

Investment Law

Teaching Material

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TABLE OF CONTENTS

UNIT ONE: A GENERAL OVERVIEW-----	1
1.1) Definition and Nature of Investment -----	1
1.2) Elements of Investment-----	7
1.3) Economic Principles of Investment -----	10
1.4) Types of Investment-----	15
1.5) Factors that Affect the Direction of Foreign Direct Investment-----	22
1.6) Investment in Developing Countries-----	25
1.7) Investment Law-----	33
1.7.1) Definition and Nature of Investment Law-----	33
1.7.2) History of Investment Law-----	37
UNIT TWO: ECONOMIC THEORIES ON INVESTMENT-----	53
2.1) The Classical Theory-----	53
2.2) The Dependency Theory-----	58
2.3) The Middle Path-----	59
2.4) The Liberal Consensus-----	63
UNIT THREE: RISKS IN INVESTMENT-----	70
3.1) Political Risks-----	71
3.1.1. Ideological Risk-----	74
3.1.2. Nationalism-----	76
3.1.3. Changes in the Industry Patterns-----	77
3.1.4. Regime Change-----	78
3.1.5. War and Conflict-----	80
3.2) Taking of Investment Property-----	80
3.3) Onerous Contracts-----	86
3.4) Economic Risks in Investment-----	86

UNIT FOUR: INTERNATIONAL LAW ON FOREIGN INVESTMENT-----93

4.1)	Sources of International Law on Foreign Investment-----	94
4.2)	International norms on Multinational Corporations-----	98
4.3)	The World Bank guidelines on foreign investment-----	101
4.4)	The World Trade Organization and Trade Related Investment Measures (TRIMs)----- -----	102
4.5)	Bilateral Investment Treaties (BITs) -----	105

UNIT FIVE: REGULATING AND ADMINISTRATION OF INVESTMENT IN

ETHIOPIA-----115

5.1.	Definition and Nature of Regulation-----	116
5.2.	Principles of Good regulation-----	119
5.3.	The Need to Regulate Investment-----	120
5.4.	Regulation of Investment in Ethiopia-----	126
5.4.1.	Constitutional Framework Investment in Ethiopia-----	126
5.4.2.	Economic Policy of Ethiopia-----	128
5.4.3.	Areas of Investment Reserved for Domestic Investors-----	132
5.4.4.	Sectors Open to Ethiopian Nationals -----	133
5.4.5.	Sectors Open to the state-----	133
5.4.6.	Investment Procedures-----	134
5.4.7.	Business Licence-----	135
5.5.	Restrictions on Foreign Direct Investment-----	138

B) THE INSTITUTIONAL FRAMEWORK FOR THE

ADMINISTRATION OF INVESTMENT IN ETHIOPIA-----148

5.6.	The Ministry of Trade and Industry-----	149
5.7.	The Investment Board-----	150
5.8.	The Investment Agency-----	152
5.9.	The Regional Investment Organs-----	154
5.10.	Others-----	157

UNIT SIX: INVESTMENT OPPORTUNITIES AND FORMS IN ETHIOPIA--162

6.1.	Investment Opportunities in Ethiopia-----	163
6.1.1.	Major Investment Opportunities in Ethiopia-----	163

6.1.2.	Favourable Situations to Invest in Ethiopia-----	167
6.1.3.	Investment Opportunities at the Regional Level-----	170
6.1.4.	Practical Problems-----	170
6.2.	Investment Options in Ethiopia-----	176
6.2.1.	Sole Proprietorship-----	177
6.2.2.	Business Organizations-----	180
6.2.3.	Public Enterprises-----	186
6.2.4.	Cooperative Societies-----	189
6.2.5.	Joint Investment-----	189
UNIT SEVEN: INVESTMENT INCENTIVES AND GUARANTEES-----		206
7.1	Incentives in General-----	207
7.2	Economic Rationales for Incentives-----	210
7.3	Incentives under Ethiopian Laws-----	213
7.4	Rethinking Investment Incentives in Ethiopia-----	219
7.5	Guarantees to Investors-----	222
7.5.1	General Remarks-----	222
7.5.2	Repatriation of Capital and Profits-----	226
7.5.3	Guarantee against Expropriation-----	227
7.5.4	Federal and Regional Laws-----	233
UNIT EIGHT: CONCERNS RELATED TO THE LAW OF INVESTMENT-----		241
8.1	Environmental Concerns-----	241
8.2	Human Rights-----	250
8.3	Displacement of People-----	253
UNIT NINE: INVESTMENT DISPUTE SETTLEMENT-----		266
9.1	Dispute Settlement: General Remarks-----	267
9.2	Settlement of International Investment Disputes-----	277
9.3	Investment Dispute Settlement under Ethiopian Law-----	281
9.3.1	Disputes Between Ethiopian Government and Contracting Party-----	281
9.3.2	Investor –Ethiopian State Dispute-----	284
GLOSSARY-----		305
BIBLIOGRAPHY-----		306

ABBREVIATIONS AND ACRONYMS

COMESA – Common Markets for Eastern and Southern Africa

EIC – Ethiopian Investment Commission

GATT – General Agreement on Tariffs and Trade

IBRD – International Bank for Reconstruction and Development

ICJ – International Court of Justice

ICSID – International Centre for Settlement of Investment Disputes

IMF – International Monetary Fund

ITO – International Trade Organization

MNEs – Multinational Enterprises; also TNCs – Transnational Corporations

NFPA – National Forest Priority Areas

NIEO – New International Economic Order

TRIMs – Trade Related Investment Measures

WB – World Bank

UNIT ONE: A GENERAL OVERVIEW

INTRODUCTION

Since the course is the law of investment, it would be of paramount importance to first define the concept of investment. Next, we shall discuss the nature of investment. In addition, we will analyze the elements of investment. There are different types of investment, and we will discuss them based on the law of investment. What is more, we shall consider the principles of investment. Finally, we will consider the definition and nature of law of investment. We will summarize the essential points in this chapter. We will also have questions that will help you to make further progress in your learning.

