance of the Study**

The importance of the study partly lies in its treatment of Ethiopia and Tanzania as "economies in transition." Tanzania (from 1967 to 1985) and Ethiopia (from 1974 to 1991) were ruled by socialist governments whereby the state dictated their economic and political directions. The role of the state in central planning system included maintaining a fixed exchange rate, determine the direction of public investments, and set the price of


²⁶Julius Nyerere, speech delivered at the National Summit on Africa (Georgia: 9 May 1998).
goods and services. Development policies were formulated and implemented to protect the public sector through regulatory and discriminatory measures including tariff barriers and quotas.

Tanzania and Ethiopia, since the late 1980's, have begun to liberalize their economies. By adopting a free-market economy as their development model, the development policies shifted from import substitution to export-oriented development schemes. This shift in development strategy required drastic structural reforms if Tanzania and Ethiopia were to compete effectively with other developing countries that either experimented with a mixed or a central planning economic development approach. Furthermore, bold reforms were undertaken to deregulate the market, limit the role of the state in the management of the economy, and reduce and eliminate protective measures.

Public policies in both countries sought to establish credible and flexible investment policy environments to attract foreign investments without weakening the legitimate function of the state including protecting the poor, the environment, and private properties. In addition, policy-makers in both countries attempted to ensure that the investment policies and programs aimed not only to deliver economic growth but also to redistribute the benefits of market-led growth through investments in basic education and health.27

Moreover, unlike other countries who have established global trade networks, Tanzania and Ethiopia sought greater access to markets of not only the former socialist countries but also capitalist countries of Western Europe and North America. Both countries reformed their trade policies and placed emphasis on diversifying trading

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partners rather than remaining content with their previous trade relations, which were defined with ideological overtones.

A successful transformation of the economies of Ethiopia and Tanzania lies in their abilities to diversify their commodities and access the extensive market outlets for their products. These opportunities could be realized through the implementation of development policies that are predictable and nondiscriminatory. Under the previous regimes, public policies in Tanzania and Ethiopia were largely in favor of the public sectors at the expense of the domestic private sectors. This development strategy was unique to Tanzania and Ethiopia when compared with most other developing countries in that the formulation and implementation of their public policies need to be highly flexible and effective to reinvigorate the domestic private sectors.

Moreover, while the importance of the study partly lies in treating Tanzania and Ethiopia as special cases, it also contributes to development discourse by identifying some differences between the two countries' investment and privatization policies. As the United Nations study shows,

... while it may be true that no two countries face identical difficulties in their industrialization process, it is also true that countries at a similar developmental stage face difficulties of much the same kind and, being subjected to much the same economic [as well as social and political] forces, often find themselves in very similar situations.28

Research Questions

Thirty of the world's forty-nine low-income economies are in sub-Saharan Africa.29 Among the thirty countries in sub-Saharan Africa, Ethiopia is the second and

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Tanzania is the third poorest country in the world. In other words, Ethiopia and Tanzania are the poorest of the poor in the world. Much energy and resources have been expended to identify the factors that led to Africa's declining rate of production and consumption. Although there are inequalities among the poor countries of the world, much of the research dealing with poverty alleviation, productivity, and consumption in Africa assumes that the sources of and solution for economic underdevelopment are universally applicable.

The investment policies of the two countries reflect competitive incentives for foreign private investment in some sectors and designate other areas as "to be determined" in the future or as exclusively reserved for public investment. These were basically recognition of shortages of domestic capital and technology and the absence of competitive indigenous private sectors in their economies.

Governments in both countries continued reformulating their investment policies to attract foreign investment. The reformulation of the investment policies were intended to increase exports and supply of goods and services to their domestic markets, create employment, and reduce production cost. The benefits of these policies to the foreign private sectors included access to cheap labor, natural resources, tax holidays, and other investment incentives as stipulated in the Investment Acts and Amendments of Tanzania and Ethiopia. Given the challenges and opportunities facing Tanzania and Ethiopia, the following question is raised:

Under what conditions do capital accumulation and technology transfer enhance the development objectives of Tanzania and Ethiopia?

Hypotheses

The global economy is increasingly integrating, absorbing smaller nations into the
larger world community under the auspices of capitalism. In capitalistic development, competition among economic actors is crucial for successful transformation of the economy. Competition leads to efficient utilization of resources and this is possible when states play their proper role. The role of the state in the economic sphere is diminishing, paving the way for the private sector to partake in the economic development of the two countries. Based on a review of the literature with a particular focus on foreign private investment, the role of the state, the investment and development policies of Tanzania and Ethiopia, the following hypotheses are put forth:

1. The investment policies of Tanzania and Ethiopia are not consistent with their development strategies.

2. Market size and national development policy alone do not determine the flow of foreign direct investment.

**Definition of Terms**

Foreign direct investment refers to "investment abroad involving an element of control by the investor over the corporation in which the investment is made."\(^\text{30}\)

Dominick Salvatore defines foreign direct investment as investment in factories and capital goods where "both capital and management are involved and the investor retains control over the use of the invested capital."\(^\text{31}\) Apparently, the definition of foreign direct investment has expanded to include not only "some element of control" but also "retaining control" over the use of invested capital. For the purpose of this study, foreign direct investment refers to an investment abroad in which the investor not only retains

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control of the invested capital but also has a significant influence on the rate of savings, investment, and domestic capital formation. As the definition of foreign direct investment varied concurrently with changes in the international system, the role of the state in Tanzania and Ethiopia also shifted from dictating to monitoring the economies.

The role of the state, according to Max Weber, is to maintain order and stability. From a Marxist point of view, the state is an instrument of exploitation and perpetuates conflict among classes. 32 Emmanuel Durkheim, for his part, defines the state as "the sum total of social entities that alone are qualified to speak and act in the name of society." 33 Weber's definition of the state seems to be more reflective of the role of the state in contemporary socio-economic and political environments.

Given the importance of the state in command and transitional economies, the role of the state is not only to maintain order and stability but also to act and speak in the interest of the people it governs. However, in a market economic environment, some of the role of the state has been transferred to the private sector. Therefore, in this study, the state is defined not as an entity that alone speaks and acts in the name of society but as a partner to the private sector.

Another term that requires clarification is the term "economic development." In the theoretical literature, there has been much effort to distinguish between economic development and economic growth. Some maintain that there can be economic growth without development. In this study, the two terms are interchangeably used. The impact of foreign investment and national development policy on economic growth or


development is measured in terms of changes in the percentage of literacy, life expectancy, population with access to education, safe water, and health services.34

Limitations

The main limitation of this study is that it does not address the environmental impact of foreign direct investment. However, it needs to be recognized that economic growth requires exploiting labor and natural resources. How and in what capacity these resources are exploited affects the economies of Ethiopia and Tanzania and their environment. The interdependence between economic growth, foreign direct investment, and the natural environment could be a zero-sum game.

Furthermore, this research does not include a discussion on the impact of foreign direct investment on the cultures of Tanzania and Ethiopia. The exclusion of culture as an integral part of this study is significant because value system for a given society changes over time, making it difficult to measure such impact.

Examination of the changes in the culture of Tanzania and Ethiopia may also be influenced by personal bias. For example, it may be difficult to measure the extent to which foreign firms promoted or undermined cultural development of the Tanzanian and Ethiopian societies. It would, therefore, be misleading to discuss cultural changes along with changes in the economies of the two countries without greater detail and extended field research.

Research Methodology

This undertaking is based on an exploratory research methodology. It compares and contrasts the inflows of foreign direct investments and the investment policies of Ethiopia and Tanzania. In addition, it examines the role of the state in the economic transformation of the two countries. Data in this research are secondary data that were obtained from various sources. Many of the texts referred in the introductory and literature review chapters were gathered from libraries including Clark Atlanta University, Emory University, and Georgia State University. Some data have also been obtained from the Internet.

Investment policy proclamations and data on private investments were obtained from the Ethiopian Investment Authority in Addis Ababa, Ethiopia, and from the Tanzanian Investment Promotion Centre in Dar es Salaam, Tanzania. Other sources of information for this research included the International Monetary Fund, the World Bank, and the United Nations Human Development Programme annual publications.
CHAPTER II
LITERATURE REVIEW

This chapter explores the two development models, central planning and free-market economy, that have successively been adopted by Ethiopia and Tanzania. It also examines the role of the state and foreign capital and technology in the transformation of the economies of the two countries. Shortages of capital and technology are recognized as the two critical elements that inhibited economic growth in Ethiopia and Tanzania. These shortages were more pronounced when Tanzania and Ethiopia were experimenting with command economic strategy in which the states played an important role in dictating and managing the economies.

Since the late 1980s, governments in both countries have abandoned central planning development strategy and adopted a free-market economic model. This change in development scheme required a redefinition of the role of the state and its relationship with the private sector. To the extent that the state has the capacity to manage the economy, its primary role is to determine the sectors that are open for foreign, domestic, or public investment and set the rate of incentives available for the private sector. The state is responsible for formulating and implementing investment policies and allocating resources for human capital development. These and other related functions of the state makes it an indispensable partner to the private sector. If a state is to facilitate a congenial environment for the operation of the private sector and foster economic growth, its role must be compatible with its capability. For example, it needs to have the institutional and financial capacity to invest in public goods such as
infrastructure, education, and health services where the gains for the private sector are minimal.

The first section of this chapter explores how central planning economic policy, in which the state directly intervened in economic activities, affected the rise of the private sector in Ethiopia and Tanzania. Since the role of the state in developing countries has changed along with changes in the global economic system, it is important to reexamine its effectiveness and new roles. A number of examples are provided to gauge its capacity and effectiveness in a free-market economic system. Subsequently, two sections are devoted to discuss issues relating to capital accumulation and economic growth and the extent to which technology transfer closes the digital gap between the developing and advanced nations.

Central Planning As a Development Model

The end of the Second World War ushered in a new era that altered the relationship between Western Europe and Africa. In less than two decades following the end of the Second World War, many African countries gained their political independence. Consequently, the relationship between these two regions changed from dominance-dependence to interdependence.1 However, as Immanuel Wallerstein and Peter Gutkind affirmed, in the process of colonization and decolonization, Africa is "incorporated" into the capitalist world economy where it plays its marginal role in the global economic system.2 After "independence," many African governments sought for a development model that would both sustain their political independence and reflect

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1For further discussion, see Cedric Grant "Equity in international relations: a Third World perspective," International Affairs 71, 3 (1995): 567-587.

their unique economic conditions. Anglo-American scholars constructed a theoretical frame of reference with which these nascent states transform their economies.3

The diagnosis of the conditions of Africa by Western scholars led to the prescription that the transformation of Africa from underdevelopment to development requires Western democratic culture and the implementation of a free-market economic policy. As John Rapley noted, for some Western scholars "the problem of the Third World was a mere shortage of capital. . . . To others, it was a question of value systems: Third World peoples lacked the cultural values such as the profit motive, which would make them entrepreneurial."4 As a result, the prescriptions "emphasized . . . on a minimal role for the state, greater reliance on private initiative and market forces, and increased openness and greater integration into the world economy."5

Fidelis Ezeala-Harrison noted that the experiences of the developed countries were accepted as evidence that the foreign sector could actually be the most important source of capital for development.6 Many developing countries, however, feared that opening their economies for foreign investment and adopting Western culture simply to spur the flow of foreign capital and technology would interfere with their national economic interests, political independence, and territorial sovereignty. For example, for a stable level of capital flow by multinational corporations, there must be a significantly


low level of corporate and income tax rate, reliable infrastructure, and a stable political environment.\textsuperscript{7} A significantly low level of tax meant, however, lower revenue to governments, which imposed financial constraints on the state and weakened its capacity to effectively carry out its responsibilities.

For Ethiopia during the military regime and Tanzania during Nyerere's era, these prescriptions and preconditions were simply ramifications of history repeating itself, that the reliance on Western capital inflows and cultural values would compromise their political independence and the potential for economic self-reliance.\textsuperscript{8} Especially for Tanzania, because of its colonial experiences, it was important to search for an alternative development model that cultivates political solidarity and economic self-reliance.

