

# ST. MARY'S UNIVERSITY COLLEGE

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## Thesis

Title: The Investment Law framework in Ethiopia as an  
incentive to attract Foreign Direct Investment (FDI)

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*Addis Ababa Ethiopia*

*June 10, 2010*

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## **Introduction**

This paper focuses upon the Ethiopian investment law to what extent it tries to create a conducive environment for the achievement of the over all economical development of the country. In the first chapter readers would understand the Historical background of Ethiopian Investment Law and investment climate in developing countries particularly in Ethiopia and why developing countries need the flow of foreign direct investment (FDI) to their country. In the chapter, there is a brief legal analysis about the historical background of Ethiopian investment law since the first investment law was enacted in the form notice in 1950 by the regime of Emperor Haile Sellassie I up to the current FDRE investment proclamation 280/2002.

In the second chapter readers can understand that the concept of Investment Internationally and in Ethiopia and the objective of investments according to the current investment proclamation and the area of investment, almost in all developing countries distinctions are made on areas of investment permitted to the potential investors, so due to this Ethiopian investment law also puts its restriction on foreign investment not to participate investment areas like banking and financial sectors. Forms of investment in Ethiopia are part of this chapter. Countries use different mechanisms to restrict FI by putting condition in their entry and establishment of investment, such as capital requirement to get permission.

The other important thing in this chapter is Ethiopian investments incentives to attract Foreign Direct Investment and to promote the in flow of

foreign capitals, and technology in to Ethiopia. 100% exemptions from the payment import customs duties and profit tax holidays are granted to both domestic and foreign investors engaged in areas eligible for investment incentives.

In the third chapter readers can understand the Legal analysis for Investment Promotion, investment objective and areas of Investment to the FI. If we need to create a favorable investment environment in the country the law should try to minimize the risk of investors by providing a legal guarantees. Primary, investors needs protection from expropriation and nationalization of their property by the government to attract FI and investment can be protected by the constitution, investment proclamation, bilateral treaties and protection by the multilateral treaties.

The other thing in this chapter is administrative of investment. In many capital - receiving countries to coordinate and supervise the establishment of industries national investment authorities are established. In addition to these the authority establish to perform screening, monitoring, administrating and to develop and implement the strategy for attracting foreign investment to the country.

For these purposes the Ethiopian investment agency established by the proclamation No. 280/2002. This agency has dual functions, externally and internally. Externally it promotes Ethiopia is as a good place for foreign investors. Internally it entertains the proposal of foreign investors to insure that the investor proposal is much with the government objective economical development.

## **Chapter One**

### **1. Historical Background of Ethiopian Investment Law**

Ethiopian Investment law development was started the regime of Emperor Haile Sellasie I. At that time new economic development policy was formulated and for the achievement of this policy government was trying to strengthen the legal and institutional frame works for the private sectors. Due to this, Ethiopia was among the few countries in Africa which adopted planning as an investment policy in the early 1950s. The economic policy was classified in three different land marks. These economic policies were took place in 1950, 1954 and 1963. In the 1950 the industrial policy was outlined was outlined in the form of notice.

In 1954 a proclamation was enacted to encourage agriculture and industry. And finally, in 1963 the investment decree was passed to motivate capitals. And this decree has withdrawn the notice and repealed the proclamation. And the notice represented the previous two legislations.

The other measure takes by the government to facilitate the legal framework for the investment is the enactment of the 1960 Ethiopian Commercial Code. And the enactment of this Code provides for a firm a legal basis to invest in Ethiopia.

#### **1.1 The importance of the 1950 Notice**

The basic objective of this notice was to attract private foreign investors in the industry activities. The preamble of the notice is elaborates in what ways the

foreign direct investors was encouraged. "The Imperial Ethiopian government has decided upon a general working policy for the encouragement foreign capital investment in Ethiopia in enterprises deemed to be beneficial to the country. For the achievement of its policy, the government was prepared to grant special facilities to new enterprises started in Ethiopia with foreign capital?"

Therefore, this policy emphasized mainly to encourage only to those enterprises which were" ... deemed to be beneficial to the country ..." <sup>1</sup>. But here the law did not put specifically which activities are beneficiary or not. So, the government has a power to take a discriminatory measure by saying the government needs to exclude some kinds of enterprises from the incentive. But if companies already passed this stage they were made to be free from the payment of tax for five years from the date when they are served for the installation production is started<sup>2</sup>. So the tax exemption for five years and free from the payment of customs duties for their machinery were considered as specific incentives for the establishment of a new industry.

Therefore, the issuance of this notice clearly tells us to what extent the government tries to promote or encourage the private sector to participate in the development of the country by investing in the production activity. But in the other and the first investment laws was drafted in the form of notice this forms show us the government gives less attention to the private sector because the position of notice in the Ethiopian hierarchy of law was the list powerful law which was enacted by each Ministry office.

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<sup>1</sup> Ibid, (From the Imperial HaileSELLASE I Ethiopian Investment Policy of In 1950)

<sup>2</sup> Ibid Articles 1 and 2

But when we see the end result of the incentives provided by the government was not satisfactory on the attraction of investment. In 1951 the total number of industrial enterprises was established only 107 and the total amount of investment in manufacturing was not more than five million Ethiopian birr and also the number of employees in these enterprises was totally about 700, among there 400 were foreigners.

Its significance may be judged from the fact that this number was approximately equal to one - thousandth of the population of working age in Ethiopia. By the other side these few industries produced a few commodities that were restricted only in some areas such as textiles, flour, oil, cement, leathers, tobacco, bear and wine. These major parts of industrial productions consisted of transforming agricultural products. The main characteristics of employment in industries were that almost all technical and administrative staffs were foreigners.<sup>3</sup>

## **1.2 The 1954 Proclamation for the industrial and Agricultural Expansion**

The proclamations introduced a significant improvement when it compared with the notice of 1950. The first difference between them is in terms of their hierarchy, the 1950 Notice was enacted by the delegation of power to the Ministry of Finance and economic, whereas the proclamation was a form of primary legislation, issued by the legislative bodies after a due processing and deliberation of bills by the chambers of Deputies and the Senate. Therefore, the proclamation of 1954 has higher legislative status than the notice and can

<sup>3</sup> Ibid,

understand the government was given better attention to encourage the private sector.

The second basic difference is in the area of coverage of activities. The notice was a statement of policy for the encouragement of foreign capital investment; its scope was restricted only to the external capital. But the proclamation had contained a wide scope. In this proclamation the encouragement of foreign capitals formed only apart and also it included domestic investors to be beneficiary by the proclamation.

The 1954 proclamation was intended to deal with industrial and agricultural development of the Ethiopian economy<sup>4</sup>. Therefore; the proclamation marked the second stage in the history of Ethiopian investment Law. Among the significant steps taken by the government in this proclamation to promote investment in Ethiopia were introduced two new elements: it enlarges the area of import duty relief by specifically exempting industrial and agricultural machinery<sup>5</sup>.

### **1.3 The 1963 Investment Decree**

The 1963 investment decree was enacted for achievement of the third development policy of the Emperor government. The decree was needed due to the gap of the second plan. Because the second plan did not indicate clearly the government suggested the following divisions: in the basic industries which required relatively high investment and for this reason private investors were not easily engaged in this investment (due to lack of capital). And the government was forced to participate in the heavy industries, and the other reason was the government tries to create harmonies regional development if one region is less

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<sup>4</sup> Supra note 3, the Preamble

<sup>5</sup> Ibid

developed comparatively with the remained regions, the government enter its hand to balance this difference by investing its money because the government objective is to bring equal development through out the country.

For the achievement, the economic policy and to increase the role of the private sector in the production of goods the government tries to facilitate adequate transport facilities to make the market accessible for the production.

Here there was a big problematic question up on the determination of which industry should entitle the determination of which industry should entitle to the tax exemption. To ensure this problem a permanent investment committee was set up by the Ministry of commerce and Industry to administer the investment law and to select those industries.

#### **1.4 Ethiopian Investment Law in the Derge Regime**

When Derge came in to power in 1974, it attempted to introduce a socialist economic policy, through the country. After this it declared that the National Democratic Revolution (NDR) is followed the principle of socialism for both economical and social development. Due to this the government was totally charges the provisions Ethiopian economic policy which is highly participated by the private sector. For this reason under NDR, there was nationalization from 1975 onward.