1.1 DEFINITION AND NATURE OF INVESTMENT

The term ‘investment’ may mean different things in different disciplines and contexts. Thus, it may mean “expenditure to acquire property or assets to produce revenue”.¹ Fisher and Jordan² define investment as commitment of funds made in the expectation of some positive rate of return. According to them, the return will commensurate with the risk the investor assumes if the investment is properly undertaken. We observe from this definition that investment is a commitment of funds. Thus, a person would commit fund on something. In addition, the commitment is made with the expectation of some positive rate of return. This positive rate of return is a profit gained from the commitment of the fund. However, it is important to bear in mind that investment carries with it a risk, i.e. the commitment of the fund might end up with no profit. Thus, the investor needs to properly manage the investment to make sure that it will be profitable.

From the legal point of view, investment is defined as:

¹ Bryan A. Garner,(Editor-in-Chief), **Black’s Law Dictionary**,(Eight Edition), Thomson, West, United States of America, 2004, p.844

² Fisher and Jordan

Every kind of asset and in particular shall include though not exclusively:

a) movable and immovable property and any other property rights such as mortgages, liens and pledges;

b) shares, stocks and debentures of companies or interests in the property of such companies;

c) claims to money or to any performance under contract having a financial value;

d) intellectual property rights and goodwill;

e) business concessions conferred by law or under contract, including concessions to search for, cultivate, extract or exploit natural resources.³

According to many international investment agreements investment is something established in accordance with the laws of host countries.⁴ This is intended to ensure that the investment has been properly registered and licensed and that it complies with the laws and regulations of the host countries.

Under a bilateral investment treaty to which Ethiopia is a party, investment is defined as: “Any kind of asset and any direct or indirect contribution in cash, in kind or in services, invested or reinvested in any sector of economic activity.”⁵ As per this Agreement though not exclusively, it includes:⁶

movable and immovable property and rights *in rem* like mortgages, liens, pledges, and usufruct;

shares;

bonds, claims to money and to any performance having an economic value;

copyrights, industrial property rights, technical processes, trade names and goodwill;

³ ASEAN Agreement for the Promotion and Protection of Investments, Article 1(3), from UNCTAD, 1996a, Volume II, p. 294.

⁴ UNCTAD **International Investment Agreements**, Volume I, (2004), p 122

⁵ The Reciprocal Promotion of Investments Agreement between The Belgian-Luxemburg Economic Union and the Federal Democratic Republic of Ethiopia, Article 2.

⁶ **Ibid**

concessions granted under public law or contract to explore, develop, extract or exploit natural resources.

In general, investment may be defined as making an outlay of money or capital for profit. The definition given under our investment law is in line with this definition. The provision of Art 2(1) of Proclamation No. 280/2002 (as amended) reads as:

“Investment” means expenditure of capital by an investor to establish a new enterprise or to expand or upgrade one that already exists.

There are some essential elements in defining the term investment under our law. Now let us consider them turn by turn.

A. Expenditure of capital- To have an investment there must be an expenditure of capital. ‘Capital’, according to Article 2(3) of Proclamation No 280/2002 (as amended), means “local or foreign currency, negotiable instruments, machinery or equipment, buildings, initial working capital, property rights, patent rights, or other business assets.” Capital includes currency. What does currency mean? Currency is a system of money used in a country or sometimes an economic block. In other words, currency is money or cash as represented by notes, which are known by various designations in different countries. A currency could be local or foreign. Local currency means Ethiopian Birr whereas foreign currency denotes money other than Ethiopian Birr such as Euro, the Chinese Renminbi (people’s money), the Israeli Shekel, US Dollars Nigerian Naira, etc. Thus, money is capital, and expenditure of money is investment so long as all other elements of the definition of the investment are fulfilled.⁷

In addition to money, negotiable instruments also constitute capital according to the definition of the term under our law. Have you taken the law of banking and insurance? If you have, you must be familiar with negotiable instruments. Do you remember the definition of negotiable instruments and their nature?

⁷ See Seyoum; A Partial Work, (unpublished), 2007, Pp. 2-3

The word 'negotiable' means 'transferable by delivery', and the word, 'instrument' means 'a written document by which a right is created in favour of some person'. Therefore, the term 'negotiable instrument' literally means 'a written document transferable by delivery.'⁸

Negotiable instruments are defined as "documents representing legal claims which are regarded by law as transferable and which give to the purchaser in the ordinary course of business a good title even though that of the seller may have been defective"⁹

In light of this definition, a negotiable instrument transfers a good title to the purchaser. Good title means better right, better protection. It is only a holder in good faith, a holder in due course who can acquire better title, better rights, and better protection than the transferor can. A transferor is one who transfers/sells/the negotiable instrument to the holder. For example, W/o Almaz has a cheque from Ato Melaku after paying the price, in good faith. She is a holder.

What is essential is that it is possible for a person to contribute a negotiable instrument, i.e. a bill of lading, a document of title to goods shipped, warehouse certificate, a cheque, a promissory note instead of contributing the goods or money to an enterprise.

What is more, things like machinery, equipment, buildings are regarded as capital according to Article 2(3) of Proclamation No 280/2002 (as amended).

Furthermore, incorporeal things, like patent right, are also considered as capital under our law. Thus, business assets like trademark, trade name, goodwill etc... are regarded as capital. In general, what is important is that the thing being contributed or otherwise invested should have economic value and help in the attainment of the purpose of the enterprise, i.e. making profits.

B. An Investor- A person who invests in Ethiopia is an investor. The person may be local or foreign investor.¹⁰

'Domestic investor' is defined as "an Ethiopian or a foreign national permanently residing in Ethiopia, who has made an investment, and includes the Government, public enterprises as well as a foreign national, Ethiopian by birth and desiring to be considered as a domestic investor."¹¹

⁸ M.C. Kuchhal; **Mercantile Law**, Vikas Publishing house PVT LTD, New Delhi, 1992, P 359

⁹ A lecture by Zekarias, 2005

¹⁰ Proc. No 280/2002 (as amended). Re-Enactment of the Investment Proclamation, **Federal Negarit Gazeta**, 8th Year No. 27, Addis Ababa, 2nd July, 2002, Art. 2(4)

An Ethiopian is a domestic investor so long as s/he invests in our country. A foreign national may also be regarded as domestic investor if s/he is Ethiopian by birth and willing to be considered as a domestic investor. Persons who are Ethiopian by birth may acquire foreign nationality. Such persons may invest in Ethiopia. If they need to be treated as domestic investor, the Ethiopian Government will consider them as domestic investors. On the contrary, if they are not willing to be considered as domestic investor, they could not be considered as domestic investor. Thus, the option is given to them to choose whether to be treated as a domestic investor or not because they have foreign nationality and they are Ethiopian by birth.