Tanzania and Ethiopia adopted a command economic system, which was developed and tested by socialist counties, countries that were not directly associated with Africa's colonial subjugation and whose economies were as underdeveloped as Tanzanian and Ethiopian. According to Francis Fukuyama, the Soviet Union is known to have demonstrated the possibility of transforming an agrarian economy into an industrial powerhouse. Fukuyama made reference to the Soviet Union under Joseph Stalin as an example that "had accomplished a fantastic social transformation from a largely peasant agricultural country to an industrial powerhouse, without permitting its citizens either economic or political freedom."\textsuperscript{9}

In addition, as James Mittelman noted, "political solidarity," particularly at an initial phase of development, was viewed as an essential precondition for successful

\textsuperscript{7}Ibid.


\textsuperscript{9}Francis Fukuyama, The End of History and the Last Man (New York: The Free Press, 1992), 90.
economic development. He cited the East Asian newly industrializing countries as examples that placed limitations on democratic rights in their drive for rapid economic growth.\(^{10}\) Furthermore, the experiences of the advanced nations of the 19th and early 20th centuries were archetypes for policy-makers in developing countries in that the states played a critical role in stimulating savings and investment and accelerating industrialization.\(^{11}\)

From the viewpoints of policy-makers in Ethiopia and Tanzania, the economic histories of the industrialized, socialist, and newly industrializing nations were sufficient to justify the need for political solidarity and the implementation of a development policy that protects the economic interests of Tanzania and Ethiopia.

Policy-makers in both countries attempted to formulate a development policy to stimulate economic growth and domestic capital formation through regulatory and protective measures against foreign firms. These measures included tariffs and quotas on imported goods, subsidies to public sectors, and the protection of infant industries.\(^{12}\) Tariff and non-tariff barriers were imposed on foreign products with the hope of stimulating domestic demand for goods and services produced mainly by the public sector.

China, Brazil, India, and South Korea, among others, adopted Import Substitution Industrialization (ISI) schemes and have been able to strengthen their private sectors, increase savings and investment, and accelerate their economic growth. For the newly


\(^{11}\)For extensive examination, see Arthur W. Lewis, The Theory of Economic Growth (Homewood: Richard D. Irwin, Inc., 1955).

industrializing countries, ISI was a suitable development strategy. The implementation of ISI was perceived as an effective development approach because it was relatively easy to protect their industries as compared with forcing developed nations to lower their trade barriers.\textsuperscript{13} In addition, provided that there exists a large domestic market for industrial products, the implementation of this policy was to help escape the impact of unfavorable terms of trade and price fluctuation for their primary products.\textsuperscript{14}

Tanzania and Ethiopia vigorously implemented ISI strategy. They hoped to promote industrialization by utilizing domestic resources to meet domestic demands and by imposing barriers to foreign private enterprises. The implementation of ISI was also to increase savings and foreign exchange that was previously spent on imported manufactured goods.\textsuperscript{15} Import Substitution Industrialization was a suitable development approach for countries with foreign exchange constraints, weak private sectors, and large domestic markets. For Tanzania and Ethiopia, however, the result was disappointing. The development model was unsuitable for the very reason that prompted the implementation of the strategy: the protection of the domestic markets and infant industries. The regulatory enactment undermined domestic private investment, hindered the development of indigenous-based capital formation, and limited their access to the industrialized nations' markets, technology, and capital.

The emphasis on industrialization also diverted resources from investments in other sectors to the industrial sector without cultivating linkages among the various economic sectors. The lack of linkages among the various sectors coupled with the


\textsuperscript{14}Ibid.

diversion of resources to the industrial sector inhibited productivity, particularly, of the agricultural sector.\textsuperscript{16} Low productivity of the agricultural sector brought a chain of reactions and affected the demand for manufactured goods and decelerated domestic savings and investment. The decline in domestic savings and investment, in turn, resulted in little or no domestic capital formation and technological advancement. This ultimately led to reliance on foreign resources which was conditional on structural reforms.\textsuperscript{17}

The most important weakness of the development model was, perhaps, the severe restrictions imposed on the domestic private sector. As Friedrich List observed, inside a country the policy of free trade is beneficial if citizens were free to manufacture what they pleased, and were not restricted by institutional and infrastructural constraints.\textsuperscript{18} These and other constraints that were imposed through central planning policy instruments on domestic and private sectors are no longer the case. In fact, it is not only Tanzania and Ethiopia that removed the barriers to private-sector-led economic growth but also other developing countries that effectively implemented ISI development schemes. By the early 1990s, Ethiopia and Tanzania enacted favorable investment policies to induce the inflows of foreign capital and technology and lifted many of the restrictions that inhibited domestic and foreign private sector's participation in their economies.

The 1997 United Nations Conference on Trade And Development report indicates that at least 143 countries and territories (including Ethiopia and Tanzania) enacted favorable investment policies recognizing that the gains from foreign direct investment

\footnotesize{\textsuperscript{16}Ezeala-Harrison, Economic Development: Theory and Policy Applications: 191-194.}


would speed up the process of economic development.\textsuperscript{19}

**Market Economy as a Development Model**

One of the most important developments in the international system that prompted a re-visitation of development policies was the end of the East-West confrontation. The demise of the Soviet Union and its satellite states in Eastern Europe, East Africa, and elsewhere proved that development without a significant involvement of the private sector may be possible but unsustainable. It revitalized the conviction among neoclassical economic theorists who argued:

> In any society, growth can never be a purely quantitative affair but is necessarily accompanied by changes in techniques, attitudes and institutions. In the emergence of the industrial society, these changes are of peculiar importance. They are not only the source of the more measurable indications of growth but must find a place in any explanation of how development begins.\textsuperscript{20}

James Wolfensohn, in his address to the World Bank Board of Governors in 1998, supported the neoclassical view when he stated: "development involves a totality of effort."\textsuperscript{21} He admitted that the international development community had not taken a wholistic approach to tackle the challenges faced by many of the developing countries.\textsuperscript{22}

In his view, a free-market economy (or the wholistic development strategy) offers a more pragmatic and broad-based approach to transform the economies of the developing countries.


\textsuperscript{22}Ibid.
In a free-market economic environment, economic power is diffused among the private sectors and the state stimulates growth by managing, but not regulating, the economy. Economic growth is stimulated and the effectiveness of the state is enhanced when the state is "permitting competitive free markets, privatizing state owned enterprises, promoting free trade and export expansion, [and] welcoming investors from developed countries." As List maintained, the domestic private sector contributes to economic growth when it is left to its own devices. In cooperation with the state, the private sector would help speed up the process of economic growth when trade barriers are lifted and reliable infrastructures exist. The notion of cooperation between the state and the private sector is as indispensable to a steady economic growth as the principle of the division of labor.

The implementation of a free-market economic policy is to remove the factors that hinder the ability of the private sector to operate smoothly. The elimination of trade barriers and quotas, for example, allow the free flow of goods and services. When a free-market economic policy is implemented broadly, foreign and domestic private sectors compete for markets, cheap labor, and raw material. Competition among the private sectors would, in turn, reduce the price of goods and services.

Another factor that affects the effectiveness of the private sector in mobilizing resources and accelerating productivity is the condition of the communication system. According to the United Nations Centre on Transnational Corporations, underdeveloped infrastructure including telecommunication and transport systems are unique challenges.

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to the economies in transition. Reliably infrastructures facilitate the economic activities of the private sector and because the financial gains for investment in these services are unattractive to the private sector, the state is accorded the responsibility of improving the condition of the communication systems. However, shortages of capital constrain the state from carrying out its responsibility of providing a reliable means of transportation and communication.

Many have argued that in order to effectively utilize scarce resources and match the capability of the state with its responsibilities, there must exist a division of labor between the state and the private sectors. Furthermore, public and private investments must be allocated to economic sectors based on the principle of comparative advantage. Some policy-makers and scholars maintain that agricultural transformation is the key to broad-based economic growth in the developing world and that development policies need to be formulated toward transforming the agricultural sector. What follows is an examination of the effectiveness of the state in a free-market economic environment and whether or not Ethiopia's and Tanzania's comparative advantage lies in the production of agricultural commodities.

A. The Role of the State in a Free-Market Economic System

The resignation of Mwalimu Nyerere from power and the collapse of the Soviet Union and the military regime of Ethiopia signaled that successful transformation of an economy necessitates more than resource mobilization. A successful economic transformation requires the liberalization of the economic and political marketplaces

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simultaneously. The economic crisis that took place in these countries was partly associated with the consolidation of political and economic powers in the hands of a few elites and the transfer of property from private owners to the state.\textsuperscript{27} In other words, in central planning development system, the state was everything. Because the state was everything, it essentially overextended itself from carrying out its primary responsibilities of defending national sovereignty, protecting citizens' rights, and providing public or collective goods to become an agent of social, economic, and political transformations.\textsuperscript{28}

The Tanzanian and Ethiopian states did not have the financial and institutional capacities to deal with the economic challenges facing their countries, and the model with which they attempted to address these challenges was not akin to the unique circumstances of the two countries. The states were arrested by their own piecemeal but ambitious development strategy. They neither delivered public goods and increased national savings and investments nor accelerated domestic capital formations. As recognition of the weaknesses of the states in many of the developing countries including Ethiopia and Tanzania, advocates of the wholistic development approach hold that matching roles to capability is essential for mobilizing resources efficiently.

The World Bank correctly pointed out that matching roles to capability is not a simple message to dismantle the state or to redirect the role of the state to provide basic services and build roads and provide infrastructure.\textsuperscript{29} It is, however, to foster cooperation and partnership between the state and the private sector; it is a division of labor among

\textsuperscript{27}Lewis, \textit{The Theory of Economic Growth}, 60.


social, economic, and political actors. "The transition from centrally planned to market economies creates, at least in the short run, major economic uncertainties" which could be dealt with effectively when a division of labor exists among social and economic actors and the state.\(^\text{30}\)

In an environment of competition and conflict, the role of the state is to resolve disputes arising between domestic and foreign private sectors and manage conflicts resulting from contradictory economic interests between labor unions and the private sector. When a market economic policy is enforced in its broadest sense of the term, foreign and domestic private sectors compete for markets, cheap labor, and raw material. Although the private sectors compete for resources and market outlets, they are unified by their common interests of reducing production cost. The working class, on the other hand, aspires for higher wages which translate into higher production cost and lower profits for the private sectors. Therefore, there are disputes between the private sectors and conflicts between them and the working class.

If disputes are resolved, conflicts are managed, and the state is an arbitrator of disputes and conflicts, then competitions between the private sectors are disputes that could be resolved by the state. On the other hand, competition between the private sectors (or employers) and labor unions are conflicts that can be managed but not reconciled by the state. The strategy for managing conflicts between labor unions and employers may be different but the objective is to safeguard unfair practices by employers or labor unions. The role of the state as a mediator of conflicts or disputes is driven by the interest to stabilize the economy and avoid dramatic shifts (for example, the gravitation of competition into conflict or monopolistic practices by giant corporations).

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In the absence of a middle ground or when competition gravitates towards conflict, the state acts like a lion to maintain order and undermine conflict.31

Therefore, if a state is to play its proper role in economic development it must, at least, be effective enough to exert reasonable influence on other states, private sectors, and its citizens. It must also have the institutional capacity to formulate and implement development policies that facilitate the participation of the private sector and redistribute the gains from international trade and investment. Consequently, for any development strategy to be pragmatic and effective, it must rectify the weaknesses of the previous development scheme. However, given the institutional, financial, technological, and capital underdevelopment in many parts of Africa and most certainly in Tanzania and Ethiopia, some problems surface with the wholistic development strategy when it is implemented in the broadest sense of the term.

For example, a prudent tax system could serve as a mechanism for redistributing the gains from market-led economic growth. Revenues generated from the collection of taxes and customs duties could be invested in building and expanding infrastructure and the human capital stock. With the declining role of the state in the economic arena, the public sector could not be a primary source of revenue and, therefore, revenues must be directly derived from other sources such as the private sector. However, there are problems with this approach of generating revenue from the private sector. First, the tax system in Tanzania and Ethiopia, as it is the case in many parts of Africa, is inefficient. Hence, the rudimentary system of tax collection could not extract sufficient funds that are necessary for the states to manage their economies.