For the first time after Derg took the power proclamation No, 26/1975 was enacted which stated in its preamble that. "*It is the basic principle of socialism to eradicate idolatry of personal gain to dive primacy to the interest of community.*" It is necessary to transfer to the government ownership of those resources that

are crucial for the economic development or one of such character they promote an indispensable service to the community and " it is the duty of the government to insure, by participating in essential economic activities not amenable to complete government ownership that the public interest is served" <sup>6</sup>.

As the result of this the government took over ownership and operation of over 100 private manufacturing enterprises.<sup>7</sup> By the same year the government enacts were issued on the public ownership of the rural land <sup>8</sup>.

And the government did not stop here, it continued in the enactments of different laws which make the private sector to abstain from investing in Ethiopia. Among these laws proclamation No. 312/1975 and proclamation No. 39/1975 which allows to the government to control mineral prospecting, expropriation and mining activates, proclamation No. 47/1975 which declared government ownership of urban lands and extra houses and also proclamation No. 54/1975 it allowed to transfer private schools to the public owned schools.

All these socialists' oriented laws allowed to the government to control the whole production activates by monopoly.

After Derg paralyzed the whole private sector which involves in the production areas, it enable him the only entity in the production activity but it did not stop there the government wants to participate in the distribution of its good and service. The tropical example was the establishment of Agricultural Marketing cooperation through which the government tried to control the agricultural purples to finance other sectors. And the establishment of grain.

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<sup>6</sup> Ibid Article 29

<sup>7</sup> The Preamble of Proclamation No. 26/1975, A Proclamation to Nationalization Privately Owned Enterprises

<sup>8</sup> Harold G.A Marcus, New Trends in Ethiopian Study, Vol.2, 1994.p 282

Agency by the proclamation No./12/ 1977. This proclamation was enacted to create a mechanism for controlling the price of the agricultural products.

Finally the government tried to show its willingness the participation of investor in Ethiopia by issuing a new proclamation which allows the private sector to invest in Ethiopia by the form of joint venture. So these proclamation eras the state capital investors to

work with the state capital in which the government holds at least 51% of the shares.

Here Derg needs foreign investors for the introduction of technology and know in to the national economy and also they can create new employment opportunities in the country. But this right, to create an enterprise by the form of joint venture was exclusively allowed to the foreign investors.

To conclude the policies of Mengistu regime (1974-1991) support the public sector in achieving its economic policy with regard to production and distribution of good and service Therefore, the market force was totally excluded the private sector from the involvement of Ethiopian economy by doing this the socialist government favored to the country only to stand in the eastern block.

### **1.5 The Investment policy under the transitional Government of Ethiopia (TGE)**

After the seventeen years civil war in Ethiopia, the Mengistu regime was collapsed. After this the Ethiopia peoples started a new life with EPRDF. Due to the change of government, Ethiopia was lead by the transitional Government until the new government elected by the people. And the TGE started its work by

changing its Ethiopian economic policy from the command economy to the market economy. So the TGE made its strategy to give the main role in production and distribution of good and service for the private sector. During this period new economic policy introduced in four different categories, and for this paper I will try to see the 1<sup>st</sup> and 3<sup>rd</sup> categories.

In the first strategy; it tries to limit the role of the government in a few sectors and it tried to participate the private sector in production activities. In the long run the government needs to create a conducive environment for the development of the private market-based economy. By doing this the government tried to change the previous command economy, which is totally paralyzed the private sectors from investing its capital in Ethiopia, to the capitalist economy.

In the third strategy the government formulates a long term economic development. This strategy stresses on the Agricultural Development Led Industrialization (ADLI). The objectives of the strategy is to achieve economic growth by raising the productivity of peasants agriculture thereby promoting export oriented agro-based industrial sector that would be labor intensive and based on domestic raw materials. The strategy envisages increased reliance on market force and increasing participation of the private sector in the development process. When the government tries to encourage the private investment to participate in the Ethiopian economy it took different measures among these trade liberalization and privatization are the major ones.

### **1.5.1 Trade Liberalization**

In the trade liberalization measures the government aimed to eliminate all forms of distortion, (mainly cost - price distortion). Licensing restrictions and administrative bottle necks that have hampered the growth of private sectors activities. In this regard the TGE takes a specific measures including:

- Procedure for licensing both domestic and foreign trade has been stream lined restriction on the area of trade and capital ceiling have been abolished.
- An export duty incentive scheme has been introduced since August 1993, providing duty draw-back and duty free importation of raw materials and inputs for out puts produced wholly for export.

### **1.5.2 Privatization**

The other fundamental measures taken by the TGE to strengthen the role of investors, especially the private sector was privatization, according to this the government tried to privatized its enterprises which are participated in the production areas. The aim of the privatization is to give great investment opportunities for the private sector by reducing government role in the productive sectors. For this purpose the government established the privatization agency. It has been established and implements a phase-by-phase privatization schemes paying attention to their social impacts.

According to the new investment Code, which adopted by TGE, new domestic and foreign investment as well as expansion of investment to existing prospect will attract tax holidays and other incentives. The investment area which attract incentives are agricultural development including agro- processing,

manufactured products and a variety of manufacturing activities large scale capital incentives construction and building projects, development, productions of natural resources (excluding mining investment) which are governed by a separate investment code). So if an investor to be qualified for the incentives domestic investors should invest a minimum of Br. 250,000 and foreign investors minimum of \$500,000.

The final measure taken by the TGE was the establishment of Ethiopian Investment office to provide its service in one office to foreign investors and also regional investment offices have also been set up and began operations, to provide their services to domestic investors in their respective regions. Investors experiences under the Mengistu's regime was discouraging due to the nationalization policy of the government. After reading this chapter, reader would understand the concept of investment, classification and investment climate. Countries especially developing countries are beneficiaries from the flow of foreign investment for their attainment of economic development strategies, for these purpose I will try to see the relationship between law and investment and the nature of the investment law which are designed to regulate foreign Investment in this chapter.

### **Investment and Investment law in the FDRE**

The FDRE follows free market policy in order to attract Foreign Direct Investment. To encourage private investment, the Ethiopian Government has developed a package of incentives under Regulations No. 84/2003 for investors engaged in new enterprises and expansions, across a range of sectors. These incentives are available both to foreign investors and domestic investors and the said Regulations don't discriminate between foreign and domestic investors or between foreign investors of different nationalities.

## Chapter Two

### **2. The Concept of Investment Internationally and in Ethiopia**

Today the concept of investment is in a motion, there is no internationally accepted legal definition of investment. And in this section I will try to show a detailed analysis of possible definition of investment in both economic and legal aspects. In economic field different economists put its meaning in different senses. Certain economists put the concept shortly as:

Investment can be considered as any activity that requires the commitment of current wealth to set of specified assets for the purpose of enhancing future wealth. These assets can be either real (e.g., gold, art, real estate) or financial (e.g. stock, bonds.)

On the other hand economist Malcom Warner defined the term as:

*"It is allocation of capital resources with the expectation of that time will remained them with greater returns" <sup>9</sup>*

This definition indicates that investment is the sacrifices of current capital which could have been used for another purpose for the greater expected enhancement of future wealth. It is the activity forgoing an uncertain form of returns for the future and it is the act of placing capital resources in to creation of assets in the manufacturing and resources in to creation of assets in the manufacturing and services sector of the economy. It is also the act of placing monetary resources in to financial assets namely by the purchase of shares or bonds.

The second is the legal definitions of the term investment, Black's Law

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<sup>9</sup> Malcom Warner, International Encyclopedia of Business and Management, Vol.3, (1996), p. 2347

dictionary defines the term as expenditure to acquire property or other assets in order to produce revenue, the asset to require. It is the placing of capital or lying out of money in a way intended to secure income or profit from its employment. It is the purchasing of security of a more or less permanent nature, or to price money or property in business ventures or real estate, or otherwise lays it out, so that it may produce revenues or gain or both in the venture <sup>10</sup>.

The term investment is defined as including:

1. Movable and immovable property rights; such as mortgage, liens and pledges
2. Shares, stocks and debentures in companies and other interests in companies.
3. Claims to money or to any performance under contracts having financial value.
4. Intellectual property rights and good will.
5. Business concessions including concessions relating to natural resources.

These rights are recognition of the fact that many of rights which the foreign investor obtains in the host state are administrative law might based on permission to conduct certain activities in host state. So the whole foreign investment is depend on the existence of such public law the investment can be decreased by its value if right, such as export rights, are withdrawn by the administrative agency which is granted to them in their establishment.

Therefore, states will not regulate the foreign investment by surrendering its public law powers. The inclusion of this public law rights will mean that rights that are granted in connection with the exploitation of natural resources cannot be later withdrawn without violating the treaty.