Nevertheless, what is the advantage of being considered as a domestic investor? There are some advantages to being considered as a domestic investor related with the privileges granted under the investment law. Therefore, if a foreigner who is Ethiopian by birth chooses to be considered as a domestic investor, s/he would be legible to exercise the privileges granted to domestic investors while they are not granted to foreigners.

Foreign investor is “a foreigner or an enterprise owned by foreign nationals, having invested foreign capital in Ethiopia, and includes an Ethiopian permanently residing abroad and preferring treatment as a foreign investor.”¹²

According to this definition, a foreign investor could be an individual or an enterprise (business organization) who has foreign nationality. An enterprise that is owned by foreigners is a foreign investor. This means the enterprise may be established in Ethiopia according to our law(s). An enterprise that is established here in Ethiopia is considered as Ethiopian. However, such enterprise is regarded as a foreign investor notwithstanding its establishment in Ethiopia. What is important, according to our law, is that the enterprise should be owned by foreign nationals. Here it is essential to raise a question: should the enterprise be owned wholly or partially by foreigners? This is not clear from the law. However, the intention of the legislature seems that the enterprise should be wholly owned by foreigners.

¹¹ **Ibid**; Art. 2(5)

¹² Proc No 280/2002, **Ibid**, Art. 2(6)

The definition also includes an Ethiopian who permanently resides abroad and chooses to be treated as a foreign investor, i.e. s/he is a foreign investor. Here nationality does not seem to be a criterion to categorize a person as foreign investor, because an Ethiopian who permanently resides in a foreign country may not necessarily be a foreigner. Here, what is the determining factor is the choice of the Ethiopian who resides permanently abroad to be treated as a foreign investor. Consequently, an Ethiopian who permanently resides abroad and chooses to be treated as a foreign investor is not allowed to invest in the financial sector, for example. However, what do we mean by an Ethiopian? Does it include an artificial person, i.e. an enterprise or only an individual? The law of investment does not clearly respond to this issue.

C. Enterprise- is another essential term in the definition of the term investment. What does an enterprise mean? The term “enterprise” is defined as “an undertaking established for purpose of gaining profit”.¹³ In other words, an enterprise is an undertaking whose purpose is profit making. This means the enterprise should accrue an economic benefit for those who invest upon the sector. An enterprise whose purpose is profit is a trader according to Article 5 of the Commercial Code of Ethiopia. However, if an enterprise is established for the purpose of cultural, religious or political goals, but not obtaining economic benefits for the person(s) who make capital available for it, such an entity is not an enterprise. Consequently, expending capital in such entity cannot be regarded as an investment.

D. Expansion and upgrading- is also regarded as an investment under our law of investment.¹⁴ There could be an expenditure of capital on an already existing enterprise to expand it or upgrade the same. “Expansion /upgrading” means increasing in value, by more than 25% the full production of service capacity of an existing enterprise, be it in variety, volume, or both.”¹⁵

Let us assume that XYZ Share Company is an enterprise established with Birr 200,000 to produce leather products, such as bags. Now, the sector is promising and the demand of the consumers increases. Thus, the owners decided to upgrade the production capacity of the Share Company by more than 25%. Accordingly, the capital of the company is increased to Birr 275,000. Such an upgrading or expansion of the company is regarded as an investment.

¹³ Proc. No 280/2002 (as amended), **Ibid**, Art. 2(2)

¹⁴ **Ibid**, Art. 2(1)

¹⁵ **Ibid**; Art. 2(8)

Let us consider another example. Cheque Share Company is an enterprise investing on flower on the road to Nazareth on 2,500 hectares. The capital of the Company is 2.5 Million Birr. Now the owners of the Company reached a decision to invest more to expand the investment. The Government has granted them 1,000 square hectares for expanding the investment on flower. The shareholders agreed to expend some 325,000 Birr for each the expansion. This expansion of the investment with Birr 325,000.00 on additional 1000 square hectares is an investment pursuant to Article 2(2) of the Investment Proclamation No 280/2002(as amended).

QUESTIONS

Define the term investor in light of Ethiopian law.

Explain domestic investor as per Ethiopian law.

Analyse the elements of investment in light of Ethiopian law.

1.2 ELEMENTS OF INVESTMENT

There are three factors that are considered as elements of investment.

a) reward (return); b) risk and return; and c) time.¹⁶

A. Reward

We have seen above that investment is made with the intention to gain profit. Thus, investors, generally, may expend their fund to earn a return on it. The return is known as reward from the investment, and it includes both current income and capital gains or losses which arise by the increase or decrease of an investment.

¹⁶V. Gangadhar and Ramesh Babu; **Investment Management including Portfolio Management And Security Analysis**, Anm Publications Pvt, Ltd, New Delhi, 2003, Pp. 3

Let's say, Ayal has started producing bread in a modern way at Arat Kilo and distributes it to the customers in Addis Ababa. The capital for the investment is Birr 10,000. She invested on the sector with the expectation of profit. Moreover, let us assume that she has got Birr Two thousand within six months of her investment. This is a reward from the investment.

B. Risk and Return

The second element of investment is risk and return. Risk may be defined as the chance that the expected or prospective gains, or profit or return may not materialize. It also includes the fact that the actual outcome of investment may be less than the expected outcome. It is important to note that the greater the variability or dispersion in the possible outcome, the greater the risk will be.

In addition, risk means estimation about the degree of happening of the loss. Risk and return are inseparable. Return is an expected income from the investment. It represents the benefits derived by an investor from his/her investments. The rate of return required by the investor largely depends on the risk involved in the investments. Thus, the investment process must be considered in terms of both aspects of risks and return. Risk can be quantified by using precise statistical techniques. Therefore, risk is a measurable element.

Example: Hailu has invested on flower on the road to Jimma. He must assess the risks involved in the investment. For instance he should consider the possible pests that may cause damage to the flower, the risk of the market failure, the risks involved in transporting the flower to Bole, and then the air transport to export it to foreign countries and so on. On the other hand, Hailu should estimate the expected return, i.e. profit from the investment. We have seen that risk and return are inseparable. Thus, Hailu should consider both the risks and return of his investment together.