In addition, governments may need to broaden the tax base to protect the poor and small-scale private sectors. This leads to the second problem of generating revenue for investment in the public services that are prerequisites to bring about economic development in the two countries. As it is stated in the investment policies of Tanzania and Ethiopia, lower corporate tax, tax holidays, and freedom for the private sector to repatriate its profits are means of increasing the flow of foreign capital and technology. Lowering corporate taxes, granting tax holidays, and significantly improving infrastructure may, therefore, be mismatches of development policies. In other words, it creates revenue dependency on a few taxpayers and results in disincentives for the domestic private sectors.

The extent to which the governments of Tanzania and Ethiopia have the financial and institutional capacity to play their role in regulating monopolistic practices, as effectively as their trading partners, is vital to understand the complex challenges facing the economics in transition. The role of the United States government in harnessing competition among private sectors and the agricultural policies of Western European governments reveal the complexity of the challenges to the governments of Ethiopia and Tanzania in a free-market economic arena. Important lessons can be derived from the role of the United States government and the agricultural policies of Western European governments.

On May 18, 1998, the United States Department of Justice filed a lawsuit alleging that "Microsoft has engaged, and continues to engage, in a broad course of conduct that improperly maintains Microsoft's monopoly in desktop operating systems and unlawfully

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restrains trade." According to a report in *The Washington Post*, "Microsoft Corp. has used its unparalleled dominance in the computer industry to bully rivals and squelch competition." More recently, the Department of Justice "filed a civil antitrust lawsuit to block the $168 million cash tender offer by Compuware Corporations to acquire Viasoft Inc., because the transaction would result in higher prices and lower quality service" to consumers.

It can be inferred that the Department of Justice, as a machinery of the state, is acting in the interests of Americans by promoting competition among the private sectors. It is also monitoring and regulating monopolistic practices, creating a level playing field, and protecting "infant" industries. In effect, the state is promoting competition but undermining conflict. This is possible because the United States government has the financial and institutional capacities to implement effective regulatory policies.

Therefore, the role of the state is, as demonstrated by the Department of Justice, to act as an independent entity in the interests of the peoples governed. The role of the states in Tanzania and Ethiopia, due to their economic, social, and political circumstances, is greater than their counterparts in advanced nations. In addition to what has been said above, the governments of Tanzania and Ethiopia need to "ensure that the

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35Department of Justice, "Justice Department Files Lawsuit to Block Compuware's Acquisition of Viasoft," www.usdoj.gov/atr, released 29 October 1999.

benefits of market-led growths are shared, particularly through investments in basic education and health.  

B. Broad-Based Agricultural Development Strategy

Strategic consideration is one of the most important aspects of public policy formulation and implementation, irrespective of the level of advancement of any economy. When planning a development policy, one has to take into consideration available resources and ensure that these resources are efficiently utilized. Japan, for example, is one of the poorest in natural resources but it is among the leading economic powers in the world. Among the factors that led Japan to become an economic giant is not that policy-makers there invented the wheels to transform their economy but rather they invested their resources in the production of goods and services where the country has comparative advantage.

Similarly, the governments of Ethiopia and Tanzania strive to accommodate the environment within which the private sector engages in the economic sectors where the two countries have comparative advantage and strategic interests. For example, Christopher Delgado observed that the agricultural sector in Africa accounts for 70% of total employment, 40% of merchandise export and 33% of Gross Domestic Product (GDP). Delgado argued that agriculture is central to economic growth and the alleviation of poverty in Africa. For him, agricultural transformation through increased "specialization, greater use of purchased inputs, greater resource inflows to farming from other sectors and substantial cuts in unit costs of production due to technological change"

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is key to Africa's economic growth. Based on this premise, he asserts that Africa has comparative advantage in the production of agricultural commodities.\textsuperscript{39}

The recent Policy Framework Paper developed by the Ethiopian government, in cooperation with the International Monetary Fund, concurs with Delgado's view in that it stated that "agriculture and rural development is the highest priority of the government."\textsuperscript{40} Given the percentage of population engaged in the agricultural sector (80\% and 84\% of the labor force as of 1995 in Ethiopia and Tanzania, respectively), the contribution of the agricultural sector to GDP for the same year (57\% in Ethiopia and 58\% in Tanzania),\textsuperscript{41} and the significance of backward and forward linkages to economic security, it is easy to assume that if the economies of Ethiopia and Tanzania are to reinvigorate they must necessarily be anchored around the agricultural sector.

That resources should be allocated to increase productivity in the agricultural sector is morally and strategically relevant. However, this policy proposal may not be economically feasible due to the lessons derived from the command economic systems which favored and "delinked" one sector from the other. Given the two countries endeavor to benefit from a free-market economic environment, which presumes a broad-based development approach, the most obvious weakness of the assertion is that it opts for sectorial development by allocating resources to the agricultural sector. This is a contradiction to the principle of broad-based development policy.

Furthermore, the technological advancement in Europe and North America, (which Delgado seems to accept unequivocally) significantly reduces the cost of

\textsuperscript{39} Ibid, 153-158.


production and, thus, the price of agricultural commodities. This has a critical implication on the successful transformation of the economies in transition. The advanced nations have, for example, developed substitutes for coffee and sugar and manufactured synthetic leather that causes a decline in commodity prices for African farmers. As Emmanuel Egbe pointed out, "the buyers of tropical raw materials may develop temperate substitutes due to cost consideration and for strategic and security reasons." The ability to develop substitutes is correlated with technological advancement; so is the extent to which governments create a level playing field between competing groups.

A report by the United States Trade Representative also indicated that the "European Community grants export subsidies . . . on a wide range of agricultural products including wheat, wheat flour, beef, diary products, poultry, and certain fruits, as well as some manufactured products such as pasta." The export subsidies provide Western farmers even more advantage over African poor farmers. Due to the financial capabilities and institutional effectiveness, Western nations are likely to allocate greater subsidies to their farmers than their African counterparts. In addition to subsidies, advanced communication and transport systems provide Western farmers greater leverages over their counterparts in Africa. In comparison with other countries and, especially with its main trading partner (Western Europe), Africa lacks the technology for

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44 Ibid.
accurately forecasting weather. It also lacks advanced techniques to increase productivity and reduce cost.

Thus, it is highly unlikely that African countries have comparative advantage in the production of agricultural commodities. Benno Ndulu, Nicolas van de Walle, and others pointed out that the unpredictability and instability of sub-Saharan Africa's economies is partly attributable to its "higher dependence on the price-volatile primary products." They argue that Africa's economic growth lies on a development strategy that takes into account the importance of sequencing and timing of policy formulation and implementation, strengthening domestic institutions, pursuing economic and political reforms simultaneously, and on an education system that reflects the development needs of the people.45

As the World Bank report suggests, in an era of free-market economy the choices are many and must be tailored to the circumstance of each country.46 In other words, Tanzania and Ethiopia need not invent the wheels to march toward development. What may be necessary is that the role of the state in creating a level playing field between the domestic and foreign private sectors must be enhanced and investment policies must reflect the unique circumstances of the host nations.

From the above discussions, it can be inferred that states with rudimentary technologies and weak capital, institutional, and financial bases could not effectively manage their economies and regulate practices that are hostile to the growth and development of domestic private sectors. Although the economic power of the developing countries has not improved significantly, as a result of the new world order


"that is at once uni-polar and multi-polar,"47 the opportunities for developing countries to transform their economies are far greater now than they were during the bi-polar world era. Because the world is no longer bi-polar, the uncertainty or diffusion of power suggests that the bargaining leverage of poor countries would be enhanced.

The enhancement of the bargaining leverages of developing countries is evident from their economic growth. For example, the World Bank Africa Region reported that "In 33 countries [in Africa], economic growth now exceeds population increases, allowing for a modest improvement in per capita incomes for the first time in decades."48 This modest improvement (but significant when viewed from the vantage point of Africa's poor economic performance in the past three decades) is associated with the increasing flow of foreign investment which brings with it new techniques of reducing the cost of production; namely, capital and technology.

**Capital Accumulation and Economic Growth**

As indicated throughout this paper, Tanzania and Ethiopia have liberalized their economies in an effort to broaden their access to foreign markets and benefit from industrialized nations' technologies and capital. The advanced nations, in turn, are said to have opened their markets and invest in the economies of Tanzania and Ethiopia. The underlying assumption embodied in the new development policies adopted by Tanzania and Ethiopia is the belief that their economic growth depends on the rate of savings and investment. Domestic savings and investment could be improved by permitting the flow of capital and technology into their economies. An increase in productivity, resulting

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from the inflows of capital and technology, will then be accompanied by an increase in
domestic savings, investment, and capital formation.

Many scholars observed a linear relationship between savings and investment and its implication on economic stability. They argued that maintaining this linear relationship is essential for economic stability. In other words, savings is equal to investment, and as long as this equality is maintained there will be no tendency for economic instability.49 Charles Jones took the view that there is a linear relationship between capital accumulation and economic growth. He pointed out that the "decline in capital accumulation . . . reduces the growth rate of the economy."50 Given the lower rate of savings and investment in Tanzania and Ethiopia, the main source of capital and technology would have to be the foreign private sectors. It follows that the rate of economic growth is directly associated with the rate of investment inflows.

For Thomas Lairson and David Skidmore, foreign investment is more than a vehicle that delivers capital and technology. They argued that the flow of physical capital and technology into the developing countries not only increases productivity but also enhances their access to the extensive foreign marketing networks available to Northern firms.51 Their position was very much in line with the views of prominent Western scholars including W. W. Rostow, Arthur Lewis, and others. These distinguished scholars have long argued that economic growth is a linear function of capital. Lewis and Rostow contributed immensely to development discourse and policy where the latter constructed "the stages of economic growth" from a historical point of


view and the former sought to develop and apply a theory of economic growth to developing countries.

Arthur Lewis published his seminal work, *The Theory of Economic Growth*, almost a decade before Africa's independence from colonial rule. In *The Theory of Economic Growth*, he observed that in the Third World very little capital exists and very little employment is offered by capitalists. He further contended that the peasant sector of the economy is steeped with surplus labor and that this unproductive labor needed to be mobilized into the industrial sector. Moreover, Lewis maintained that the supply of labor could be controlled by the demand in the capitalist sector. Since the capitalist sector in developing countries lacked capital and technology, a larger proportion of these crucial elements of productivity had to come from abroad. He also emphasized that domestic savings combined with foreign investment increase productivity which, in turn, increase the rate of profit. Profit from both domestic and foreign investments would then be reinvested to generate more investment (and thus more profit).

Lewis was also keen in identifying a source of revenue to accelerate industrialization in the urban centers. He noted that the agricultural sector in developing countries constitutes 50% to 60% of the national income and, consequently, he suggested that it makes economic sense to draw on resources from that sector. He argued that "at a time when profits for business enterprises are low and their expansion is necessary for industrialization, there is no other way of accelerating capital formation and savings than to levy substantially upon agriculture."

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53Ibid.


55Ibid.
Simon Kuznets also concurs with Lewis when he argued that Third World countries experience distressingly low productivity per worker in the agricultural sector.\textsuperscript{56} In other words, the productivity of labor was low when viewed from the point of view of the law of diminishing returns — the more labor is applied to a fixed capital the lower its contribution to productivity.

Rostow viewed all societies as progressing in a linear fashion toward capitalistic development. For him, progress towards advancement follows an evolutionary process. Thus, the economies of traditional societies advance toward the pre-conditions for take-off. Societies in the pre-conditions for take-off make headway to the take-off stage; from the take-off stage to the drive to maturity; and from the drive to maturity to the stage of high mass consumption. This development model was attractive because it said nothing about disruption or revolutionary transformation of society.

The linear stages of economic growth also seemed to simplify the complex process of development by relating development to a few factors of production such as capital and technology. Once scarcity and surplus of the factors of production are identified, policy-makers would then formulate a development framework accordingly. For example, traditional societies are characterized by low level productivity, unskilled labor, and chronic shortages of capital and technology. The necessary economic reform policy would, therefore, take into account the formation of capital, transfer of technology, and training of the labor force.