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<sup>10</sup> Henry Cambel Black'S Law Dictionary, (1969)

In short, investment is the process of acquiring, holding and disposing both movable and immovable property; loans designed to faster national production in which case it is used to finance productive economic enterprises, associations, co-operatives and other entities, know how and other benefits attached to business, more formally investment can legally be defined as including all rights and interests in anything owned or possessed, whether movable or immovable, tangible or intangible. Like wise the re-enacted Investment Proclamation No. 280/2002 of Ethiopia adopts the 3<sup>rd</sup> approach, it defined investment as:

"Investment of capitals by an investor to establish a new enterprise or to expand or upgrade one that already exists"

Therefore, the term investment under the proclamation means any expenditure of capital commodities, services, patents, processes or techniques in either of the above form for the establishment of new business enterprises or upgrading or expansion of the already existing enterprise.

### **3. Classification of Investment**

In this part different kinds of investments would be discussed. Investment can be classified into public, private commercial, industrial, foreign, domestic investment.

#### **3.1 Public Investment**

Public investment derives from governmental decisions for the achievement of some public demand. It may be the achievement of some economic loss as oppose to make profit.

In our case according to article 2(1) of the proclamation, public enterprise is an undertaking owned by the Federal and Regional Governments established

to carry out manufacturing, distribution, service rendering or other economic and related activities for gain. This proclamation defines public enterprises the same to the definition provided under Article 2(1) of public enterprise Proclamation No. 25/92<sup>11</sup>.

Here public enterprises are entities established and run by the government carrying out its activities in the same manner as possible as private enterprises do. So in terms of its business activity it is the same to the private investment but the basic difference is it is state owned business organization.

Public enterprises establishes with multi purposes, as the name itself indicated it is owned by the public and as an enterprise it produces and distributes goods and services in the market. And it has also a public character. The public should get benefit as the owner of a private enterprise get from his investment. So by this function the government tries to redistribute the country's resources. By doing this the income of the enterprises goes to where it comes from.

Government also invests its money in the form of capital investment in certain activities to bring welfare in the country, such as improving health, education, construction of road and other infrastructure. These are purely public investments.

### **3.2 Private Investments**

Private investment is investment undertaking by private individual or enterprise primarily for profit making purpose.

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<sup>11</sup> Public Enterprise Proclamation No. 25/92 Article 2

Such kind of character makes similar both the public and private investments in this case both of them act with the entrepreneur motives. And the whole benefit is transfer to the investor due to this we can say that private investment is the committed by a private investors(s).

### **3.3. Commercial and Industrial**

Investment can be classified in to commercial and industrial, based on which the investor is participating. In the case of commercial investment the investor(s) engages in commercial activity. Such as finance for making or intending to make a profit where as in the case industrial investment, the investment constitute in the industrial development of production.

### **3.4. Foreign and Domestic**

The other broad classification of investment is between foreign and domestic investment. Domestic investment is that made by public enterprises, government, national and domestic investors<sup>12</sup>.

But foreign investment is the one that is made by foreign investors. Under Ethiopian investment law article 2(5)<sup>13</sup> domestic investors defines as investment made by an Ethiopian or a foreign national permanently residing in Ethiopia, government, public enterprises, as well as foreign nationals, Ethiopian by birth and desiring to be considered as a domestic investors.

Investment made by foreign national, an enterprise established by a foreign national and an Ethiopian permanently residing abroad and performing treatment as a foreign investors. Such kind of significant distinction is made for the purpose of imposing different requirements and restriction upon the establishment of investment in Ethiopia.

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<sup>12</sup> Ibid

<sup>13</sup> Investment proclamation No. 280/2002 Article2 (5)

### 3.5. Foreign Direct investment and Portfolio

Foreign investment participation in the transfer of tangible or intangible assets from one country to the other country for the purpose of generating wealth from the transferee country under the total or partial control of the owner of the assets. There are two classes of foreign investment: private investment portfolio and Foreign Direct Investment.

Foreign Direct Investment distinguished from private foreign portfolio investment is more than a financial flow. Foreign Direct Investment is given the investors direct control over the management and use of the capital flows in the receiving enterprises, usually a wholly or partly owned subsidiary, affiliate or branch. It therefore represents the foreign enterprise. Foreign Direct Investment is the amount of financing provided by a foreign owner that also is directly involved in the management of the enterprise. For statistical purposes, the investment monetary fund (IMF) defines foreign investment as: - "when the investors hold 10% or more of the equity of an enterprise"<sup>14</sup>

And this is usually enough to give power to the investors in the management of the enterprise. The other difference among Foreign Direct Investment and portfolio investment is that Foreign Direct Investment are made largely by multinational corporations. Due to this the sum involved in such kind of investment tends to be large as a result so the element to control becomes large. We can classified Foreign Direct Investment in to two distinction the first one is production or distribution facilities are located abroad or patent and know-how are licensed in order better to serve the foreign market.

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<sup>14</sup> Ibid

This type of investment mostly establishes in highly developed countries where effective demand exists for such kind of investment and general social, political and infrastructure can confidentially be used by the sponsor.

This type of investment mostly establishes in highly developed countries where effective demand exists for such kind of investment and general social, political and infrastructure can confidentially be used by the sponsor.

The second one is the supply oriented and this is the typical investment in developing countries. Therefore, the host states seek to extend the processing which occurs prior to export and generally increase the contribution made to the overall development by this Foreign Direct Investment. This is because the processing in the developed countries which are also the principal markets for the finished products.

Portfolio investment on the other hand includes loans and purchase of equality securities and do not necessarily entitled commercial control of the enterprise. In this case the investor takes up on him the risk involved in the making of such investment. And it is indirect form of investment the investor simply buys a stake in an enterprise.

Therefore, it shows us there is a financial flow which does not require the physical presence of the foreign investor in the host state. In our context foreign capital is that is obtained from foreign sources (Article 2(7)). Investment is the expenditure of this capital either to establish new enterprise or to upgrade or expand that already exists. In the former case the amount of capital by the foreign investors in the establishment of new enterprise is a Foreign Direct Investment. But today upgrading or expansion constitutes additional investment

to the enterprise it included. And it can be done by simply buying a stake in an enterprise or holding share in same which is portfolio investment. In addition to this Article 20(1) (2) of the proclamation an investor can remit proceeds from the transfer of recognize the direct participation foreign investor in an enterprise-portfolio investment? Therefore we can understand from the proclamation is recognized both Foreign Direct Investment and portfolio investment in Ethiopia.

#### **4. The Need for Foreign Investment**

The only way to raise the living standard of the world population especially in developing countries is by rapid economic development. Even if many of these countries (developing countries) possess valuable natural resources, they lack the basic investments for exploiting their resources for the economic benefits of their people's capital, skilled man power and technological investors.

In the need of foreign investment there are two contradictory views (theories). The first one is it maintains that foreign investment is wholly is beneficiary the host state. But in the second view, if the host state is dependence on the foreign development, it cannot achieve economic development.

There are reasons to support this theory. These are domestic capitals which is prepared for the investment can be transferred to other uses of public benefits since the foreign investors brings with him technology which is not available in the host state and this helps the host state for the diffusion of technology from the developed states.

On the other hand the foreign investment can create an opportunity for employment and the labor employed will acquire new skills introduction with the

technology which the foreign investor brings with him, skills in the management of large projects will also be management by the local employees. The other reason is infrastructure facilities will be built either by the foreign investor or for the general benefits of the country.

Therefore these theories indicates us foreign investment is creates dependency mentality up on the developing countries on the central economies of developed countries, rather than promote economic development. After this the developed states will dominate the economy of the developing countries and gradually the economic dominancy comes to political domination. In other way multinational corporations could be engines for the economic development of the developing countries. This study shows us the positive and negative effects of foreign investment upon the host countries.

In general it is clear the flow of foreign investment to a country is essential for its economic of social development. So one can say FI come with multi-fold contribution to the host state's economy. This view summarized by Wolfgang Peter as:

"In practice the host state is mainly interested in; fiscal resources and foreign exchange earnings; infrastructure development; acquisition of technology, managerial know how and labor training; increased income for local labor; opening of markets and promotion of trade and attracting further investment"<sup>15</sup>.

This view shows us the advantage of foreign capital on the world economy and on the developing countries in partial interims of improving the long term

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<sup>15</sup> Grey, supra note 38. p.9

efficiency of the host country through greater compensation, transfer of capital, technology and managerial skills and enhancement of market access and in terms of expansion of international trade.