C. Time

Time is the third element of investment. It offers several different courses of action. Conditions change as time moves on and investors should re-evaluate expected return for each investment.

An investment could not be materialized within a very short period of time. In other words, investment is of long-term in nature. For example, if one needs to invest on a cement factory, s/he should conduct market research to ensure the viability of the investment. Conducting research needs a certain period of time. After the research is done, machineries should be imported and installed. This also is to be done through time. Then, the factory should produce sample cement, distribute the product, and collect the feedback from the customers. Then, the factory would start production and distribute cement to customers. All the above-mentioned activities need to be done through time.

Let us consider another example. Almaz wishes to invest on the textile. First, she saved a certain amount of money, and let us also assume that she was granted a loan from the Commercial Bank of Ethiopia. Secondly, she has to import necessary machineries from, say, German, Italy or any other country. The machineries should reach Ethiopia and an installation is necessary. Then, the factory starts production. The production process needs a certain period of time. In general, investment by its very nature is of a long-term process. During this time, the investor has the opportunity to re-evaluate the risks involved in that particular investment, and take necessary measures to minimize the degree of risk.

Further, investment requires a continuous flow of decisions. As we can observe from the above examples, the investors should decide on each and every level of the investment. Thus, investment is the result of a series of decisions.

Moreover, investors should from time to time reappraise and reevaluate their various investment commitments in the light of new information, changed expectations and ends.

Investment decisions are based on data which represent the observable environment and the general and specifics of a given investment. It takes the ability to analyze the data and specifications properly to make an appropriate decision. Thus, investment is the result of a series of decisions.

Thus, investment is an art and depends on the art the individual investor employs to be successful. An investment may be successful where the investor employs a suitable art. On the other hand, investment is a science because there are rules and principles developed through time. In general, investment is an art and a science.

QUESTIONS

Analyse the time as an element of investment.

How do you explain risk and return in investment?

1.3 ECONOMIC PRINCIPLES OF INVESTMENT

We have seen that investment is both an art and a science. As a science, there are fundamental principles applicable to investment. Under this part of the material, we shall discuss the essential ones.

A. Safety of Investment

An investment needs safety since the investor invests his/her fund and time. Thus, adequate protection should exist against the risk of loss of capital. Investing in the form of shares is said to be relatively safe because the risk is spread due to diversification among different scripts of companies.¹⁷

For instance, if Abebe invests his fund alone, the risk of loss is higher compared with the investment made together with others in the form of Share Company. In general, what is required is maximizing the chance of getting profit in any manner.

B. Liquidity

¹⁷ Gangadhar and Babu, **Ibid**, p 15

Liquidity is the second principle of investment. Any investment is said to be liquid, if it can be converted into cash or sold as and when required. A liquid investment would enable the investor to encash his/her investment whenever the need arises. It would also permit the investor to sell off an unremunerative investment, there by minimizing the losses, and switch over to a more prommising investment. Thus, the liquidity of an investment offers flexibility in the face of changing economic and political environment.¹⁸

For instance, Dendir was investing on food processing in Eritrea before the prevailing regime came to power. Investment on this sector is safe since the return is very high in that particular area. However, Dendir has sold it easily and came to Ethiopia as the political conditions changed dramatically. Thus, the investment Dendir has made is liquid since it was possible to encash it whence it was required.

C. Profit

We have seen that profit is an element of investment. The main reason of investment is to accrue profit. Profit can be realized in either or both of the capital appreciation yield¹⁹

Capital appreciation occurs when an investment is disposed of at a higher value compared to the price for which it was purchased. Where the difference between the net selling price and the purchase price is positive, it is said to be capital appreciation.²⁰

Yield, on the other hand, is derived in the form of interest or dividend. The rate of dividend may fluctuate from year to year, depending on the profitability of the area in which money has been invested where as the rate of interest is usually fixed.²¹ If for example Kedir invests on purchasing shares, such shares are expected to yield a dividend at the end of the year. This is an investment for Kedir i.e a capital appreciation or yield.

¹⁸ **Ibid**

¹⁹ **Ibid**, p. 16

²⁰ **Ibid**

²¹ **Ibid**

D. Tax Implications

The investor may be required to pay tax on his/her income.²² According to Proclamation No. 286/2002, Article 4, “every person having income as defined here in shall pay income tax in accordance with this Proclamation”. Income is defined as “... Every sort of economic benefit including nonrecurring gains in cash or in kind, from whatever source derived and in whatever form paid credited or received.”²³

In addition, an income from business activities is taxable income under Proclamation No 286/2002 (Art. 6(b)). We have seen that investment is made to gain profit. An activity recognized by the Commercial Code of Ethiopia as trade and is made to gain profit is known as business activity.²⁴

The rate and manner of business income tax is regulated by the provisions of Income Tax Proclamation No 286/2002.²⁵ According to this proclamation, business organizations shall pay 30% of their income as tax.²⁶

E. Inflation

Inflation erodes the value of money invested. To earn a rate of return, the money should be properly invested. We have seen that investment is a business activity. Business is undertaken for profit, and the investment must at least compensate for the rate of inflation.²⁷

What do we mean by inflation? The term generally means, “increase in prices coinciding with a fall in the real value of money”.²⁸ The increase of price and the decrease of the real value of money definitely will have a negative impact upon the investment. For instance, the capital of the investor is Birr 220,000. If

²² **Ibid**

²³ Proc. No 286/2002, (as amended), **Ibid**, Art. 2 (10)

²⁴ **Ibid**, Art. 2(6)

²⁵ See **ibid**, Arts. 17-30

²⁶ **Ibid**, Arts 2(2) and 19(1)

²⁷ Gangadhar and Babu, **Ibid**

²⁸ Bryan; **Ibid**, p. 794

inflation occurs, the real value will decrease and the capital will not have the power that it was at the time of investment. Therefore, the investor might be forced to increase the capital.

F. Government Control

Government controls certain economic sectors and that may affect investment. For instance, pursuant to Article 5 of Proclamation No 280/2002, it is only possible to invest on electric energy under a joint investment with the Ethiopian Government. Thus, Government control affects investment and it must be considered.²⁹

G. Legality

The investor is required to invest on areas that are allowed by law. S/he should also fulfil other requirements like license etc. For instance, grinding mills, retail and brokerage, among others, are areas exclusively reserved for domestic investors.³⁰ Therefore, no foreign investor is allowed to invest on areas that are reserved only for domestic investors.