Rostow also recognized the agricultural sector as the principal driving force behind the process of industrialization and argued that an "increase in agricultural

production and productivity plays a multiple role in economic development."\textsuperscript{57} He argued that the industrial sector is financed by incomes generated from heavily taxing the agricultural sector; and, the supply of cheap means of subsistence (through pricing mechanisms) increases the rate of savings for the urban laborer.\textsuperscript{58}

While the process of capital formation and technology transfer could be consummated in the short-run, particularly by opening up an economy for foreign investment, the economic gains from investment in human capital are usually a long-term one. Additionally, with financial constraints taken into consideration, the development policy would have to emphasize foreign investment as a means of accelerating economic growth rather than allocating scarce resource on investment in capacity development. As Lewis noted:

If the choice is between local capital and foreign capital, then the advantage may lie with the former, but if, as is more often the case, the choice lies between foreign capital or leaving resources undeveloped, then there is little doubt that foreign investment plays a most useful role in providing income to pay for higher standards of consumption, of education, and of domestic investment . . . . In most countries at a low level of development it is the foreigner who brings new techniques, and it is the spread of these new techniques among the people which carries development along.\textsuperscript{59}

Kuznets, for his part, argued:

While it is true that increased productivity on land and the resulting surplus population to be drained off the farms necessitate employment opportunities elsewhere ... the setting up of a small number of advanced


\textsuperscript{58}Ibid.

\textsuperscript{59}Lewis, \textit{The Theory of Economic Growth}, 258.
industrial plants [are] usually characterized by high capital and low labor intensity.  

He also observed that "such preoccupation may easily and rapidly lead to an imbalance between a few advanced production sectors and underdeveloped agriculture that undermine the very process of capitalist development."  

However, particularly in the case of Tanzania and Ethiopia, efforts to increase capital formation in the industrial sector may have actually slowed the process of industrialization and caused a dramatic decline in the productivity of the agricultural sector.

Some attribute the decline in productivity to lack of incentives, distorted pricing mechanisms, and excessive tax systems which imposed a heavier burden on the agricultural sector. These deficiencies in policy frameworks were disincentives for farmers to remain engaged in the production of agricultural goods. For the farmers, it made perfect economic sense to abandon their lots in search of employment in the urban sector where commodities were relatively cheaper.

Other prominent scholars had quite opposing views regarding capitalist development, generally, and the transfer of capital and technology, particularly. Karl Marx, Rosa Luxemburg, Paul Baran, Samir Amin, and others took the position that the accumulation of capital in a few of the advanced nations was a source of underdevelopment of the Third World.  

For these scholars and their proponents, overproduction and accumulation of capital goods in some region lead to the search for market outlets in other regions where these capital goods are in short supply.

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60Kuznets, *Six Lectures On Economic Growth*, 60.

61Ibid.

Marx devoted three volumes to explore the essence and purpose of capital. In his first volume, Marx stated that "a machine that does not serve the purpose of labor, is useless." A machine becomes useless or its value declines under conditions of overproduction and accumulation. To make it productive, it needs to be exported to countries where capital is in high demand (usually to “backward countries”), profits are usually high, the price of land is relatively low, and labor and raw materials are cheap. In Marx's view, in countries where this surplus capital is exported, the capitalist repeatedly converts capital into a machine that throws the producer of additional capital out of work.

How do Marxists explain the rate of profit in "backward" countries being usually high? In their view, the capitalist could maximize the rate of profit by investing in capital-intensive industries if the marginal productivity of capital is higher in relation to labor-intensive industries. In this case, profit is derived from lower cost of production. There are two other ways where the capitalist increases the rate of profit for its surplus capital: by the sale of the surplus capital which is cheaper in advanced nations and expensive in underdeveloped countries and by paying lower wages to the working class in the "backward" countries.

Technology Transfer and Economic Development

Simon Kuznets, Robert Solow, and others pointed out that the transfer of technology from developed nations is essential for Third World countries' economic growth. Solow argued that technology is "a prime determinant of economic growth

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64Ibid, 546.
throughout the world." He maintained that the transfer of technology is facilitated if the culture, political ideology, and monetary policy of the recipient nation are in harmony with the home nation. Thus, less advanced countries should create the environment for the transfer of technology from advanced countries by implementing policies to remove barriers to the transfer of technologies.

According to Solow, there are three tracks of technology transfer: the single, the new, and the cross-track technology transfers. In the single-track model, the transfer of technology "follows an established slot in a going operation." The second is the new-track model. This model requires laying a new track or foundation in host economies that is operationally different from the pre-existing ones. The third is the cross-track transfer. A cross-track transfer of technology takes place if the technology of the host economies is cognate with that of the home economies. Furthermore, Solow observed that:

... the transfer of new technology to developing countries are new transfers, except that the track that must be laid is likely to be not simply the operation of a new firm ... but the brining into being of an institutional, technical, cultural infrastructure as a context for organization and operation.

The choice of adapting the single, the new, or the cross-track model depends on the structure of the economies and the development policies pursued by the host nations. Whichever track is adapted, foreign direct investment plays a crucial role as a channel through which advanced technology is transferred from one nation to another.

E. Borensztein, J. De Giregorio, J-W. Lee examined the effect of foreign direct investment on economic growth and whether or not the inflow of foreign technology

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66 ibid.

67 ibid.
"crowds-out" or "crowds-in" domestic technology and domestic private investment. Borensztein, Gregorio, and Lee argued that "foreign direct investment contributes to economic growth only when a sufficient absorptive capability of the advanced technology is available;" namely, the human capital stock measured by the initial-year level of average years of the male secondary schooling.  

Given the minimum threshold stock of human capital stock in the host nation, they asserted that foreign direct investment closes the technological gap and that it crowds-in, rather than crowds-out, domestic technology and private investment. If strategic considerations such as the fear of immediate or future competition exist in host economies, then the strategies adopted by foreign investors would be to maximize short-term profit. In the absence of immediate threat of competition, the transfer of technology "from the advanced North to the lagging South occurs only slightly ahead of the Southern technology frontier." 

The extent to which the transfer of technology either through the single, the new, or the cross-track model contributes to economic growth in Ethiopia and Tanzania partly depends on their socio-economic and political structures. In other words, harmony in social, political, and economic structure between host and home economies are necessary but not sufficient conditions for the transfer of technology. Even if these preconditions are satisfied -- the structures of the host and home economies are compatible -- the transfer of technology would still be constrained by the absorptive capacity of the recipient nation.


69Ibid.

Amy Jocelyn Glass and Kamal Saggi offer a different perspective on the interplay between technology transfer and economic growth. While others argued that the stock of human capital significantly constrains technology transfer, Glass and Saggi stressed that indigenous technological capability in an industry effectively constrains its ability to absorb foreign technology. For Glass and Saggi, investment in human capital narrows the technological gap between host and home economies. Furthermore, a high level of human capital in host economies is an incentive for foreign firms. This is because trained employees would be available to operate the new state-of-the-art machinery. Glass and Saggi concluded that technology transfer is best achieved through the cross-track method (one of Solow's models) and that mere technology transfer does not guarantee sustainable economic growth.

Paul Krugman, on the other hand, argued that the transfer of new technologies is possible when there is continuous innovation by the North. In his view, the technological gap between the North and the South can be seen as beneficial to the North and the South. Under competitive markets, the North is induced by the South to invent new technologies. Krugman further pointed out that, for every new technology transferred, the South's technological advancement is pressed at least one step ahead of its previous advancement, but at least one step backward to that of the North's technological advancement. Under these circumstances, the transferred technologies are always wholly new or contain partly new technology. Whatever the compositions of the technologies transferred to the South, they are only new to the South but never to the North. Krugman

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71 Ibid.
concluded that the North's monopoly of innovation is continually eroded by technology transfer and must be maintained by constant innovation of new technologies. 72 For Solow, Krugman, and others the underlying assumption is that the South has no comparative advantage in invention and innovation. In light of this, the technological gap between the North and the South would be a continuous process of invention, innovation, and absorption. In this process of invention, innovation, and transfer the South remains a market outlet for the North's technology. Old technologies in the North will be new technologies in the South and the gap is maintained as inducement for the North to continue its invention and innovation, and for the South to continue adopting foreign technologies to its peculiar needs.

On the other hand, the faster the South absorbs the North's technology, the slower the North's innovation, the narrower the technological gap, which is a highly unlikely proposal. It is an unlikely scenario because the North has an economic interest in speeding up its technological advancements. Moreover, the very meaning of the term "technology transfer" presupposes a technological gap between the host and home economies. For "technology transfer" to take place as a continuous process, there must be scarcity of technology in the recipient nation.

72 Paul Krugman, Rethinking International Trade (Massachusetts: The Massachusetts Institute of Technology Press, 1990), 147.
Almost a decade ago, Tanzania and Ethiopia were among the leading proponents of socialism in Africa. Since the late 1980s, both countries have embraced market economy and, as a result, have been experiencing a shift in values, traditions, and beliefs. Capitalistic doctrine and political ideology are replacing faith in the socialist world order and the "divine power" of the proletariat. These changes are being reinforced by the belief that there is not "an ever increasing pursuit of profit accumulation among capitalist firms,"¹ and that the objective of opening an economy for foreign private investment is not to systematically displace workers and substitute them with advanced technologies.²

The investment policies of Tanzania and Ethiopia aim at mobilizing natural and human resources in the primary interest of the nationals and creating a favorable environment for foreign and domestic private investment. Consequently, as markets open for foreign investment aimed at enhancing the development objectives of both countries, public policies must create a suitable environment for foreign investments including reliable transportation and communication systems.

Given that there is a deep-seated shortage of capital in Tanzania and Ethiopia, foreign investment serves as a vehicle to deliver physical capital and technology. This is contingent upon fostering an environment conducive to the operation of the private sector.


²Ibid.
and on reducing the role of the state as the primary producer and consumer of goods and services.

Some scholars and policy-makers recognize that the state is best suited for managing an economy. In this regard, the important role played by the state is evident in the proclamation of investment and development policies. With this division of labor between the state and the private sector, it is anticipated that the delivery of physical capital by foreign private enterprises would usually be accompanied by a high rate of domestic capital formation, gross domestic product, employment, and economic growth.³

By liberalizing their economies, Tanzania and Ethiopia seek to benefit from the industrialized nations' technology, capital, markets, and management and entrepreneurial skills. Economic liberalization policy is also an effort to increase the production of goods and services for the domestic market in Tanzania and Ethiopia and to efficiently utilize the countries' natural and human resources. Conventional belief holds that economic liberalization would bring handsome rewards including specialization, tax revenues, and employment opportunities to the host nation economies.

Access to foreign markets induces an increase in the production of goods and services which, in turn, helps improve the balance of payments and foreign exchange earning. This will allow governments to allocate resources for human capital development: the expansion of health services, education, and infrastructure. An increase in the human capital stock will, in turn, determine the rate of technology transfer. Other rewards from opening their economies for foreign investment are increases in energy consumption, access to safe water and sanitation, and urbanization.

Furthermore, economic liberalization facilitates an increase in the rate of savings and investment which, in turn, narrows the capital gap and leads to economic growth. The cyclical "savings-investment-capital-growth" process is believed to pave the way for capitalistic development of agrarian economies of Tanzania and Ethiopia. Although there are greater expectations of and beliefs in the capacity of the private sector to deliver the crucial elements that increase productivity, a country's ability to reap the gains from private investment largely depends on a pragmatic development policy formulation and implementation.

Formulating and implementing investment policy is complex, to such a degree that virtually all African governments have repetitious investment policies. Perhaps these may have arisen from their involvement in the Cold War and from the foreign debt that has been accumulated since the mid-1970s. It may also be the result of the economic structure inherited from the imperial powers. Although some or all of these factors influence the development strategies of Tanzania and Ethiopia, both governments must demonstrate their ability to eclipse the various structural and functional barriers and lead their countries toward economic development.