#### **4.1 Ethiopian Need of Foreign Investment**

Ethiopia is one of developing countries and is low productive, a low rate of saving and development, low perceptive national income, shortage of capital and technology needed for her development. So in order to change this condition, she needs flow of capital and technology to the country as a basic means of economic development. Because such kind of things cannot get from the local sources. Thus Ethiopia, as a developing country, needs foreign sources through encouraging and promoting investment activities to accelerate the economic development of the country and to improve the living standard of the people <sup>16</sup>.

According to the investment policy of the country Ethiopia needs investment to improve the living standard of the people through the realization of sustainable economic and social development of the country.

Under Proclamation 280/2002 ... are stated

- to accelerate country's economic development
- to exploit and develop immense natural resources
- to develop the domestic market through growth of production
- to increase foreign exchange earnings through encouraging expansion in the volume of export products
- to sale foreign exchange thorough production of import substitution products

- to create employment opportunities; and

To faster transfer of technical know how, managerial skill and the technology required for progress. Therefore Ethiopia needs for foreign investment could be generally characterized by the advantage of FDI for her economic development, in terms of opportunity to acquire technology to generate employment opportunity for nationals, to link the national market with the international market, to develop local resources, widen tax revenue, generate foreign exchange stimulates local industry and so on.

## 5. Investment Guarantees and Legal Protection

As we say in the first chapter of the flow of FI in developing countries, it has an important role for the economic development of the host countries. So if there is an obstacle to the investment it must be removed. Foreign investors genuinely need for legal guarantees that may be fulfilled through the legal action of the host state.

Host countries generally provide legal guarantees for foreign investors in respect of their property. These guarantees usually certain general statements concerning the treatment of foreign investment or provisions for the special procedure through which the individual foreign investor is guaranteed against non-business risks, or both.

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<sup>16</sup> ..... / ..... .....? ..... - ( ..... ) .....  
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## **5.1. Investment Guarantees**

No country gives guarantees to the investors merely to the guarantying states have to commit themselves as to the future to promise that certain measures are not going to be taken, or that the investors will be compensated for any loss due to charges in such measures. So these guarantees have compensatory functions.

Generally we can put some reasons why states give guarantees for the potential investors. These are: it makes the investor's loss probable, promotes investments in developing countries, it indicates that there is favorable investment climate in the host state.

The type of guarantee to be granted will be depends on different factors, including political and economical situations, international and domestic, of the host state and particular difficulties to foreign investments. However, the principal measures against which investors seek protection are expropriation and nationalization. After this we will deal with the investment protection in Ethiopia.

## **5.2. Investment Protection**

Government in developing countries tries to show their real needs to protect foreign investors by putting out official pronouncements of government policy in relation to investors. They have also property protection provisions in domestic legislations and constitutions. All these are intended to show how much developing countries give attention to guarantee private property against unlawful action by the government of the host state. After this let us see them one by one.

### **5.2.1 Protection by Investment Law**

It is known that states have the right to nationalize or expropriate the property of investors (both domestic and foreigners) who works in the territory of the state. But when states do this appropriation compensation is to be paid by the state concerned in accordance with the applicable legal rules and principles of the host state.

In Ethiopia the proclamation clearly shows that no invest men may be expropriated or nationalized except when required by the pubic interest (Article 21(1)). Even when public interest so demands, it should be done in compliance with the requirement of the law. This law must be the law of expropriation provided in the Civil Code (Articles 1460=1988). Expropriation or nationalization undertaken in this manner is entitled to adequate compensation in advance which is paid corresponding to the prevailing market value. And also the investor has the right to freely remit the compensation out of Ethiopia. This proclamation provided that compensation is paid "in advance" during legal expropriation.

### **5.2.2. Protection by the Constitution**

Almost every countries Constitution articulates the principles of expropriation and specifies the intent or reason for any state measure which can be taken.

In our FDRE Constitution Article 40(8) states that:

*"The government may expropriate a private property for public purpose"*

But it guarantees that compensation should be equivalent to the value of the property being expropriated.

The standard or the extent of compensation includes by the Constitution and the proclamation is different in the English version in both provisions (Article 40(8) of the Constitution and Article 21(2) of the Proclamation proved different standards for the extent of compensation. In the Constitution the standard sets is "compensation commensurate to the value of the property" but the proclamation sets "adequate compensation". What is adequate may be less than the value of the property. Therefore, the standard set by the proclamation should be amended according to the Constitution.

### **5.2.3. Protection by Bilateral Treaties**

Protection of private property in a host state is one of the major consideration which influence foreign investors in deciding whether or not to invest in the country. But through out the world accepted that states has a right to expropriate foreign investors' property but it is done according to the legal framework.

There is broad agreement that the exercise of the right should not be discriminatory and have a basis in public purposes<sup>17</sup>. Almost in all bilateral investment treaties the principle of public purpose and non-discrimination puts as a condition for the implementation of expropriation and nationalizing and there can be a little doubt that these conditions form part of customary international law.

In a bilateral investment treaties mostly contain provisions relating to the standard of compensation according to the appropriate compensation. But developed countries which are capital exporting states needs the standard and

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<sup>17</sup> M.Soronajah, International Law on Foreign Investment, (1994), p.253

compensation is, prompt, adequate and effective compensation, for the satisfaction of investors in time of expropriation.

Therefore, bilateral investment treaties are not intended to formulate a uniform standard of compensation but the party need it to agree to the standard on which they would compensate in the event that one of them nationalize the property of a national of the other party. As I mentioned in the above, developed countries do not have the same standard of compensation, bilateral treaties have become the means by which the parties could agree on the standard of compensation that is to be used between them.

The Ethiopian government has signed the bilateral investment promotion and protection agreements with different countries. Such as Italy, China, Switzerland, Kuwait, Russia, Malaysia, Yemen, Sudan, Turkey, Tunisia, Denmark, Algeria (see Annex). For example Article 4 of the agreement between Ethiopia and the Republic of Turkey provides that investment can be expropriated for public purpose and in non-discriminatory manner up on payment of prompt, adequate and effective compensation and in accordance with the due process of law.

#### **5.2.4. Protection by Multilateral Treaties**

Multilateral investment treaties is another effective method for protection investors, because the states (the importing and exporting states) would be parties to the treaties, then foreign private investment should not be discriminated and expropriation of private property would be followed by payment

of compensation at uniform standard. Therefore, protection by multilateral treaties is good if it covers more countries.

One of the multilateral treaties is the Multilateral Investment Guarantee Agency (MIGA), which serves as an insurance of foreign investment risk. It was prepared to promote the flow of foreign investment to developing countries because it takes the risk of foreign investment away from the foreign investors.

Ethiopia has ratified the MIGA on September 21, 1990 by Council of State decree No. 39/90. Therefore, the convention gives additional protection too foreign investors in Ethiopia. By ratifying this treaty Ethiopia facilitates good investment climate for foreign investors.

#### **5.2.5 Ethiopian Laws on the Investment Dispute Settlement**

The previous Ethiopian investment proclamation <sup>18</sup> offered arbitration as alternative dispute settlement mechanisms. But this proclamation does not incorporate conciliation or meditation. However the current proclamation, Proclamation No. 280/2002 complete removed the provisions on the settlement of investment disputes. This is major negative change brought by the proclamation which is against the basic objective of the proclamation.

This indicates that the only available alternative as a gap filling is resorting to other law of Ethiopia. Basically, the Civil Code and the Civil Procedure Code of Ethiopia are relevant in this respect. Under these laws three major dispute settlement mechanisms are recognized. The first is compromise, which is a contract whereby parties through mutual concessions, terminate an existing dispute or prevent a dispute arising in the future. It is provided under Articles

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<sup>18</sup> Proclamation No. 37/96 which is amended in 1998 in order to redefine "domestic investors"

3307-3317 of the Civil Code and Articles 274-280 of the civil procedure Code and 274-280 of the Civil Procedure Code. The second is conciliation it is provided under Articles 3318-3324 of Civil Cod, it is done by using third party with the mission to bring them together. The third one is arbitration. Arbitration is a contract whereby the parties to a dispute entrust its solution to a third party. It is provided under Articles 3325-3346 of the Civil Code and under Articles 315-319 of the civil procedure Code of Ethiopia. Therefore, Disputes between any parties, including investment disputes may be settled in any of the three mechanisms.