Pre- requisite for investment

To have an investment, the income during one period of time should produce earning in future periods. In order to obtain a greater return in the future, consumption in the current period is foregone. In general, for an economy as a whole to invest, total production must exceed total consumption.³¹ In other words, there must be saving. Saving is the process of setting aside a portion of current income for future use. Saving may take the form of increases in bank deposits, purchases of securities, or increased cash holdings.³²

²⁹ Gangadhar and Babu, **Ibid**

³⁰ Council of Ministers Regulations No 84/2003, **Federal Negarit Gazeta**, Year, No....., Addis Ababa, Schedule

³¹ Encyclopaedia of Britannica; vol. 10, Pp. 837-38

³² **Ibid**, p. 482

Saving is important to the economic progress of a country because of its relation to investment. An individual should be willing to abstain from consuming his/her entire income and save. The preference of individuals for future over present consumption, their expectations of future income and to some extent the rate of interest affect the extent of saving by individuals.³³

Once individuals do saving, they must be willing to invest their money so as to increase productive capacity.³⁴ To invest, it is essential to fully understand the principles of investment we have discussed hereinabove.

Investment increases an economic capacity to produce. In addition, investment is the factor responsible for economic growth. For growth to occur smoothly, It is necessary that savers intend to save the same amount that investors wish to invest during a time period. It is worth noting that if intended saving exceeds intended investment, unemployment may be the result. In addition, inflation may occur if investment exceeds saving.³⁵ Therefore, it is essential to balance the saving with investment. In general, saving is an essential pre-requisite for investment. A saving should be properly invested otherwise, inflation may occur.

QUESTIONS

Explain the prerequisites of investment.

How do you explain legality from the investment point of view?

Analyse inflation from the investment point of view.

1.4. TYPES OF INVESTMENT

³³ **Ibid**

³⁴ **Ibid**

³⁵ Encyclopaedia of Britannica ,Vol. 6, P. 363

Investment may be categorized differently. From the standpoint of an individual, two types of investment may be distinguished: investment in the means of production, and purely financial investment. Both types may provide a monetary return to the investor. However, from the standpoint of the entire economy, purely financial investments appear only as title transfers, and do not constitute an addition to productive capacity.³⁶

Investment may also be grouped into foreign (international) and local (domestic) investment. The classification of investment into foreign and domestic depends on the identity of the investor because the identity of the investor would attract several legal consequences. The identity of the investor poses different policy considerations, and this in turn attracts several legal manifestations.

Foreign investment is an investment by a foreign investor while a domestic investment is an investment by a domestic investor.

Foreign Investor- who is foreign investor? See Article 2(6) of Proclamation No 280/2002.

A foreign investor is one who is a foreigner not permanently residing in Ethiopia and who invests capital obtained from foreign sources or reinvests profits accruing to her/him from investment already made in Ethiopia or

A foreigner who is an Ethiopian by origin and chooses to be treated as a foreign investor and invests capital s/he raised abroad, or reinvests profits made in Ethiopia from previous foreign investment; or

An Ethiopian permanently residing abroad and chooses to be treated as a foreign investor and invests capital obtained outside Ethiopia, or reinvests profits obtained from prior foreign investment in Ethiopia, or an enterprise owned by foreign nationals who invest capital raised abroad or reinvest profits made from previous foreign investment in Ethiopia.

In general, investment made by a foreign investor is a foreign investment.

Foreign investment “involves the transfer of tangible or intangible assets from one country into another for the purpose of use in that country to generate wealth under the total or partial control of

³⁶ The New Encyclopaedia Britannica; Vol 6, 2003, Pp. 363

the owner of the assets”.³⁷ We observe, from this definition, that transfer of intangible asset is an essential element. Intangible assets include intellectual property rights, such as patents, copyrights, know how etc. In addition, foreign investment also includes transfer of tangible assets. The purpose of transferring tangible and intangible assets to another country is to generate wealth. Generating wealth indicates that foreign investment is profitable.

The term ‘foreign investment’ may also be defined as: “A transfer of funds or materials from one country (called the capital exporting country) to another country (called the host country) in return for a direct or indirect participation in the earnings of that enterprise.”³⁸

What are the essential elements of this definition? The first essential point with regard to this definition is that it involves transfer of funds or materials. Fund denotes “the sum of money or other liquid assets established for the purpose of” investment in another country [Garner; 2004:696]. The foreign investor will transfer this fund from his/her country to another. Thus, we have two countries which involve in the transaction of foreign investment. They are: capital exporting country and host country. A capital exporting country is a state (country) from where the investor sends his/her its funds/and/or materials to invest while a host country is a country where the investment is made. In other words, a country where the fund and materials reach and the actual investment takes place is a host country. A capital exploring country is also called “home state”.³⁹

The main purpose of foreign investment, according to the above definition, is to participate in the earnings of the enterprise. In other words, investment is made with the main purpose to accrue a benefit from the investment.

Foreign investment may be either foreign direct investment or portfolio investment.

Foreign Direct investment (FDI) is investment that is made to acquire a lasting interest the investor’s purpose being to have an effective choice in the management of the enterprise. To be more specific, a foreign direct investment is ownership of assets by foreign residents for the purpose of

³⁷ M. Sornarajah; **The International Law on Foreign Investment**, Grotius Publications, Cambridge University Press, New York, 1996, p 4

³⁸

³⁹ II SD Model International Agreement on Investment for Sustainable Development; 2005, Art. 2(I)

controlling the use of these assets.⁴⁰ In case of foreign direct investment, the foreign investor directly controls his/her assets that are made on investment in host country. For example, John is an American investor who invests on flowers in Ethiopia. He has expended Birr 1.5 million on the investment. He recruits staff working for his investment, like the guardian, secretary, flower cutters and soon. Thus, John has exercised the right of ownership over his assets directly. Therefore, the investment is foreign direct investment.

According to the United Nations (UN), an investor is said to have the controlling power over the investment where s/he/it has ten percent (10%) or more of the voting powers in the firm. This is to indicate the power of the investor to decide upon the affairs of the investment. In other words, controlling the investment refers to the power to exert control on the management of the affairs of the enterprise.