Most of the investment policies formulated by African policy-makers highlight cheap labor, abundant raw materials, tax holidays, repatriation of profits, and large domestic markets as incentives for foreign investors. Despite these similarities in incentives, some countries have attracted more foreign private investment than others. The degree of openness for foreign investment also varies significantly from one country to another. For example, some countries have privatized the communication sector on the belief that the coordination of the various sectors and the mobilization of resources and products necessarily require optimal utilization of this part of the infrastructure.
Although other countries may recognize the importance of integrating communication with other economic sectors, they may reserve this integration for public investment as a means to ensure national security. Albeit there are differences and similarities in investment policies that may exist among countries or between Tanzania and Ethiopia, their common objective is to bring about economic development.

A. Investment Policy of Tanzania

Since 1985, Tanzania has liberalized its market for foreign investment and promoted a privatization policy. In 1990, the Tanzanian government formally adopted a national investment policy designed to enhance the “development of . . . Tanzania through means which contribute toward building a more nationally integrated economy capable of providing steadily improving standards of living for the entire population.”

The investment policy of Tanzania outlined an eleven-point broad-based strategy for reaching social and economic goals. This strategy included the maximum utilization of domestic and regional capacities and resources including natural and surplus labor. It also emphasized an increase in external resource inflows through export-oriented activities and the transfer of appropriate technologies that are linked with domestic economic activities. Furthermore, the policy encouraged non-debt-creating foreign investments and promoted the distribution of balanced and equitable growth throughout the country.

The government of Tanzania also granted foreign investors the right to repatriate 100% of their profits in foreign currency and capital. It also permitted the employment of

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4The United Republic of Tanzania, National Investment Promotion Policy (Dar es Salaam: The President's Office Planning Commission, 1990), 2.
five foreign nationals in any project that qualifies for incentives.\textsuperscript{5} The government welcomed investment in agriculture, tourism, mining and petroleum development, manufacturing industries, construction, transport, transit trade, and computer and other high technologies.

Foreign investors, with local private enterprises or the public sector, have equal access to all the priority investment areas. The government of Tanzania also attempted to foster joint ventures between local and foreign investors without imposing a predetermined proportion of equity holdings. Some areas, however, were reserved for public investment and for Tanzanian nationals. The areas reserved for public investment included steel production, machine tool manufacturing, chemical fertilizers and pesticides, airlines, the making and distribution of arms and explosives, electricity, public water, railways, postal and telecommunication, radio and television broadcasting, and banks and insurance. Some of these sectors were exclusively reserved for public investment because they were associated with national security issues. For example, iron and steel production, chemical fertilizers and pesticides, the making and distribution of arms and explosives, and electricity and public water generation and distribution were reserved for public investment, primarily because they have a dual purpose: economic and military security.

Tanzanian nationals were encouraged to invest in retail or wholesale trade, operation of taxis, butchers, and barber shops. Since the government of Tanzania aimed to increase the inflow of foreign technology and capital into the economy, foreign investments were discouraged in the areas mentioned here as transfer of capital and technology were unlikely to take place. A minimum requirement of $250,000 was

\textsuperscript{5}See, The United Republic of Tanzania, Procedure for Obtaining TIC Certificate of Incentives (Dar es Salaam: Tanzania Investment Centre, 1997).
imposed to discourage foreign private investments in the areas indicated above. This minimum requirement discouraged foreign investors because the potential for profits was unattractive. Imposing a minimum requirement may also have been a strategy to protect the interests of Tanzanian nationals as many of them were engaged in the aforementioned economic activities. The Tanzanian government was also particularly concerned with ensuring the acquisition of land in the hands of its citizens.

Under a discrete section, the investment policy stated:

... village land is not available for commercial activities, except by the village itself. ... Village land may be sub-leased by the village for small or medium scale, private or public, economic activities. It should be emphasized that there are extensive areas of arable land, outside designated village land, which are still available for lease by private or public investors.6

Furthermore, the government has adapted a legal framework and joined the International Centre for Settlement of Investment Disputes and the Multilateral Investment Guarantee Agency to protect private properties owned by local or foreign investors. In addition to these legal and policy frameworks that protect the interests of local and foreign investors and secure their property rights, both of which were systems of inducing investment inflows, the government of Tanzania provided handsome financial incentives for investments in selected sectors of the economy.

Provided that private investments take place in priority sectors, investors receive tax holidays for the first five years of their operations. Thereafter, a fifty percent tax was to be applied on profits earned by non-residents and forty percent on residents. Furthermore, irrespective of the proportion of the equity holding, if local or foreign investors established a joint venture with the Cooperative Societies, investors will enjoy the same tax holiday and a 22.5 percent tax rate applied thereafter. Lower tax rates for

6The United Republic of Tanzania, National Investment Promotion Policy, 6.
joint investment with the public or domestic private sectors and a significantly lower tax rate (22.5%) for joint investment with the Cooperative Societies were viewed as an effective approach to encourage the transfer of entrepreneurial skills and technology. Put differently, foreign investors and the Cooperative Societies enjoy special privileges and tax incentives.

Protection under the investment act was automatically granted when investors submit an application for certificate of incentives, contingent upon the approval of the project. The certificate of incentives was non-transferable and would be voided if the holder of the "certificate does not commence operations within the first two years of issuance of a certificate without satisfactory reasons." The tax policy, also, had another important purpose in the Tanzanian economy. Through deductions and concessions, the tax policy was hoped to bind the various sectors of the economy by encouraging forward and backward linkages of factor inputs. For example, for imported items that were of interest to the expansion and development of the priority sectors, the government provided tax concessions either for customs duty-free imports or the refund of taxes including those on domestic sales.

**B. Investment Policy of Ethiopia**

The military government of Ethiopia gradually abandoned its central planning economic policy and opened the economy for foreign private investment with the hope to engender economic development. After a negotiated removal of Mengistu Haile-Mariam from power, the transitional government formally adopted an investment policy to speed up the economic and social development of the country. This policy was designed to

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increase the supply of goods and services and advance the interests of domestic consumers and foreign investors.

The 1992 Investment Proclamation stated that the primary objective of the investment policy was to accelerate the production of quality goods and services for the domestic market and reduce the unemployment rate. It was also to foster export-led economic growth. These objectives were to be achieved by promoting the transfer of know-how, technology, and technical skills.\(^8\) In this endeavor for social and economic reconstruction of the country, the investment policy emboldened foreign investors to play "proper" roles through joint investments in the priority sectors which included large scale engineering and metallurgy, mining and energy sectors, and pharmaceutical and fertilizer plants.\(^9\) Other sectors of strategic importance including military and economic (the defense industries, large scale production of electrical energy, transportation, and communication sectors) were reserved for public investments.

Although the 1992 investment policy delineated the criterion and procedures for incentive eligibility and tax exemptions, it did not clearly state the sectors that were open for private investment. Rather, it outlined the sectors that were reserved for public or joint investment and left the private sectors to search for investment opportunities in the economic sectors that were not listed in the investment policy. For example, the 1992 investment policy stated that investments in the social services and mass media were to be determined by future government policy and law. It also stated that investments in the news media including radio, television, newspapers, and journal broadcasting services

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\(^9\)Ibid.
were designated as areas requiring further examination.\textsuperscript{10}

In 1996, the government of Ethiopia enacted a coherent investment policy which outlined the sectors that were open for foreign and domestic investors. As the 1996 Investment Proclamation pointed out, "[t]he investment policy of the Federal Democratic Republic of Ethiopia is designed to improve the living standards of the peoples of Ethiopia through the realization of sustainable economic and social development.\textsuperscript{11} The objectives of the 1992 and 1996 investment policies and the means with which these goals were to be achieved remained basically unaltered. It sought to achieve "sustainable economic and social development" by exploiting the natural resources, developing the domestic market, and increasing foreign exchange earning through an expansion and diversification of export products. It also stated that a foreign investor may hire senior expatriate experts and managers provided that (upon appropriate announcement) Ethiopians with comparable qualifications were not available.\textsuperscript{12}

In the 1996 Investment Proclamation, the areas reserved for government, domestic, foreign, or joint investments were unambiguously designated. While the defense industry remained strictly for public investment, other sectors of strategic importance were open (with some conditions) for private investments. Investments in production and supply of electric energy with installed capacity of 25 megawatts or more and air transport services with a capacity of more than 20 passengers or a cargo capacity of more than 2,700 kg were specifically designated for public investment. Additionally, all rail transport services, telecommunication, and postal services with the exception of

\textsuperscript{10}Ibid.


\textsuperscript{12}Ibid.
courier services were reserved for public investment.

Domestic investors were encouraged to invest in any other sector given that they satisfy the minimum capital requirement and remained outside of these restricted economic sectors. Those sectors that were designated for public investment in the 1992 Proclamation (engineering and metallurgical industries, and pharmaceutical, basic chemical, petrochemical, and fertilizer industries) were listed among the areas open for domestic and foreign private sectors joint investment. However, as stated in the investment policy, the equity share of the domestic investor in a joint investment, with a minimum total capital of $20 million, was not to be less than 27% of the total capital invested. The minimum requirement for foreign investors remained the same ($500,000) and the minimum capital required for joint investment with a domestic partner was $300,000. In a joint investment, the foreign investor may contribute no more than $219,000 to the joint venture.

Relaxing the minimum requirement for joint investment in addition to financial rewards in the form of incentives was a method of inducing the inflow of foreign private investment. Additionally, the reduction in the minimum requirement was to encourage joint venture between foreign and domestic private sectors and create an environment for the transfer of technologies and know-how. This scheme may also have been an attempt to promote a level playing field between foreign and domestic private sectors.

The 1996 investment policy of Ethiopia was also designed to retain profits and capital within the Ethiopian economy. For example, to discourage the outflow of profits and capital, the government expanded the investment incentive packages to a minimum capital of $100,000 for investments made in new projects. The provision of incentives was also used as a means to increase the inflow of foreign financial capital. For example, foreign investors qualify for incentives if 25% of the total capital entered the economy of
Ethiopia in the form of cash. In the case of a domestic investor, investment incentive certificates could be secured upon proof of total capital investment of Birr 250,000 which was approximately $40,000 at the 1992 exchange rate.\(^{13}\)

The investment policy also stipulated that importation of items essential for the operation of foreign or domestic owned industry would receive up to 15% tax exemption, provided that those items were not available in the country in comparable quantity, quality, and price.\(^{14}\) Private investors were also exempted from income taxes up to a maximum of three years from the date of commencement of production or operation. The 15% tax exemption was another method of promoting factor input linkages and exploitation of domestic resources. Furthermore, in line with export-led industrialization schemes, many of the export products were exempted from duties and other taxes.

**Comparison of Investment Policies and Investment Inflows**

As stated in the investment policies of Ethiopia and Tanzania, the main purpose of liberalizing their economies was to enhance the social and economic development of the countries through export oriented development strategies. The Tanzanian investment policy, in particular, emphasized an increase in non-debt-creating foreign investment and equitable distribution of growth in both the urban and the rural sectors. The Tanzanian government's attempt to ensure equitable distribution of foreign investment between the rural and urban areas was evident in the provision of greater incentives for joint investments between foreign or local private investors and the Cooperative Societies. The Ethiopian investment policy, in contrast, stated that the primary objective of the investment policy was to develop and expand quality goods and services for the domestic

\(^{13}\)Ibid.

\(^{14}\)Ibid.
market and create employment opportunities. It also stipulated that the primary concern of the government was to improve the standard of living of the people of Ethiopia. The areas that were reserved for public or domestic private investment and those that were open for foreign investment in both Tanzania and Ethiopia were similar, except during the transitional period in Ethiopia. In addition, the investment policies of both countries did not state a restriction on the repatriation of profits. Both governments also allocated almost identical incentives and tax holidays to foreign investors. However, the data in Table 1 reveals significant differences in the flow of foreign direct investment between Tanzania and Ethiopia.