In my conclusion in the Ethiopian point of view, our investment law should be contain the dispute settlement mechanism to attain (achieve) the basic objective of the investment law (to attract foreign direct investors). Because each laws and regulations determines the flow of investment in this country because investors do not want unreasonable increase risks or reduce returns to the investors. In this respect both the Civil Code and the Civil Procedure Code of Ethiopia are enacted nearly half a century ago so that they are outdated. So they cannot run with current globalize world. This may create problem to the flow of investment to Ethiopia. Therefore, this helps us to think about the need for engagement in law reform that would serve to reduce the risks and costs of foreign investments and thereby encourage the flow of private foreign capitals.

### 5.2.6 Trend of Licensed and Operational Investment Projects by fiscal year

(1991 - 97) Ethiopian Fiscal Year (1998/99-2004/05) Investment Capital in Million Birr)

	1991 (1998/99)		1992 (99/00)		1993 (00/01)	
	No. of Project	Investment Capital	No of Project	Investment Capital	No. Of Project	Investment Capital
<b>Project Description Licensed</b>	<b>713</b>	<b>10,060.06</b>	<b>624</b>	<b>19,127.02</b>	<b>687</b>	<b>8,858.00</b>
<b>Foreign investment</b>	<b>30</b>	<b>1,376.92</b>	<b>54</b>	<b>1,626.84</b>	<b>45</b>	<b>2,923.27</b>
<b>Operational Investment</b>	<b>314</b>	<b>1,153.12</b>	<b>333</b>	<b>5,430.68</b>	<b>62</b>	<b>484.11</b>
<b>Foreign Investment</b>	<b>12</b>	<b>356.69</b>	<b>16</b>	<b>317.21</b>	<b>9</b>	<b>83.93</b>

1994 (01/02)		1995 ( 02/03)		1997(04/05)			
No. of Project	Investment Capital	No of Project	Investment Capital	No of Project	Investment capital	No of Project	Investment capital
801	9,192.63	1217	13,437.86	2274	21,645.07	3105	42,722.12
35	1,474.12	84	3,368.82	340	7,094.34	615	15,643.72
177	1,711.85	162	1,888.77	183	2,247.21	170	2,274.22
6	105.26	9	188.66	89	1,738.00	72	1,318.89

## Chapter Three

### 3. Legal Analysis for Investment Promotion, Investment Objective and Areas of Investment

#### 3.1 Investment Objective

In the first place the investment law should contain the provision of investment objectives and areas country<sup>19</sup> and other importance of investment objective is that it enables us to identify and list areas from which foreign investors are to be excluded.

Foreign investors are allowed to invest in areas where they can contribute to the overall economic development of a host State.

The host State will determine the investment objective either to be broad or narrow. In this point Shiferaw has pointed out that typical investment laws, which are provided under Article 4 of Ethiopian Proclamation 280/2000, basically provide the following.

1. Accelerating the countries economic and social development (article 4(2))
2. Exploiting and developing the immense natural resource of the country (Article 4(2))
3. Developing domestic market through the growth of production, productivity and services (Article4(3))
4. Fostering the transfer of technical know how, managerial skill and technology required for the progress of the country (Article 4(8))

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5. Creating wide employment opportunities (Article 4(8))
6. Increasing foreign exchange earning by encouraging expansion in volume and variety of the country's export products and services and the improvement of their equality as well as to save foreign exchange through production of import substituting products (Article 4(4))
7. Encouraging balanced development and integrated economic activity among the region and provinces and to strengthen inter-sectoral linkage of the country (Article 4(5))
8. Enhancing the role of the private sector in the acceleration of the development of the country's economy.
9. To render foreign investment play <sup>20</sup> its proper role in the country' economic development.

The Federal democratic Republic of Ethiopia investment law objectives basically designed to improve the living standards of the peoples of Ethiopia through the sustainable economic and social development.

### **3.2 Investment Areas**

In almost all developing countries distinctions are made on areas of investment permitted to the potential investors based on their national security (to prevent control of the national economy by foreigners.) And in other areas are closed to foreign investors. Investment laws usually areas reserved for the government, domestic investors and foreign investors

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<sup>20</sup> Ethiopia Investment Proclamation, Proclamation No. 280/2002, Article 5

as well as area in which they act only on joint venture. In our investment proclamation Article 8 puts investment area which opens to foreign investor, the Proclamation reads as:

"All areas of investment, other than those exclusively reserved, under this proclamation for the government or joint venture with the government or for the Ethiopian national or other domestic investors which shall be open for foreign investors."

From this article we can understand that foreign investors prohibited in four different investment areas that are open exclusively for the government, areas reserved for joint venture with the government, areas exclusively reserved for domestic investors and area exclusively reserved for Ethiopian nationals. But the above four areas doesn't show as particular investment areas foreign investors can participate. Therefore, it is essential to deal with these lists to reach on the areas open to private foreign investors.

### **3.2.1 Areas of Investment Exclusively Reserved for the Government**

The total exclusion of any private investment, where foreign or domestic, from certain branches of the economic activity under Article 5(1) of the Proclamation there are two areas of investment that are exclusively reserved for the government.<sup>21</sup>

The first one is transmission and supply of electric energy production of electric is no reserved for both domestic investors and nationals of Ethiopia. And also it is not reserved for joint venture with the government. In general such kind of activity is totally excluded the private sectors, including foreign investors. The second area is postal services with the exception of courier services. This exclusion is done mainly for public interest and also ordinary postal service is not as much profitable. But private investors can render courier

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<sup>21</sup> Super note 3. Proclamation No. 280/2002, Federal Negarit Gazeta 8th Year No. 27 Article 5

services. But mostly such kind of investment areas reserved for the government exclusively for different reasons such as for the purpose of source of revenue and fear of foreign control. In developing countries the main source of revenue is from those enterprises, which are owned by the government unlike developed countries, collected their revenue from different kinds of taxes. And developing countries that had just achieve political independency from colonial powers and they did not want to substitute economic control by the foreign firms. Government feared that this firms broader objectives could lead them in to decision that were not in the best interest of the host country.

In the proclamation No.280/2002 investment proclamation introduces so many changes, in this regard; the proclamation opens more areas of investment for private sectors. These areas which were exclusively reserved for the government under Proclamation No. 37/96 but now open to private investors. These are:

1. Air transport services using aircrafts with seating capacity of up to 20 passengers.
2. Rail transport services
3. Manufacturing of weapons and ammunitions
4. Telecommunication services

These areas of investment need strong financial, technical and managerial capacities that the government cannot cover it by itself. Therefore, opening of these areas to private investors (both domestic and foreign) the country builds its financial capacity to invest in such areas. In addition to this, it may use as an

incentive for foreign capital in flow for it allows foreign investors to invest in areas of their choice.

Areas 1 and 2 are totally open to private investors and in case of 3 and 4 private investors can invest only in joint venture with the government under the regulation no. 84/2003 Article2.

### **3.2.2 Investment in Joint Venture with the Government**

The joint venture is collaborative arrangement between two or more business to achieve a particular objective or to involve in a new business activities, it may be more successful organization as a result of their sum of resources and technologies.

There is a wide preference for joint as the method for foreign investment when foreign investment enters in many developing market economy. They do this to minimize the risk upon the foreign investors in the time of failure.

If the area of investment is given to State monopoly, this will mean that the joint venture will have to be made with State operations. Therefore when the joint venture is with the government, it ensures the government policy in a particular industry is given expression at every stage of particular industry is given expression at every stage of the venture in which the foreign investor participates.

In Ethiopia there are two areas of investment that are to be undertaken only in joint venture with the government. As stated under Article 5(2) these includes: manufacturing of weapons and immunities and telecommunication service. In this case the business can be done only in joint venture with the government, so the government can control each process. Regarding businesses to be undertaken in this way the supervising authority of public enterprise shall

receive investment proposal from any private investor intending to invest in joint venture with the government and submit same to Ministry of Trade and Industry for decision and designate the public enterprise to invest as partner in the joint investment (Article 7).

### **3.2.3 Areas of Investment exclusively reserved for Domestic Investors**

Most countries in the world reserved certain areas of investment for domestic investors, to give the first opportunities of investment for the local entrepreneurs.

In Ethiopia, like in other countries there are areas of investment reserved exclusively for domestic investors. As Article 3 of Regulation No. 84/2003 these areas are provided under Article 1 of the schedule attached to this regulation. And all areas listed under this schedule takes as areas reserved for complex technologies and can be performed by indigenous technological capacity or domestic know how. In the previous proclamation and regulation there are reserved areas for domestic investors including retail, whole sale and import trade, and other small and medium scale sectors such as:<sup>22</sup> printing, small scale transport, all these activities are also including under the current regulation.