The power to control the management of the enterprise could vary according to the type of business organization in question. For example, in cases of partnership, all shareholders have equal voting powers irrespective of their contribution unless otherwise agreed.⁴¹ Thus, according to the principle of management of partnership, a person who contributed 1000 Birr will have equal voting power as another who contributed 100,000 Birr. However, our commercial code gives the liberty for shareholders (partners) to agree that the voting power should be as equal as the amount of the contribution of each partner.

On the contrary, the power of voting depends on the amount of contribution of each shareholder in case of companies. For example, according to Article 535(1) of the Commercial Code, a majority is a “majority of members representing more than one half of the capital” of the private limited company. Similarly, a shareholder in a share company has a voting power depending on the proportion to the amount of capital contributed (Art. 407(1) of the Commercial Code). For example, Azeb has contributed Birr 500 to a share company while Zinash contributed Birr 150,000 to the same company. Consequently, Zinash has the power of voting 300 times more than that of Azeb.

⁴⁰Sornarajah; *Ibid*, p. 4

⁴¹ Commercial Code of the Empire of Ethiopia, Proclamation No. 166 of 1960, **Negarit Gazeta**, 19th Year No. 3, Addis Ababa, 5th May 1960, Art. 234

Therefore, the UN threshold of 10% of voting rights would be meaningful with regard to companies under Ethiopian law, and it would be otherwise in case of partnerships devoid of the agreement.

The second criterion to determine foreign direct investment is that it is made to acquire lasting interests. This means that foreign investment is made for long term.

What do you understand by lasting interest? Or long-term investment? In fact, there are no specific yardsticks to determine whether or not a given investment is lasting. However, we can take into account the intention of the investor. If the intent of the investor is invest for a long period of time, that would indicate the intent of such investor is to acquire a lasting interest from the investment. The amount of investment may also indicate whether or not the investment is lasting. The sector of the investment would also indicate the nature of the investment. For example, investment made on factories in general could be regarded as a long-term one since it could not be accomplished during a short period of time.

In a foreign direct investment, the investor is entitled to protection of both the domestic law of the host state and the diplomatic protection of the home state from which it was exported⁴²

Why such double protection is granted to a direct foreign investment?

First and for most, a foreign investor uses the economy that would have been used to advance the economy of the home state. In other words, if the investor were not investing the capital in a host country, it would have been used to promote the development of the capital exporting country.⁴³ For example, Mike and his two friends invest on the pharmaceutical sector in Ethiopia with a capital of 5 million Birr. There is a general presumption that if Mike and his friends did not invest such capital in Ethiopia, they would invest it in their country, they are using the wealth of their country to invest in Ethiopia. In general, foreign investors use the wealth of their country. Therefore, the home state is justified in ensuring that the resources invested in a foreign country (host state) are protected.

⁴² M. Sornarajah; **Ibid**, p. 5

⁴³ **Ibid**

In addition, investment by its very nature requires the continuous presence of the investor and his/her its capital in the host state.⁴⁴ Then, this requires or necessitates the protection for the person(s) (the investor) and the capital that is invested. For example, the investors should spend a certain period in the host state so long as the investment continues. To perform the investment peacefully, legal protection is essential. We have seen that personnel and the plant for the investment should be present for a long period of time in the host state. The enterprise (or the plant), as a property needs protection. Moreover, the personnel require legal protection: their rights should be protected while they are at work.

Further, the investment is made for the good of both nations. The investment made in the host state definitely will enhance the economic development of the host state. It would create an employment opportunity for the residents of the host state. The benefits accrue from the investment will not eventuate in the absence of such investment.⁴⁵ The capital exporting state will benefit from the profits that accrue from the investment because the investor is entitled to take the profits to his/her/ its home.

Foreign direct investments are made largely by multinational corporations. Multinational corporations are large business organizations so the sum of money invested is large. Further, those multinational corporations will implement a global strategy in making foreign investment. Consequently, controlling is essential for the implementation of the global strategy⁴⁶

We have seen that in foreign direct investment, it is necessary for the investor to be present physically in the host state. The foreign investment has to be held in the host economy since it operates there. This will create the conducive environment for the investor to be active participant in the economic and political process of the host state.⁴⁷

In foreign direct investment, there is a movement of people and property from one state to another, and such movement has potential for conflict between the two states. The investor needs to keep

⁴⁴ **Ibid.**

⁴⁵ **Ibid**, p 5-6

⁴⁶ **Ibid**, p. 6

⁴⁷ **Ibid**

secret the competitive advantages of that state to maximize the profit. Similarly, the host state requires to acquire a lot out of the investment such competitive interests require the protection of both the interest of the investor and the host state. Personnel attract diplomatic protection while the property requires equal protection. Thus, it is argued that the right of alien can be extended to the protection of foreign investment. At this juncture, it is important to note that the roles of international law on foreign investment lie in the effort to extend diplomatic protection to the assets of the alien. However, this argument was criticized on the ground that it leads to unwarranted interference in the domestic affairs of the host state.⁴⁸

Portfolio Investment- “is a movement of money for the purpose of buying shares in a company formed or functioning in another country.”⁴⁹ The World Bank defines portfolio flows as consisting of “bonds, equity (comprising direct stock market purchases, American Depository Receipts (ADRs), and country funds), and money market instruments (such as certificates of deposits (CDs) and commercial paper”.⁵⁰ As we can see from these definitions, in portfolio investment, the investor purchases shares from the host country business organization. The nature of portfolio investment does not offer the opportunity to control the business organization. In other words, in portfolio investment, there is a divorce between management and control of the company and the share ownership in it.⁵¹

Domestic Investor-Proclamation No 280/2002 Art 2(5) defines domestic investor as:

An Ethiopian or a foreign national permanently residing in Ethiopia having made an investment, and includes the Government, Public enterprises as well as a foreign national, Ethiopian by birth, and desiring to be considered as a domestic investor.