Table 1

Foreign Direct Investment, Import, and Export from 1986-1996
(Millions of US $)

<table>
<thead>
<tr>
<th>Year</th>
<th>FDI</th>
<th>Import</th>
<th>Export</th>
<th>Imp/Exp Balance</th>
<th>FDI</th>
<th>Import</th>
<th>Export</th>
<th>Imp/Exp Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986</td>
<td>8</td>
<td>892</td>
<td>329</td>
<td>-563</td>
<td>1</td>
<td>1101</td>
<td>464</td>
<td>-636</td>
</tr>
<tr>
<td>1987</td>
<td>-1</td>
<td>904</td>
<td>282</td>
<td>-622</td>
<td>-3</td>
<td>1101</td>
<td>370</td>
<td>-731</td>
</tr>
<tr>
<td>1988</td>
<td>4</td>
<td>805</td>
<td>269</td>
<td>-536</td>
<td>2</td>
<td>1085</td>
<td>421</td>
<td>-664</td>
</tr>
<tr>
<td>1989</td>
<td>6</td>
<td>998</td>
<td>364</td>
<td>-634 *</td>
<td>0</td>
<td>953</td>
<td>452</td>
<td>-501</td>
</tr>
<tr>
<td>1990</td>
<td>-2</td>
<td>1363</td>
<td>331</td>
<td>-1033</td>
<td>12</td>
<td>1076</td>
<td>294</td>
<td>-782</td>
</tr>
<tr>
<td>1991</td>
<td>3</td>
<td>1553</td>
<td>342</td>
<td>-1211</td>
<td>1</td>
<td>472</td>
<td>189</td>
<td>-283</td>
</tr>
<tr>
<td>1992</td>
<td>12</td>
<td>1533</td>
<td>423</td>
<td>-1110</td>
<td>-</td>
<td>707</td>
<td>169</td>
<td>-536</td>
</tr>
<tr>
<td>1993</td>
<td>20</td>
<td>1546</td>
<td>455</td>
<td>-1091</td>
<td>-</td>
<td>787</td>
<td>199</td>
<td>-588</td>
</tr>
<tr>
<td>1994</td>
<td>50</td>
<td>1501</td>
<td>520</td>
<td>-981</td>
<td>3</td>
<td>1026</td>
<td>343</td>
<td>-682</td>
</tr>
<tr>
<td>1995</td>
<td>150</td>
<td>*</td>
<td>*</td>
<td>*</td>
<td>8</td>
<td>*</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>1996</td>
<td>190</td>
<td>*</td>
<td>*</td>
<td>*</td>
<td>5</td>
<td>*</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Average</td>
<td>39</td>
<td>1233</td>
<td>368</td>
<td>-865</td>
<td>3</td>
<td>922</td>
<td>322</td>
<td>-600</td>
</tr>
</tbody>
</table>


* = data unavailable.
For both countries, the ratio of imports to exports was such that imports were increasing faster than exports. In addition, although Ethiopia and Tanzania offer almost identical incentives and investment environments, the data reveals that foreign investment in Tanzania was steadily increasing and in Ethiopia it was fluctuating. From 1986 to 1996, referring to Table 1, the average foreign direct investment in Tanzania was $39 million, which is substantial when compared with little or no investments during the country's transitional phase (from 1986 to 1991) from a central planning to a market economy. The average imports and exports and the import/export balance were (in millions of dollars) $1,233, $368, -$865, respectively.

Between 1986 and 1991, foreign direct investment in Tanzania was at its lowest when compared with foreign direct investment from 1992 to 1996. The low level of imports, exports, and the narrow gap in the ratio of imports to exports seems to be correlated with the low level of foreign investments. In 1991, Tanzania had the greatest trade imbalances with a ratio of 5:1. Stated differently, Tanzania imported five times more than it exported. This wide gap between imports and exports took place with the improvements in the flow of foreign investment from -$2 million to +$3 million. In 1990 and 1992, Tanzania imported four times more than it exported or, stated differently, the ratio of imports to exports was 4 to 1.

In 1993 and 1994, the ratio of imports and exports declined to the level of 3 to 1. The 1993 and 1994 import/export ratios were similar to the ratios of import/export from 1986 to 1989, when the country was in the process of liberalizing its economy. Notice that the decline in the ratio of imports to exports occurred during the transitional period from a central planning to a market economy. In Ethiopia, on the other hand, foreign direct investment was low and fluctuating throughout the years under consideration. Foreign investment in Ethiopia amounted to a mere average of $3 million. The average
imports and exports were $923 million and $322 million, respectively. The average import/export balance was -$600 million. Throughout the years under consideration with the exception of 1991 when the country was in political crisis, the import/export balance remained within a very small margin away from the average import/export balance of -$600 million.

The ratio of imports to exports from 1986 to 1989 was approximately 2.5:1. In 1990, however, the economy experienced one of its highest import/export imbalances. Ethiopia imported four times more than it exported (4:1). In 1991, the import/export imbalance declined to a ratio of (3:1), only to widen in the subsequent years when the government implemented an economic liberalization policy.

Notice also that the highest import/export imbalance occurred when the country received the highest foreign investment which amounted to $12 million. Moreover, given the low level of foreign investments and imports in Ethiopia, the volume of the average exports was not far behind the volume of the average exports of Tanzania.

**Determinants of Foreign Investment Flows**

Although the economies in transition face similar development challenges and both adopted similar development strategies and provided competitive incentives, the two countries' success in maintaining a steady flow of foreign investment and stable political environment was very different. Political stability has been recognized as one of the most important factors that determine the direction of foreign direct investment.

Hinder Singh and Kwang W. Jun asserted that political risk significantly influences the flow of foreign direct investment.\(^{15}\) Examination of the record on foreign

direct investment in Tanzania and Ethiopia and in a number of other African countries may reveal whether or not the fear of political instability is an important factor that influences the decision of the private sector to invest in other economies. The flow of foreign investment in Tanzania during the transitional period from a planned economy to a market economy seems to confirm Singh's and Jun's assertion. However, a closer look at the flow of investment in Ethiopia and Tanzania and in other African countries invalidates their assertion.

Tanzania, rich in human and natural resources with a population of approximately 30 million and one of the most politically stable country in sub-Saharan Africa, had negative balance of foreign direct investment. In 1986, foreign investment in Tanzania started out with a negative balance and continued to fluctuate until 1991. This low level of foreign investment may be attributable to the transitional phase from a command to a market economy. From 1991 onwards, Tanzania improved its share of foreign direct investment inflows into its economy. By 1992, it had a total of $12 million, the largest amount of foreign investment since the transitional period.

On the other hand, the flow of foreign investment in Ethiopia between 1986 and 1989 was fluctuating and low. Like Tanzania, Ethiopia started out with a negative foreign investment. However, in the midst of political crisis, foreign direct investment flows to Ethiopia soared to $12 million, the highest amount since 1986. In 1996, despite relative political stability, foreign direct investment flow was down by $7 million. In other words, the highest amount of foreign investment in Ethiopia occurred at a time when there was political instability.

When compared with other countries in the region, foreign investments in Tanzania in 1992 and in Ethiopia in 1990 were insubstantial. For example, Mauritius, a small island with a population of 1.1 million, had $47 million in 1990, down slightly in 1996. In 1997, Nigeria was the leading recipient of foreign direct investment with a total of $1.71 billion.\(^{17}\)

In 1996, Angola had the highest ($300 million) in foreign direct investment in all of sub-Saharan Africa. In the same year, Ghana and Uganda which are said to be politically stable and in good standing with the International Monetary Fund received $120 and $121 million in foreign direct investment, respectively.\(^{18}\)

If political stability determined the flow of foreign direct investment, then why were Nigeria and Angola the leading recipients and not Tanzania? That is to say, if political risk was significantly correlated with the flow of foreign direct investment, then Angola and Nigeria would have been the smallest recipients. Furthermore, the rise in foreign investment ($12 million in 1990) occurred when the political future of Ethiopia was uncertain.

Paradoxically, when the government of Ethiopia denounced its central planning system and implemented a market economic policy, there were little or no investments in the years between 1992 and 1996. A case by case examination of the data on foreign investment in Ethiopia and in those other countries does not support the claim that political stability is the only factor that determines the flow of investment. This suggests that there may be other explanations for the differences in the flow of foreign investments between the two countries.

\(^{17}\)"Development: Global Investment Boom Bypasses Africa," \textit{Interpress Service} \textit{(21 September 1997)}.

For some scholars, a factor that may be associated with the flow of foreign investment is the differential rate of return on investment. In other words, the greater the financial rewards, such as profits and other incentives, the greater the flow of foreign investments. According to Edward M. Graham, this correlation does not hold especially when viewed from the point of view of historical records.

Graham argued that differential rate of returns from investment does not tell much about the direction foreign direct investment will flow. He maintained that the record on the determinants of foreign investment is ambiguous. According to him,

\[\text{exactly why foreign direct investment flows during the 1980s were so concentrated in the triad nations is not wholly clear. Rates of return on foreign direct investment in the triad were not higher than elsewhere; rather, available evidence suggests they were lower.}\]

William Easterly, on the other hand, argued that the record on the determinant of foreign investment is not ambiguous, and it is not necessarily true to argue that political risk or business condition determines the flow of foreign direct investment. For Easterly, it is incentives for higher returns on investment that determines the flow of foreign investment. According to him, governments, the business community, and people respond to incentives.\(^\text{20}\) Easterly's argument is in congruence with the Tanzanian and Ethiopian Investment Promotion Acts which highlighted incentives as a way to attract foreign investment.\(^\text{21}\)

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Others maintained that the provision of competitive incentives may not significantly influence the direction to which foreign direct investment flows. Sheila Page pointed out that very specific investment policies are the key to attract foreign investment.\textsuperscript{22} Page's position partly explains the differences in foreign investment between Ethiopia and Tanzania.

For example, the Tanzanian investment policy did not indicate that foreign investors have a "proper role" to play in Tanzania's social and economic development efforts. Furthermore, the investment policy of Tanzania did not take the hiring of expatriate conditional on "appropriate" announcements of vacancies. In contrast, the Ethiopian investment policy placed ambiguous conditions on hiring expatriates.

Additionally, the investment policy of Ethiopia imposed indirect restrictions on the private sector by failing to delineate the sectors that were open for privatization. The rate of return for investment and the specificity of the investment policy may be more important factors that created the differences in the flow of foreign investment between the two countries than the fear of political instability in host economies.

Implications of Investment and Development Policies

The effectiveness of the investment and development policies of Tanzania and Ethiopia manifest in the human developments of each country. Public policies play a far greater role in the development of the two countries. It serves as an instrument to forge alliance with domestic and foreign private sectors. The effectiveness of the policy instruments in forging a partnership with the private sectors and the successful

transformation of an economy could be determined by examining the data on the human development indicators.

In addition, data on employment and the concentration of private investments could help assess whether the investment policies of the two countries were coherent and effective. The following four sections are designed to analyze the data on human development, employment creation, and the concentration of private investments in the economies of Tanzania and Ethiopia.

A. Comparison of Human Development in Tanzania and Ethiopia

One of the most important differences between Tanzania and Ethiopia was the human capital stock. The human capital stock is measured in terms of access to safe water, sanitation, health services, and the percentage of pupils enrolled in secondary education. The latter has been examined in Chapter II and, thus, the other variables are the focus of the following section.

Recognizing the importance of the human capital stock as a measure of economic development and as a significant factor that affects the flow of foreign investment, in general, and foreign technologies, in particular, the governments of Ethiopia and Tanzania have formulated development policies to improve the standard of living in their respective countries. Improvement in the standard of living was not only a moral but also an economic issue that needed to be addressed as an important component in the development policies of Tanzania and Ethiopia.

The economic implication of improvements in the standard of living is crucial. Simply stated, a higher percentage of population with access to safe water, sanitation, and health services is a reliable indicator of the flow of foreign investment and the stages of
economic development. It is, therefore, important to analyze these variables (see Table 2) with specific reference to their economic implications.