### **3.2.4 Areas Exclusively Reserved for Ethiopian Nationals**

In Ethiopia in addition to areas exclusively reserved for domestic investors, Ethiopian nationals also have some investment areas exclusively reserved for them. These areas are listed under article 2 of the schedule attached to the current regulation, including: banking, insurance and micro credit and saving services, forwarding and shipping agency services, broad casting services and air transport service using air craft with a seating capacity of up to 20 passengers. This regulation added some other new areas reserved for Ethiopian nationals that were provided under the proclamation. Like broadcasting services (which was reserved for domestic services micro credit and saving services, and air transport services using air crafts which was reserved for domestic investors).

<sup>22</sup> ..... ./..... .....? .....- (..... .. 1985)  
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The government's rationales for reserving of certain areas for Ethiopian nationals are based on provisions of public services, and encourage national investors.

### **3.2.5 Areas of Investment Open for Foreign investors**

In Ethiopia foreign investors can invest either on their own or in partnership with other domestic investors. They can invest in all in all areas other than those are excluded by Article 8 of the proclamation (Proclamation No. 280/2002). Article 11(3) of this proclamation indirectly show that foreign investors can make investments wholly on their own or jointly with domestic investors in area such as engineering , architectural, accounting and auditing services project studies or business and management consultancy services. Under the previous proclamation there are areas of investment for foreign investors only in partnership with domestic investors. But under the proclamation 280/2002 there is no such mandatory participation with domestic investors.<sup>22.1</sup>

To conclude this, the government has its own reason why foreign investors exclude from certain areas of investment. Among these reasons national security consideration and to protect domestic investors are the main once. But the proclamation and the regulation excludes foreign investors from many activities, such as, telecommunication services. But such kind of restriction is not enabling the country to go long with attraction of FDI. Therefore, rather than preventing them, they should be permitted to engage in these activities to participate in the form of joint venture because they could use their financial power and great knowledge and experience.

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<sup>22,1</sup> In Ethiopia foreign investors can invest either on their own or in partnership with other domestic investors. (Proclamation No. 280/2002). Articles 8 and 11(3)

### **3.3 Investment Incentives**

Before stating investment incentives, I have to identify some important points in the restrictions on foreign investment and capital requirement.

**A- Restriction on foreign investment:** - Host states put their own control and restriction mechanisms on the flow of FDI due to the various reasons such as the protection of national economy from the excessive foreign influence or domination and support of local firms against foreign competitions.<sup>23</sup> Restrictions can be imposed upon foreign investment to exercise once country sovereignty over natural resources and economic activities. In many countries ownership of natural resources is become and important political issue. So if foreigners control these natural resources, it can create influence upon the economy of host countries.

- **Entry of Establishment of Investment**

Foreign investors can be excluded by the states in the investment of the state or conditions can be put to entry of foreign investors. In this regard Soranajah said, "Conditions could also be attached to the matter in which the investors operate his business".<sup>23.1</sup> So the laws of the host state could facilitate the legal mechanism through which the foreign investment should be made such as, the natural and amount of capital resources that should be brought from outside the state, the planning and environmental controls that the manufacturing plant should be subject to the circumstances of termination of the foreign investment and other like matters. From this we can understand that an investor should knows, he will be subjects

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<sup>23,1</sup> M. Soronajah, international Law on foreign investment Law, (1994), P.115

for screening and approval procedure by the host states agency responsible for the administration of investment.

Therefore, states can impose pre-conditions of entry for foreign investors. Ethiopian investment law also puts two requirements that can be considered as restrictions on foreign investment, requirement of capital and permit and I will discuss them in detail.

### **B- Capital Requirements**

Ethiopia investment law states a minimum capital requirement for foreign investors as conditions of entry based on different activities. Generally \$100,000 is a minimum requirement of capital for foreign investors for wholly owned invest, and \$60,000 for joint venture between foreign and domestic investors. The current proclamation reduced the minimum requirement provided in the previous Proclamation which was fixing \$500,000 for any foreign investors in wholly owned invest and \$300,000 when they are invested with domestic investors.

As an exception to the general requirement in Article 11 (1),(2) and (3) of this article reduced the minimum capital requirement which provided in the previous Proclamation from \$100,000 to 50,000 U.S dollars for a foreign investors investing in areas of engineering, architectural , accounting and auditing services, project studies or business and

### **2.4 Restrictions on Foreign Investment**

Management consultancy services or publishing when it is wholly owned investment. But the previous proclamation puts minimum capital of \$100,000 for the above activates whether they are made by wholly owned or joint venture with

domestic investors. But the current proclamation differentiates the minimum capital requirements for both full ownership and joint venture investment. So a minimum capital of \$ 25,000 of foreign investors investing in these activities in joint venture with domestic investors,

The previous proclamation sets a minimum capital of 100,000 U.S dollars for a foreign investor re-investing his profit and dividends. But under the current proclamation such kind of requirement is totally removed. This might be designed to use the profits earned in Ethiopia rather than remitting it abroad in the case of re-investing.

### **3.4. Ownership of Immovable Property and Allocation of Land**

Some countries law allows foreigner to purchase or uses of immovable in the country but other countries prohibit the ownership and exploitation of land by the foreigners. Because in the absence of proper control very rich foreign investors may purchase so many lands and this can create a huge social problem for the inhabitants. But to encourage more investment, many nations with restrictive laws began to allow total foreign ownership of land putting conditions . In Zambia foreign allow retaining total ownership of land, if the investment transfer the most modern technology to the host state, or located the plant in an area of high employment or exported a high percentage of its total output, or located research and development facilities in the nation. In Ethiopia the FDRE Constitution clearly shows us the rights to own land exclusively give to the state <sup>25</sup>. So there is no means to own land privately. But Article 40(6) of the Constitution open the issue of land to private investors to use land on the basis of payment arrangement establish by law. Therefore, currently land can be obtained or transferred only on the bases of leaseholds. According to the proclamation number 272/2002 <sup>26</sup> urban land is permitted to be hold by lease either in conformity with plan guide line; when it does not exist in conformity with the

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<sup>25</sup> Article 40(1) of the FDRE Constitution

<sup>26</sup> A Proclamation to provide for the reenactment of lease holding of urban land Proclamation No. 272/2002, Article 4

law which a regional or city government enacts <sup>27</sup>. The land can be given by three ways, either by an auction, through negotiation, or according to the decisions of regional or city government. And depending to the usefulness of the activity or the type of service the period of lease is varied <sup>28</sup>. For example 99 years lease period is allowed for education, health, cultural and sport investment activities.

The rate of lease payment is determined by the regulation issued by the regions or city government <sup>29</sup> people to whom a leasehold of urban land is permitted may be given a period of payment determined by the region or city government taking in to account a duration needed to recover costs to be incurred but there must be advance payment not less than five percent out of the total lease payment.

### **3.5 Investment Incentives in detail**

In the previous sections we have seen the requirements and restrictions on foreign investments. And these things makes obstacle upon the objective of attracting foreign investors. To neutralize it incentives are usually given to foreign investment. So investment incentives have a great role on investor's choice of location.

If one country understands the FOREIGN DIRECT INVESTMENT (FDI) can play an important role in the development of a country. This country will be entering in the competition to attract this investment.

The competition has led a number of countries to provide more and more incentives of one kind or another to increase their attractiveness for FDI .

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<sup>27</sup> Proclamation No. 280/2002, Article 4(1)

<sup>28</sup> Proclamation No. 280/2002, Article 6(1)

<sup>29</sup> Proclamation No. 280/2002, Article 6(1)

Therefore, "The widespread use of investment incentives reflects the desirability of attracting foreign investment"

Investment incentives are given for the economic development of the host state but it is not granted merely because foreign investors requested it. According to Soranajah in his book "investment incentives may be given for purposes such as developing human resources, the creation of additional employments, the development to infrastructure, or improving the balance-of-payment."

In this issue Aron said "FDI can generate a number of positive externalities such as job creator, technology or knowledge spillovers and productivity improvements.<sup>30.1</sup> It can also encourage training to remain in their country of origin by offering higher wages and more opportunities for professional enrichments than what local firms can offer, thus alleviating the "brain drain" problem that faces so many developing countries."