From this definition, we can see that for an investor to be regarded as a domestic investor s/he or it must either be 1) An Ethiopian national; or 2) A foreigner who is a permanent resident of Ethiopia; or 3) A person of Ethiopian origin who is no longer an Ethiopian national even where s/he does not live in Ethiopia so long as s/he chooses to be treated as a domestic investor; Or 4) Public enterprises which according to Proclamation No. 25/1992, business entities owned by the

⁴⁸ **Ibid**, p. 8

⁴⁹ Sornarajah; **Ibid**, p. 4

⁵⁰ Bhalla and Ramu; **Ibid**, p. 516

⁵¹ Sornarajah, **Ibid**, p. 4

Ethiopian Government or regional governments or other state entities in Ethiopia. In short, they are publicly owned business entities.⁵²

In general, we have seen that investment may be categorized as foreign and domestic. Foreign investment may further be classified into foreign direct investment and foreign portfolio investment.

QUESTIONS

Define foreign direct investment.

How do you explain domestic investment?

1.5 FACTORS THAT AFFECT THE DIRECTION OF FOREIGN DIRECT INVESTMENT

Why do you think investors wish required to invest abroad? Researchers have examined this issue almost for forty (40) years and the following three points have been forwarded as reasons for foreign investment. The first reason is that multinational companies own assets that can be profitably exploited on a comparatively large scale, organizational and managerial skills, and marketing net works. In other words, foreign investment is attractive to those who own a large amount of money and managerial skills. Secondly, the profit that could be gained from investing abroad is greater than that could be gained from the home country. Thirdly, investors decide to undertake foreign direct investment (FDI) where it is preferable to licensing the production.⁵³ In general, foreign investment is more profitable to the investor than domestic investment, and this attracts foreign investors.

There are also economic factors that determine the FDI. They are: A) **market-seeking**-FDIs are made in seeking market for goods and services; B) **Resource/asset seeking**-investors require resources or assets to produce, and therefore, they will invest in locations where resources or assets are available; C) **Efficiency**

⁵² See Seyoum; **Ibid**, p. 5-6

⁵³ (?), **Trade and Foreign Direct Investment**: (?), P. 50

seeking is another factor stimulating foreign direct investment. Thus investors will undertake investments where the production is efficient in terms of cost.⁵⁴

Economists have developed different theories to explain the factors that affect the direction of foreign investment. What are these theories? Let us discuss the most important ones.

Transportation costs-it becomes unprofitable to ship some products a long distance when transportation costs are added to production costs. For example, Cemex has undertaken FDI rather than exporting the product. It is essential to note that transportation costs have little impact on the relative attractiveness of FDI on electronic components, personal computers, medical equipment, computer software, etc because transport costs are very minor.⁵⁵

2) **Market Imperfections (internalization theory)** - Market imperfections provide a major explanation of why enterprises may prefer FDI to either exporting or licensing. What are market imperfections? Factors that inhibit market from working perfectly are called market imperfections. A market imperfection that is favoured by most economists is referred to as internalization theory.⁵⁶

Market imperfections may arise where there are impediments to the free flow of products between nations. Thus, impediments to the free flow of products between nations decrease the profitability of exporting the products. Whenever there are market impediments, investors may opt for FDI.⁵⁷

3) **Competition strategy** –Another theory that explains FDI is that FDI flows are a reflection of strategic rivalry between enterprises in the global market. If one enterprise cuts prices, another competitor will also do the same. On the other hand, if one raises prices, the others follow to retain their market share. Knicker Bocker argued that the same kind of imitative behaviour takes place in FDI. For instance, Toyota and

⁵⁴ Gibrehiwot Ageba, **Investment**; (Unpublished), 1999, Pp.10-11

⁵⁵ Charles W. L. Hill; **International Business: Competing in the global Market** (Fourth Edition), Tata McGraw-Hill Publishing Company Limited, New Delhi, 2003, p. 213

⁵⁶ **Ibid**, p. 214

⁵⁷ **Ibid**

Nissan responded to investment by Honda in the United States of America and Europe by undertaking their own FDI in the countries.⁵⁸

It is also observable that Fuji is compelled to follow Kodak to ensure that Kodak does not gain a dominant position in the foreign market. Therefore, Fuji invests in a country where Kodak invests with the intention of not allowing Kodak to take the advantage of FDI.⁵⁹

4) **The Product Life Cycle** –Raymond Vernon’s product life-cycle theory is also used to explain FDI. According to Vernon, an enterprise that is a pioneer in its home markets may undertake FDI to produce a product for consumption in a foreign market. For example, Xerox which produced photocopier in the United States of America, invests in Japan (Fiji-Xerox) and Great Britain (Rank Xerox) to serve those markets. Then they shift their production to developing countries to satisfy the demands where labour costs are lower to produce.⁶⁰

According to Vernon’s theory, firms invest in a foreign country when demand in that country will support local production, and they invest in low-cost locations. Thus, investors invest in developing countries where production cost is low. However, it is worth noting that a large demand in a foreign country does not necessitate foreign direct investment. It may be more profitable to license instead of FDI for the production of the product.⁶¹

5) **Location –Specific advantages** –According to John Dunning, location specific advantages can help to explain FDI in addition to the various factors we discussed above. Location specific advantages are advantages that arise from using local natural resources and know-how that helps the investor to produce. Dunning refers to this argument as the eclectic paradigm.⁶²

⁵⁸ **Ibid**, p. 216

⁵⁹ **Ibid**, Pp. 216-17

⁶⁰ **Ibid**, p.27

⁶¹ **Ibid**

⁶² **Ibid**, p 218

For example, an investor will invest in a country where oil as a natural resource is abundant. In addition, an investor may invest in a country where there is low-cost highly skilled labour.

QUESTIONS

Explain how competition strategy determines the direction of FDI.

Analyse location specific strategy as a determining factor of FDI.

1.6 INVESTMENT IN DEVELOPING COUNTRIES

Under this topic, we will consider the trend of investment in developing countries in general, and then we will consider the experience of India.

1.6.1) General

In developing countries, the trend is that both inflows and outflows rose in 2005 although trends varied by regions. According to the study conducted by the UN, inflows into and outflows from Latin America and the Caribbean and West Asia rose in 2005. But, only inflows rose in Africa and East, south and South-East Asia in the same year. West Asia underscored both inward and outward.⁶³

Africa

In Africa, rising corporate profits and high commodity prices helped boost inflows in 2005 to \$ 31 billion from 17\$ billion in 2004. However, the region's share of global FDI remained at around 3%. The inflows

⁶³ United Nations. **World Investment Report, FDI from Developing and Transition Economies: Implications for Development**, 2006, P.40

concentrated in mining, in particular oil and gas, although there was also investment in services from the United Kingdom, the United States, South Africa, China, Brazil and India.