Table 2. Human Development Indicators

<table>
<thead>
<tr>
<th>Country</th>
<th>Population (millions)</th>
<th>Life Expectancy at Birth (years)</th>
<th>Rural Population (as % of total)</th>
<th>Rural Population with access to SW(%)</th>
<th>Rural Population with access to SN (%)</th>
<th>Rural Population with access to HS (%)</th>
<th>Population with access to SW(%)</th>
<th>Population with access to SN (%)</th>
<th>Population with access to HS (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tanzania</td>
<td>19</td>
<td>30</td>
<td>46</td>
<td>77</td>
<td>72</td>
<td>38</td>
<td>86</td>
<td>42</td>
<td></td>
</tr>
<tr>
<td></td>
<td>30</td>
<td>56</td>
<td>42</td>
<td>49</td>
<td>87</td>
<td>11</td>
<td>7</td>
<td>25</td>
<td>9</td>
</tr>
</tbody>
</table>


*The 1992 Human Development Report shows that the rural population was 67 percent in 1990 and the 1998 report by the same agency shows that the urban population in 1995 was 24 percent. The percentage of the rural population in Tanzania in 1995 has increased by 9 percent. This indicates that either the data is incorrect or urbanization is declining (which is very unlikely).

The United Nations Development Programme Report on population growth in Tanzania and Ethiopia reveals that the population there almost doubled in fifteen years (see Table 2). In 1980, the population of Tanzania and Ethiopia was 19 and 30 million, respectively. By 1995, the population of Tanzania increased by 11 million while the population of Ethiopia grew by 26 million. Life expectancy in Tanzania declined by three years while in Ethiopia it showed a remarkable improvement, from a mere 42 years in 1987 to 49 years in 1995. Although it is not unique to Tanzania and Ethiopia, it is important to note that the majority of the people in both countries live in the rural areas. A broad-based development strategy, anchored in agriculture or in other priority sectors, would therefore have to take into account the demographics of these countries. In general, a high percentage of the rural population in Tanzania seemed to have more access to safe water, sanitation, and health service than the rural population in Ethiopia.
Assuming the increase in the percentage of the rural population in Tanzania (from 67% to 76%) is correct and noting that the majority of the rural population in 1990 had access to sanitation and health services, it can be argued that the majority of the urban population also had access to sanitation and health services. This is because of the obvious reason that the urban population has better access to the communication systems than the rural population. While the data on the percentage of people with access to sanitation in 1990 and 1996 supports the inference made above, the decline in the percentage of the total population with access to safe water and health services in 1996 may be a result of reduction in public expenditure for those services. Like Tanzania, the population of Ethiopia almost doubled from 30 million in 1980 to 56 million in 1995. In contrast, the rural population in Ethiopia, in 1990, had significantly limited access to safe water and sanitation. Eighty-five percent of the people in 1995 lived in the rural areas with no access to health services and a limited access to safe water and sanitation.

Given the percentage of population in the rural areas, in 1990, had limited access to these services, then the 1996 data may be a reliable measurement of the urban population access to safe water, sanitation, and health services. In this regard, human development in Ethiopia is at its rudimentary stage. In addition, if curative (which is usually the case in many developing countries) rather than preventive health services is provided, then the high percentage of access to health services (46%) will be off-set by the low percentage of access to safe water (25%) and sanitation (19%).

The same may not be true with regard to the provision of these services for the people of Tanzania. This is mainly because the rural population in Tanzania, in 1990, had the highest percentage with access to safe water, sanitation, and health services. For example, in 1995, fifteen percent of the population, which was about 8.4 million people, lived in the urban areas. In other words, approximately 25%, 20%, and 50% of the rural
population had access to safe-water, sanitation, and health services, respectively. The human development indicators also show that at most 1% of the population had access to safe water, sanitation, and health services. Note also, in 1996, there was a significant difference in access to sanitation between the people of Tanzania and Ethiopia (86 and 19 percent of the population with access to sanitation in Tanzania and Ethiopia, respectively).

If one of the factors determining the delivery of services to the rural communities was the communication system, then Tanzania has made progress toward achieving its broad-based development goals. This is true because mobilization of resources for investment in human capital development necessarily presupposes investment in infrastructure. The more reliable and integrated the communication system, the easier it is for the governments to reach their citizens and deliver the necessary services to improve the standard of living. Additionally, the expansion and integration of main and feeder roads reduce the cost of production as resources would be mobilized in a more timely and efficient manner. A dependable communication system is beneficial for the two countries and the private sectors. It can be viewed as an incentive similar to the reduction in tariffs and export duties, because a reliable transport system reduces the cost of production.

The government of Ethiopia recognizes the importance of the transportation system, especially roads, in integrating the rural population with the urban and global economy. According to the government of Ethiopia, the country's "current road network of 23,812 kilometers translates into one of the lowest road densities in Africa,... 75 percent of farms are more than half a days walk from the nearest all-weather road."\footnote{The Federal Government of Ethiopia, "Ethiopia -- Enhanced Structural Adjustment Facility: Medium-Term Economic and Financial Policy Framework Paper, 1998/99-2000/01," available from http://www.imf.org/external/np/pf/pf/eth/etp.htm; accessed 10 November 1999; Internet, 14.}
may, perhaps, be for this reason that the people of Ethiopia had limited access to these crucial services. If the dependability and integration of the communication systems are reliable measurements of the delivery of services and production costs, then reserving the communication sector for public investment may not be an effective strategy for social and economic development.

B. Investment and Employment Creation in Ethiopia

Although data for 1995/96 was not available, what is presented in Table 3 may be sufficient to examine a number of policy-relevant issues including allocation of resources for training and evaluation of investment and employment policies.

Table 3

<table>
<thead>
<tr>
<th>Table 3. Unemployment and Vacancies by Occupational Classification, 1990-1994 (In number of persons)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registered</td>
</tr>
<tr>
<td>unemp.</td>
</tr>
<tr>
<td>Professional, technical, and related workers . . . .</td>
</tr>
<tr>
<td>Administrators and managers . . . . . . . . . . . . .</td>
</tr>
<tr>
<td>Clerical workers . . . . . . . . . . . . . . . . . . .</td>
</tr>
<tr>
<td>Sales workers . . . . . . . . . . . . . . . . . . .</td>
</tr>
<tr>
<td>Service workers . . . . . . . . . . . . . . . . . .</td>
</tr>
<tr>
<td>Agricultural workers . . . . . . . . . . . . . . . .</td>
</tr>
<tr>
<td>Production and related workers: Skilled . . . . . . .</td>
</tr>
<tr>
<td>Laborers . . . . . . . . . . . . . . . . . . . . . .</td>
</tr>
<tr>
<td>Total . . . . . . . . . . . . . . . . . . . . . . . . . .</td>
</tr>
</tbody>
</table>


Beginning with the most obvious, total registered unemployment in 1990/91 was the lowest when compared with the record in 1991/92, 1992/93, and 1993/94. Furthermore,
the largest number of people that were registered as unemployed, in 1990/91, were in the area of clerical works followed by unskilled laborers in the area of "production."

From 1990 to 1994, reported vacancies in professional, technical, administration and management, clerical and service works, and agriculture either fluctuated or declined by a narrow margin. If the number of people registered as unemployed was lower in the subsequent year than in the previous year (as in the case of skilled workers), then it would seem reasonable to expect a decline in the number of vacancies created, unless those firms were no longer operating. The data seems to indicate that there was an asymmetrical relationship between "registered unemployed" and "reported vacancies."

What can be drawn from this discrepancy is that those registered unemployed were not qualified for the same occupation they were trained for. In addition, as long as there were vacancies in any of the occupations and so far as training and education were harnessed with the employment opportunities, the total number of unemployed persons in their respective professions would have declined. In other words, if economic liberalization opens employment opportunities, then the number of people registered unemployed in 1990/91 should have been much less than the number of people registered unemployed in the subsequent years.

In particular, consider the data on "registered unemployed" and reported vacancies in production and related occupation (second last row in Table 3). In skilled labor occupation, the lowest reported vacancy was in 1993/94. In the same year, applicants that were classified as "skilled" had only a 15.6 percent chance of getting employment in their profession. However, in 1990/91, applicants in that same category had a fifty percent chance of getting employment in their profession. This is also true for those that were classified as "laborers" in 1990/91. According to the 1993/94 report, a laborer had approximately a 27 percent chance of being hired in that occupational
category. Furthermore, it is very important to note the changes in the total number of "registered unemployed" and 'registered vacancies' from 1990 to 1994. In 1990/91, when Ethiopia was experiencing political instability, there were 44,313 unemployed persons and the reported vacancies were 8,524. Beginning in 1991/92, the number of people that were registered as unemployed increased by about 60%. This increase in unemployment was consistent throughout the subsequent two years. "Registered vacancies" also declined dramatically from 8,524 in 1990/91 to 2,139 in 1993/94.

C. Private Investment and Employment Creation in Ethiopia and Tanzania

Since employment creation is the other most important objective of the two countries, it is important to consider the data in Table 4.

| Table 4. |
|-------------------|-------------------|-------------------|-------------------|
| **Private Investment That Have Started Production/Services In Ethiopia** | **July 1992 - April 1998** |
| **Sector** | **Number of Projects** | **Investment Capital* (US $)** | **Employee/Project** | **Capital/Employee** |
| Agriculture | 401 | 232,111,230 | 7,265 | 18.0 | 31,949.24 |
| Fishing | 2 | 454,923 | 427 | 213.5 | 1,065.39 |
| Mining and Quarrying | 5 | 29,294,308 | 99 | 19.8 | 295,902.10 |
| Manufacturing | 238 | 161,228,620 | 7,832 | 30.4 | 20,585.88 |
| Construction | 27 | 195,290,620 | 7,495 | 277.6 | 26,055.12 |
| Real estate | 8 | 2,994,769 | 77 | 9.6 | 33,893.10 |
| Wholesale/retail trade | 14 | 4,637,385 | 394 | 28.1 | 11,770.01 |
| Hotel and tourism | 41 | 9,128,769 | 428 | 10.4 | 21,328.89 |
| Transport | 7 | 142,833,380 | 5,226 | 746.6 | 27,331.30 |
| Banking and insurance | 9 | 35,935,385 | 234 | 26.0 | 153,570.02 |
| Health | 5 | 427,600 | 231 | 46.2 | 1,851.08 |
| Education | 3 | 964,462 | 96 | 32.0 | 10,046.48 |
| Other business | 6 | 2,195,539 | 2,236 | 372.7 | 98.91 |
| **Total** | **811** | **817,456,900** | **32,040** | **---** | **---** |


* Investment Capital in the original document was given in Ethiopian Birr. The investment capital in this data is converted to U.S dollar based on the 1998 average exchange rate of $1:Birr 6.5.
In Ethiopia, from 1992 to 1998, referring to Table 4, ninety percent of the projects were in the agriculture, manufacturing, and tourism sectors. In terms of employment creation, the three sectors accounted for about 49% of the total employment created between 1992 and 1998. The manufacturing sector which was traditionally labor-intensive and, therefore, most appropriate for Tanzania and Ethiopia, was neither capital nor labor-intensive as it is apparent in Table 4. The capital to labor ratio of the manufacturing sector was $20,585 per an employee and ranked seventh among the twelve sectors listed in the Table, excluding the banking and insurance sectors. The mining and quarrying sector was the most capital-intensive with a capital to employment ratio of $295,902.10 per an employee.

Health and education, two of the most important sectors that determine the transfer of technology as well as contribute to economic development, have not attracted significant foreign investments. In particular, the health sector with a total capital of $427,600 employed 234 persons. The gap in the capital to employment ratio was also narrow when compared with the other sectors excluding fishing and "other businesses." Out of the 811 foreign private investments, there were only three projects in education and five in the health sectors. The narrow gap in the capital to employment ratio and the small number of projects in the health and education sectors suggest that foreign investments were concentrated in capital-intensive industries and there were little opportunities for the transfer of technologies.

The agricultural sector has traditionally been perceived as labor-intensive and, as a result, policy-makers and scholars assert that Africa's comparative advantage lies in the production of agricultural commodities. The data on private investments in the agricultural sector in Ethiopia, however, suggests that the agricultural sector was not labor-intensive. The agricultural sector constituted about 50% of the total number of
projects and ranked third in capital-intensity, followed by the transport and construction sectors (excluding the banking and insurance sectors). It is important to note, also, that the number of projects in the transportation sector was distressingly low.