### **3.5.1. Investment incentives in Ethiopia Investment Law**

In Ethiopia, as per Article 9(1) of the Investment Proclamation No.280/2002, areas of investment eligible to incentives as specified by the regulations No. 84/2003<sup>30</sup> issued by the council of Minister. The regulation determines the types and extent of entitlements to incentive. Thus, to encourage private investment promote the inflow of foreign capital and technology in to Ethiopia. The following investors engaged in areas eligible for investment incentives.<sup>31</sup>

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<sup>30</sup> Council of Ministers Regulation on Investment Incentives and Investment Areas Reserved for domestic Investors No. 84/03 Federal Negarit Gazeta, 9th Year No. 34 February 7/2003

<sup>31</sup> Taxation in Ethiopia, Direct and Indirect Taxes-categories of Tax payers, Declaration of Income and Assessment of Taxes, tax Incentives. Addis Ababa January 2005 Ethiopian Chamber of Commerce p. 34

<sup>30.1</sup> Aron :- Ethiopian Investment Incentives, Journal of business and development. (2006), vol.1

Two principal incentives are contained in the Council of Ministers Regulations. These are income tax exemptions and exemptions from customs import duties.

#### **3.5.1.1. Income Tax Exemption**

Income tax is a tax imposed on every kind of economic benefit from whatever source derived and in whatever form paid, credited or received.

A sovereign state has a right to collect incomes tax according to the law. But a balance should be created between attracting FDI and the need to raise revenue of the country by collecting tax. According to Sherif,<sup>32.1</sup> "the offer of tax incentives represents the sacrifices of possible future revenue for the sake of the country's development but also of the increase of public revenue which is a necessarily consequences of such development.

Therefore tax holydays are usually used as incentives to attract FDI. Such kind of investment incentives applies in the eligible investment by fully or partially exempted from income for a certain period of time, with full taxation applying after the holyday period. Recover their capital more quickly.

In Ethiopia, Income tax proclamation No. 286/2002<sup>32</sup> states that income tax is exempted from income tax when specifically exempted by any law in Ethiopia, international treaty, or agreement made or approved by the Minister (the Ministry of Trade and Economic Development). And also where the Council of Ministers by regulations exempt any income recognized by the proclamation for economic, administrative or social reasons.

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<sup>32</sup> Income tax proclamation No. 286/2002 federal Negarit Gazeta, 8<sup>th</sup> Year, No. 34 Article 13 (d) (i)

<sup>32.1</sup> Shrif: - Global Regulation of Foreign Direct Investment, (2002), P.65

By this power Council of Ministers regulate the regulation No. 84/2003 which provides certain exemptions from income tax Article 2(5) of the regulation defines income tax as that levied on profits from business and categorized as the revenue of the Federal Government, regional government and as their joint venture.<sup>33</sup> There are three activities under the regulation that are eligible for income tax exemption.

These are: - 1. Manufacturing

2. Agro-industrial activities and

3. Production of agricultural products to be determined by the directives to be issues by the board: (i.e. the investment board)

But by the mere fact of engaging in the above activities does not make one eligible for the profit tax holiday.

There are conditions for profit tax holiday eligibility for the inventors who engaged in the above three activates:

- A. If a lease 50% of its production is to be exported; profit tax exemption is for 5 years<sup>34</sup>. In addition if the investment is made in relatively under developed regions the profit tax exemption is for 6 years<sup>35</sup> these under developed region includes "Gambela, Benshangula and Gumz, South Omo, in Afar zones to be determined by the Board, Somali and other regions to be determined by the Board..."
- B. If at least 75% of its production will be input for the production of export items there is also a profit tax exemption for 5 years.<sup>36</sup> If the investment is made in relatively

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<sup>33</sup>Article 5(2) of the Council of Ministers Regulation on Investment Incentives and Investment areas Reserved for Domestic Investors, Regulation No. 84/2003.

<sup>34</sup>Supra note 52, Article 4(1) (a)

<sup>35</sup>Supra note 52, Article 4(7)

<sup>36</sup>Supra note 52, Article 4(1) (b)

under developed region the exemption would be for 6 years <sup>37</sup>.

- C. If the project is evaluated under a special circumstance by the Council of Ministers the profit tax exemption would be given up to 7 years <sup>38</sup>. And if the investment is made under developed regions the profit tax exemption would be given up to 8 years. However, the granting of income tax exemption for a period longer than 7 years requires the decision of the Council of Ministers.
- D. If less than 50% of the production is to be exported the profit tax exemption would be given for 2 years <sup>39</sup>. If the investment is made in relatively under developed regions the exemption would be given for three years <sup>40</sup>.

If an investor does not export his products at all the investment board may issue a directive that is totally prohibits him from obtaining any income tax exemptions. <sup>41</sup>

In all the above cases, the period of exemption begins from the date of commencement of production or the date of rendering services. <sup>42</sup>

Under Article 7 we find that "an investor who has incurred loss within the period of income tax exemption shall be allowed to carry forward his loss for half of the income tax exemption period, after the expiry of such period"

This indicates that investor's eligible for the tax exemption would be eligible to carry forward loses for an additional two years and this applies for both of domestic and foreign investors.

<sup>37</sup> Supra note 52, Article 4(7)

<sup>38</sup> Supra note 52, Article 4(2)

<sup>39</sup> Supra note 52, Article 4(3)

<sup>40</sup> Supra note 52, Article 4(4)

<sup>41</sup> Supra note 52, Article 4(5)

<sup>42</sup> Supra note 52, Article 6

It is to be noted that for expansion or upgrading of the above projects that would increase the existing production by 25% in value and if 50% of the production is to be exported, a profit tax exemption would be given for 2 years.

The current Agriculture Development-Led-Industrialization (ADLI) policy formulated by the government clearly identified the agricultural sector as one of the priority areas for attracting FDI based on the objectives of creating employment, diversifying exports and poverty reduction. Therefore, most income tax exemptions prepared to agricultural activities indicates that they are designed to achieve the above objectives. The other thing is additional period of exemption from income tax for relatively under-developed regions may attract foreign investments to those regions and thereby the objectives of balancing development among regions would be achieved.

#### **3.5.1.2. Exemption from Custom Duties**

Custom duties are important sources of government revenue. Custom duties impose on the importation and exportation of commodities, merchandises and other goods. The tariff or tax collects from merchandise, imported from or exported to foreign countries.<sup>43</sup> But exempting fully or partially, building materials, plant and machinery and raw materials for new industries can give custom duty. According to Sherif H.Seid's view, "In most cases, the exemptions apply only on items that are not available in the country in comparable quality, quantity and price". Most of them time government allows such kind of exemption but they put higher conditions and qualification on exemptions to imported higher materials than they do on capital goods and components because most developing countries wish to avoid dependence on foreign raw materials or semi-finished goods.

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<sup>43</sup> Henry Cambell Black, Black's Law Dictionary (1991), p. 268

In Ethiopia an investor is allowed to import duty free capital goods such as machinery, equipment and accessories, needed to produce goods or render services and construction materials necessary for the establishment of new enterprises or upgrading of existing enterprises.<sup>44</sup> And an investor who gets "customs duty exemption privilege" he is allowed to import duty-free capital goods only "necessary for his enterprise".<sup>45</sup>

But the investment board, by its directives, may bar the exemption where "it finds that they are locally produced with competitive price, quality, and quantity."<sup>46</sup> Here domestic and foreign investors are treated equally. The investor is also given the same privilege for spare parts whose value is not greater than 15% of the total value of the capital goods to be imported.

In the case of vehicles, the investment board would determine the condition for importation on the type and nature of the projects. However any investor may import duty free "ambulances for employees that are for emergency cases and buses for tour operation services."<sup>46</sup> where exemption was not granted on four-wheel trucks.

Under Article 10, some areas of investment are not eligible for custom duty exemptions, like Hotel (other than those star-designated), motel. Tearooms, coffee shops, bars night clubs and restaurants that do not have international standards.

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<sup>44</sup> Supra note 52, Article 8(1)

<sup>45</sup> Supra note 52, Article 8(2)

<sup>46</sup> Supra note 52, Article 9

- Wholesale retails and import trade
- Maintenance services
- Commercial and transport and car-hire services
- Real estate development and others under Article 10 of the regulation and according to Article 11 of the Regulation, Investment capital goods imported without the payment of import customs duties and other taxes levied on imports may be transferred to another investors who enjoying similar privileges.<sup>47</sup> But it is possible to transfer it to the other party upon the prior payment of the custom duty. The primary objectives of the regulation is providing investment incentives which helps the Ethiopian investment promotion and for attraction of FDI. By using these incentives we are encouraging investors to export their products to earn foreign currency to the state. But under article 8(3) of the regulation the board has a great role in the determination of these capital goods that respects "price, quality and quantity". If they are available based on ten above three standards, the investor pushed to purchase the locally produced capital goods and construction materials it also determines the investors choice of production inputs. And due to the tariff rate is high the investors uses locally produced inputs without other alternatives. Here, a big problem when it implements by the investment board. Because it is clear that this article will benefit local suppliers of production inputs without compromising the investor's ability to produce a high quality product at a competitive price because in the time of implementation the regulation

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<sup>47</sup> Taxation in Ethiopia pp 34 -35

may be " administered in a corrupt manner or under the influence of protectionist bias and high tariff rates discourage importation inefficient and uncompetitive local suppliers of production inputs." And also due to the fewer prices of the domestic products foreign investors may purchase the domestically produced inputs.

So we can conclude that Ethiopian law creates influences up on foreign investors to use locally produced inputs. Even if the law allows that investors can import capital goods and construction materials without custom duties, the law puts other restrictions indirectly as I said in the above the rights of the investors to uses such kind of incentives is in the hands of the investment board. But I did not see the importance of the board intervention to determine availability of the inputs locally in terms of its price, quality and quantity. Because it is clear investor invests their money to produce more revenue. So if inputs available in the host state that is competitive with the imported inputs without any hesitation 'they refer to use domestically produced inputs to safe the transportation costs and by other economical reasons. So without any assistance local producers can holds this market. Therefore, Article 8(3) of the regulation is articulated by the intention of "protectionism"<sup>47.1</sup> (immunity from violence) to 48 local producers of inputs.

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<sup>47.1</sup> Regulation No 84/2003. Article 8

## **Conclusion and Recommendations**

The definition of the term investment is a broad one that includes all assets in the territory of one party owned by investors of another party. The general definition of investment depends on the five categories of investment definition.

FDI involves on the movement of persons and properties from one state to another. Since the very nature of FDI shows a long-term involvement, so, the investment environment in the host state has an important role to sustain the investment the long term in the host state. Among these factors stable political and economical climate and transparent, non-discriminatory legal and regulatory framework are served as a precondition to encourage foreign investment in a host country. Ethiopian government has undertaken a huge range of reform and policy improvement. However the improvement is not enough Ethiopia needs yet more improvement in government procedure and progress on other aspects for the attractive environment of investment.

Today there is reasonable regulatory measures are taken to foreign Investment has a meaningful role for the economic development of developing countries, in the bases of transfer of technology and introduction of new management skill and it also increase productive capacity.

The foreign Investment can also widen the market for host country products by introducing his products in the world market. Therefore FDI has a powerful development through out the world.

Investor returns either he accepts the level of risk in the host State investment climate or not accepted it due to the huge risk in the investment climate of the host state. Investment law unlike other laws gives better protection and treatment to its subject. So investments law define areas in which foreign investors can participate, contain condition of entry, incentive, standard of compensation in the time of nationalization, the procedure of dispute settlement and authority for supervising investment.

There are four distinctions made in area of investment in Ethiopia these are those reserved for the government, in joint venture with the government, for domestic investor, for Ethiopian nationals only and those open for foreign nationals. The current Ethiopian investment proclamations open more area investment for the private investors. Many restrictions are imposed on foreign investors and most of all restrictions are based on national security consideration and protection of national economy from foreign domination, these restrictions may include entry and establishment of investment and ownership of immovable property.

Under Ethiopia law lands are located on leasehold basis. Foreign investors are free to employ qualified experts for the achievement of their investment. The other restriction in Ethiopian investment law on foreign investors is capital requirement and requirement of permission by EIA. The current investment proclamation also does not avoid such kind of capital requirement but when we compute it with the previous proclamation it reduced the minimum capital requirement. This requirement has an impact on the host state in the

attraction of FOREIGN DIRECT INVESTMENT (FDI). So due to this Ethiopian economy could not get benefit from some beneficiary small-scale industries. So such kind of requirements may be forces to foreign investors to look for other opportunities in other countries where there is no such requirement.

In Ethiopia incentives are given to foreign investors to attract them to invest in the country. In most developing countries including Ethiopia provides income tax incentives and custom duty exonerations. Such kinds of incentives are usually given for a fixed period to allow investors to recover their capital more quickly and the most frequently used incentives to attract FDI.

Foreign investors need legal guarantees from the host state for the action of the government. This promotes investment since the investor thinks he is secured. The major protection investor needs are protection against expropriation and nationalization. In Ethiopia the investment proclamation provision embodied in the FDRE Constitution and investment law and also Ethiopia ratified bilateral investment treaties with different countries for the protection and encouragement of private foreign investment as well as the country ratifies Multilateral Investment Guarantee Agency (MIGA) Convention on view of investment protection.

Arbitration and conciliation are the best means of investment dispute settlement mechanisms. But in the current Ethiopian investment proclamation does not put any provision on dispute settlement mechanism even laws which are provided in the Civil Code and the Civil procedure Code of the country for the

purpose of dispute settlement mechanism are out dated and could not satisfy the need of investors.

In most developing countries investment agencies are established to do three things; to promote, to screen and to monitor foreign investors. In Ethiopia EIA is established to perform the above three tasks and implementing a strategy for attracting foreign investment to Ethiopia. It gives a one-shop service but in reality or in practice its primary function is screening of foreign investment proposals.

In general terms the investment law should be prepared to attract FDI. To end this certain amendments are required upon the existing investment proclamation to make more effective implementation of its purpose of promoting the development of the Ethiopian economy.

Based on the above stated facts, I will recommend the following few points.

1. Investment areas of banking and financial sector and telecommunication service should be open for foreign investors by full ownership and to control them we can establish a mechanism for screening FDI in these sectors.
2. The minimum capital requirement should be cancelled.
3. Screening of foreign investment should be removed at least in areas open to foreign investors.
4. Dispute settlement mechanism (should be include in the proclamation and laws on the Civil and Civil Procedure Code should be amended to satisfy the need of investors.

5. Expansion should be free from any approval, since the company has already been lessened to perform its activities.
6. In the case expropriation by the law the amount of compensation by the constitution and the current investment proclamation follow different principle. So the investment proclamation should be amended according to the FDRE constitution. Because the constitution tries to provide a meaningful legal protection to investors.
7. The right personnel, persons with the knowledge who can serve investors properly rather than civil servants who have served in some economic related ministry should establish the EIA. The authority should also develop how it can serve investors post investment permission by providing relevant information. And it should also develop its capacity to create a strong coordination between regional government investment organs and other relevant ministries. The above recommendation can serve to the EIA to be proper and objectively oriented investment promotion organ.

In my Opinion, I appreciate the Government of Ethiopia for the strengthen of investment in the country. But from the proclamations of investment laws of Ethiopia which I read, and from the interview which I observed, there are few tackles and problems for attracting Foreign Direct Investors. So, all areas of investment should be opened to the Foreign Direct Investors. In addition to this, the minimum requirements and the restrictions should be avoided in order to flow Foreign Direct Investors to Develop the Economics of the Country.

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## Questionnaire

1. What is the role of Ethiopian government in order attract foreign Direct investment?
  - The Government gives different incentives.
  - The Government makes different Promoted activities abroad.
  - Image binding of the country and others as conducive investment destination.
  - Investment generation communication.
  - Investment service facilitation and after care services.
  
2. Is Infrastructure well facilitated in Ethiopia in order to attract foreign direct investment?
  - Partly yes, we can't say well facilitated but better of and the government is striving to do so.
  
3. Is the update proclamation of Ethiopia that formulated very suitable for the direct foreign investor?

If Yes, why? if no, why and why not?

  - We can't say yes very suitable, but still in progress to amend based on the current situation and comparative advantage to the country's economic development.
  
4. What are the investment areas that are open :

A - For Ethiopian Nationals ?

  - All import and small scale commercial sectors business - No exclusives to nationals except those areas exclusives to

governments eg. Telecommunication, Air Transport service above 20 seats etc.

B - For foreign nationals?

- Except all areas exclusive to domestic investors / National/ and to the governments that is agriculture, manufacturing industries and service sectors.

5. What is the incentive given in order to attract foreign direct investment?

- 100% exemption form the payment of customs duty on imported capital goods including spare - parts 15% of its total value of capital goods.
- From 2-7 years tax holding period
- No export tax to its products exporting.

6. Can you tell me the incentives allocated areas for direct foreign investment?

- To all areas of investment agriculture, manufacturing, industries & service sectors except commercial business sectors.

7. Can you tell me the main problems that refrain foreign direct investment in Ethiopia?

- Infrastructural facilities.
- Delaine in land acquisition
- Slow bank loan facilities.
- Corruption
- Discrimination etc.

# Declaration

I hereby declare that this paper is my original work and I take full responsibility for any failure to observe the conventional rules of citation.

Name -----

Name -----

Signature -----

Signature -----