In Tanzania (see Table 5 below), almost 75% of the total investments were concentrated in three sectors (manufacturing, tourism, and agriculture). More than 35% of the total projects were joint ventures, and 69% of the joint ventures were in the manufacturing, tourism, and agriculture sectors. In particular, private investments in Tanzania were largely in the manufacturing sector.

Table 5.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Total Projects</th>
<th>Local</th>
<th>Foreign</th>
<th>Joint Venture</th>
<th>Capital* (Millions US$)</th>
<th>Employment Project</th>
<th>Employee/ Capital/ Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>523</td>
<td>285</td>
<td>83</td>
<td>155</td>
<td>1,356</td>
<td>84,380</td>
<td>161.3</td>
</tr>
<tr>
<td>Construction</td>
<td>43</td>
<td>22</td>
<td>9</td>
<td>12</td>
<td>1,474</td>
<td>3,683</td>
<td>85.7</td>
</tr>
<tr>
<td>Petroleum &amp; Mining</td>
<td>38</td>
<td>11</td>
<td>5</td>
<td>22</td>
<td>310</td>
<td>4,534</td>
<td>119.3</td>
</tr>
<tr>
<td>Natural Resources</td>
<td>68</td>
<td>27</td>
<td>14</td>
<td>27</td>
<td>448</td>
<td>21,943</td>
<td>322.7</td>
</tr>
<tr>
<td>Tourism</td>
<td>152</td>
<td>67</td>
<td>25</td>
<td>60</td>
<td>310</td>
<td>15,199</td>
<td>100.0</td>
</tr>
<tr>
<td>Services</td>
<td>35</td>
<td>15</td>
<td>8</td>
<td>12</td>
<td>92</td>
<td>5,529</td>
<td>158.0</td>
</tr>
<tr>
<td>Computer</td>
<td>2</td>
<td>--</td>
<td>1</td>
<td>1</td>
<td>0.4</td>
<td>20</td>
<td>10.0</td>
</tr>
<tr>
<td>Financial</td>
<td>16</td>
<td>2</td>
<td>7</td>
<td>7</td>
<td>493</td>
<td>819</td>
<td>51.2</td>
</tr>
<tr>
<td>Telecomm.</td>
<td>6</td>
<td>1</td>
<td>1</td>
<td>4</td>
<td>28</td>
<td>394</td>
<td>65.7</td>
</tr>
<tr>
<td>Agri., &amp; Livestock</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Development</td>
<td>85</td>
<td>22</td>
<td>19</td>
<td>44</td>
<td>116</td>
<td>27,089</td>
<td>318.7</td>
</tr>
<tr>
<td>Transport</td>
<td>56</td>
<td>19</td>
<td>8</td>
<td>29</td>
<td>84</td>
<td>4,894</td>
<td>87.4</td>
</tr>
<tr>
<td>Energy</td>
<td>1</td>
<td>--</td>
<td>--</td>
<td>1</td>
<td>147</td>
<td>90</td>
<td>90.0</td>
</tr>
<tr>
<td>Total</td>
<td>1,025</td>
<td>471</td>
<td>180</td>
<td>374</td>
<td>4,858.4</td>
<td>168,574</td>
<td></td>
</tr>
</tbody>
</table>


* Investment Capital in the original document is given in Tanzanian Shillings which is converted to U.S dollar based on the 1998 average exchange rate of $1:Tsh. 664.

This sector constituted approximately 50% of the total projects, with a narrow gap in capital to employment ratio of $16,070 per an employee. It ranked tenth in capital-
intensity categorization, excluding the financial sector. Put differently, the manufacturing sector in Tanzania was not capital-intensive as it was the case in Ethiopia.

While the majority of private investments in Ethiopia were in the agricultural sector, in the case of Tanzania this sector only constituted 0.08% of the total private investments. Moreover, unlike the agricultural sector in Ethiopia, the agriculture and livestock development projects in Tanzania were labor-intensive with a ratio of $4,282 per an employee. The computer, telecommunication, and services sectors were the most directly related with technology transfer. Investments in these sectors accounted for a combined percentage of less than one percent of the total projects. In the telecommunication sector, 75% of the projects were joint ventures and the capital to employment ratio was not as narrow as the computer and service sectors. The fact that the majority of the projects in the telecommunication sectors were joint ventures may be good indicators of the possibilities of technology transfer in Tanzania. However, the number of projects where technology transfer would have taken place were very few.

The energy and transport sectors play an important role in linking the other sectors. However, investments in these economically and strategically important sectors were significantly low. There was only one project in the energy sector and fifty-six projects in the transport sector. This low level of investment in the two sectors may be a result of the financial capacity of the governments. Although the strategic importance of the energy and transport sectors is vital for the economic securities of both countries, it is also crucial to realize that underdeveloped infrastructure and energy could negatively impact the productivity of the other sectors.
CHAPTER IV
CONCLUSION

This research attempted to explore some of the challenges facing post-Socialist Tanzania and Ethiopia and the opportunities available for them to transform their economies. Ethiopia and Tanzania shifted their development policies from a command economic system to a free-market economy to correct some of the main weaknesses of the previous development strategy that undermined domestic capital formation and indigenous technological advancements. The shift in development models also brought about the need to redefine the role of the state, and the recognition of the private sector as a propellant of economic development. The importance of the private sector in the economic transformation of the two countries is evident in the investment policies of Tanzania and Ethiopia.

The development models pursued by Tanzania and Ethiopia in the Cold War period were essentially designed to mobilize resources in an efficient and coherent manner and to deliver public goods and services on the bases of equity. In this regard, central planning system sought to correct inequalities that were inherited from colonialism, in the case of Tanzania, and from the feudal monarchy, in the case of Ethiopia. The human and technical capacities, necessary for the mobilization of resources and delivery of public goods, were not fully developed. Consequently, it was essential for the public sector to engage in the production and distribution of economic resources. In so doing, however, it undermined the very foundations of indigenous development -- the domestic private sector. The development policies that were designed to promote the rise of the domestic private sectors through subsidies, tariff,
and quotas did not permit them to experiment with new techniques and devices.

In addition, because industrialization was perceived as a measure of advancement, many countries in Africa disproportionately allocated scarce resources to the industrial sector. Central planning development schemes failed to cultivate linkages among the various sectors of the economies. Because the industrial sector was perceived as the spring-board upon which the economies of Tanzania and Ethiopia leap-frog from underdevelopment to development, other segments of the economies including the agricultural and communication systems remained in the shadow of the leading sector. *Ujamma* and *Sefera*, which emphasized agriculture-based development, were the flip sides of the industrialization schemes. Irrespective of the shifts in allocation of resources, the urban and, latter, the rural-based development approaches resulted in low domestic savings and investments and decelerated economic growth.

Given the experiences of Tanzania and Ethiopia and many other African countries, some scholars and policy-makers remain convinced that African countries have comparative advantage in the production of agricultural commodities. Their conviction is grounded on the assumption that the technological advancements made in other regions suit the development needs of the poor countries in Africa. It also rests on the financial and institutional capacities of African states to implement policies that would ensure a level playing field among competing economic agents.

Compared with their primary trading partners, the Western nations, many African countries lack the techniques to increase productivity, reduce cost, and allocate competitive subsidies to their farmers. Similarly, with institutional, technological, and financial constraints, it is highly unlikely that Tanzania and Ethiopia regulate and manage their economies as effectively as the industrialized nations, making them vulnerable to external pressure and less competitive in a free-market economic environment.
In addition, to say that the two countries have comparative advantage in the production of agricultural commodities and that resources need to be allocated to that sector is to argue for a piecemeal development strategy. This assertion by some policymakers and scholars serves little purpose to address the development challenges of Ethiopia and Tanzania. Therefore, for any development policy that seeks to reflect the unique circumstances of these countries, it must necessarily be pragmatically broad-based and not necessarily anchored in the agricultural sector.

The United States Department of Justice intervention to restrain monopolistic practices by Microsoft Corporation and others has important implications on the role of the state in Tanzania and Ethiopia. It is, therefore, important to note that even exponents of free-market economy make the effort to protect their "infant industries." If invention and innovation are to be sustained, then the state needs to 'act like a lion' to promote competition, undermine conflict, and create a level playing field among competing private sectors.

However, the regulatory instruments of the economies in transition do not allow them to dismantle monopolistic practices by giant (domestic or foreign) corporations. In other words, a state with institutional, financial, and human capacities is more likely to formulate and implement prudent development policies and provide a favorable investment environment than a state mired with unpredictable investment and development policy. The relevant question, then, is should the role of the state need to be redefined by what it does rather than by its capacity to protect the interests of its citizens and strengthen its domestic private sectors?

Throughout the Cold War era, the economic power of African countries was weak and, as a result, there was a need to compensate for this weakness by aligning with powerful nations elsewhere. African countries’ alignment with the capitalist or socialist
nations had a political ideology overtone. In the new international economic order, however, political ideology as a defining element for alignment has become a wasteful strategy to achieve economic goals. Economic power is diffused among many advanced and newly industrializing countries.

Given that African governments realize the spread of economic power among advanced and industrializing nations, there exist greater opportunities for Africans to reap the benefits of globalization and strengthen their economic muscle. Among these benefits that may be reaped, contingent on the formulation and implementation of effective investment policies, are Western technologies and physical capital.

In general, there could be little doubt on the contribution of technology and capital to accelerate economic growth. In particular, however, the origins and purposes of these essential elements are important considerations to conclude whether or not they contribute to economic growth and development in Tanzania and Ethiopia. First, it would not be incorrect to suggest that in international trade and investment, one of the most important strategies to accelerate economic growth is to maximize efficiency in utilizing domestic resources. Second, efficient utilization of resources includes factors of production that are domestic as well as foreign in origin. Finally, to maximize the benefits from foreign capital and technology, the governments of Tanzania and Ethiopia need to provide reliable infrastructure that would also enable producers and consumers to meet each other's interests.

However, foreign capital and technology, in and of themselves, are useless unless they are augmented by domestic resources such as labor and natural resources. In other words, foreign capital and technology are necessary but not sufficient conditions to transform the economies of Tanzania and Ethiopia. There are incompatibilities between domestic and foreign technologies that, according to Solow and others, require at least
three sets of structural reforms and building of the human capital stock to absorb foreign technology. These structural reforms include the single, the new, and the cross-track models of technology transfer which impose, to varying degrees, a financial burden on the host nations.

In addition, the human capital stock in Ethiopia and Tanzania is significantly low and, in order to enhance the inflow of foreign technology and capital, public resources must be allocated to increase the human capital stock. If such policies are implemented with the primary purpose of absorbing foreign technology, then allocating public resources to build the human capital stock become no less distorted than the previous development strategies pursued by Tanzania and Ethiopia.

Moreover, there seems to be little interest among the private sectors to invest in the sectors such as education, health, telecommunication, and computers in which technology transfer may have taken place. Therefore, the conditions under which foreign capital and technology enhance the development goals of Ethiopia and Tanzania depend on whether foreign capital and technology are modified to suit the development needs of both countries, coupled with increases in the human capital stock.

Furthermore, as the data in Table 3 indicates, employment opportunities were not available in most of the sectors discussed there. In fact, the number of people registered as unemployed increased from 44,313 in 1990/91 to 64,682 in 1993/94. Therefore, it could be argued that the relationship between the flow of foreign investment and employment creation was not strong.

In addition to creating employment opportunities, the opening up of Ethiopia's and Tanzania's economies was to enhance their access to foreign market outlets. The data in Table 1 suggests that the volume of exports and imports from and to Tanzania has increased. The same was also true in the case of Ethiopia. However, the import/export
balance continued to widen as foreign investment inflow increased. This suggests that both countries may have improved their access to foreign market outlets at the expense of debt-creating investments. Furthermore, the increases in imports of goods and services by Tanzania and Ethiopia indicate that market outlets were incentives for foreign investors, but it does not suggest that market size and national policies were important considerations that alone determine the flow of foreign direct investment.
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