With respect to manufacturing, low skill labour, fragmented markets and lack of diversification inhibited FDI in Africa.⁶⁴

South Africa, Egypt, Nigeria, Morocco and Sudan accounted for 66% of the region's FDI inflows in descending order of value of FDI in 2005.⁶⁵ Investment from China and other Asian economies increased particularly in the oil and telecom industries.⁶⁶

FDI inflows into East Africa fell to \$ 1.7 billion from \$ 1.9 billion in 2004, which represented only 5% of the inflows to Africa. Two factors are pointed out as reasons for the decline in the inflow of FDI in East Africa. These concern the fact that the sub-region is poor in resources, and there is a political instability. As a result, the inflow of FDI into Ethiopia, Kenya, Madagascar and Mozambique declined in 2005. On the other hand Uganda attracted more FDI due to its continued macro economic and political stability.⁶⁷

With regard to out flow FDI in 2005, Africa's share fell by 44% to \$ 1.1 billion from \$ 1.9 billion. This comprises only 0.1% of the world FDI outflow and only 0.9% of developing countries out flows. In 2005, Nigeria, Liberia, Morocco, the Libyan Arab Jamahiriya, Egypt and South Africa were the top six countries in out ward flow FDI, accounting for 81% the region's outflows.⁶⁸

Sectorial trends

⁶⁴ **Ibid**, P.40

⁶⁵ **Ibid**, P.41

⁶⁶ **Ibid**, P.42

⁶⁷ **Ibid**, P.44

⁶⁸ **Ibid**, P.45

The trend shows that the FDI inflows to Africa in 2005 were tilted towards primary production, particularly oil. It also shows an increase in service sector, especially in banking. Algeria (55%.) Egypt (37%.) Nigeria (80%) and Sudan (90%) attracted FDI in oil production.⁶⁹

Policy Developments

African countries continued to liberalize their investment environments. Most of the African countries made their environment favourable to investment although some of them made the environment less favourable. In addition, the trend towards privatization continued across Africa. African countries also attempted to change the investment climate. Countries like Egypt, Ghana, Senegal and South Africa have reformed their tax systems, and as a result they often reduced corporate income taxes. In addition, some have ensued operational conditions for TNCs. For instance, Egypt has been facilitating the entry and residence of foreigners.⁷⁰

Further, some countries such as Ghana, and Mali have reformed their admission procedures by introducing one-stop shops, having recognized that an investor-friendly admission phase has a beneficial effect on the subsequent relationship between the host and the investor. Some other countries also acted to remove some of the key constraints in attracting and benefiting from FDI. South Africa, for instance, has introduced a Skills Support Programme (SSP) to enhance the supply of skilled labour.⁷¹

Some policy changes have also been made with respect to regulatory framework less favourable to FDI in the extractive industries. For example, the Central African Republic introduced an indefinite suspension of the issuance of new gold and diamond mining permits and banned foreigners from entering mining zones. Zimbabwe continued its indigenization program by requiring all foreign- owned mining companies to sell a 30% stake to local businesses within a 10-year period.⁷²

⁶⁹ **Ibid**, P.45

⁷⁰ **Ibid**, P.46

⁷¹ **Ibid**

⁷² **Ibid**, Pp. 46-8

African countries concluded bilateral investment treaties to regulate investment.⁷³

1.6.2) India: A Successful Developing Country in Investment

Since 1991, India has opened its doors to foreign investment. Prior to the implementation of the 1991 Indian economic policy, foreign investment was allowed on a case-by-case basis. However, now the Indian Industrial Policy liberalized the internal licensing requirements for business and retained only minimum procedural formalities. The policy removed restrictions on investment and it facilitated easy access to foreign technology and foreign direct investment.⁷⁴

The Industrial policy of 1991 was aimed at avoiding the red tape and corruption in the bureaucracy, and liberating Indian business. The policy has resulted in increasing income and improving the living standards of Indian residents over the last decade.⁷⁵

Labour- The local employment population is another great benefit for investment in India in addition to the liberal investment policy. India is one of “the largest domestic markets in the world and it has a large labour force available at relatively low cost”.⁷⁶ India has very educated workers especially in the area of engineering and science. The country welcomes approximately 200,000 new engineers per year. India offers investors higher potential rate of return than any country in the computer software sector. The people are fluent in the global language English, which offers an advantage for foreign investors in the country. The Indian labour has a generally favourable attitude towards foreign investment. What is more, foreign investors could employ foreigners since the Indian investment law does not prohibit doing that.⁷⁷

Despite the fact that India offers educated workers, investors faced delays due to Indian workers failure to understand what they are expected to perform. The reason is believed to be that Indian workers are not being onsite. In addition to delays, there are also hidden costs associated with outsourcing jobs to India.

⁷³ **Ibid**, P.48-9

⁷⁴ Mark B. Baker, “Awakening the sleeping Giant: India and Foreign Direct Investment in the 21st Century,” 15 **Indiana International & Comparative Law Review**, 389 (2005),

⁷⁵ **Ibid**

⁷⁶ Dev. Econ. Group, **World Bank Group, Improving the Investment Climate in India** 10 (2002)

⁷⁷ Mark, **Ibid**

As a result, investors have been forced to expend more money and hence, many companies could actively look for places cheaper than India, such as Argentina and Colombia.⁷⁸

Tax treatment- India has also made changes to its tax law with a view to increasing foreign investment. As a result, the rate of import duties for capital goods has been greatly reduced.⁷⁹

Investing in developing countries abroad

Foreign investors are encouraged by several factors to invest abroad in general and in a developing country in particular. There are also factors that pull investors to invest abroad. These factors may be categorized as **pull** factors and **push** factors. **Pull factors** are factors that attract the investor towards developing countries to invest. **Push factors**, on the other hand, are unfavourable factors in the home state of the investor that repel the investor from that country. Thus, push factors have the force to push the investor to opt for a favourable condition to invest in. Therefore, the investor will go to abroad to invest. It is worth noting that push factors are the opposite of pull factors.

The following may be the **pull factors** for investors to invest in a developing country:

- 1. Market pull factors**– Investors need market for their production. Now a days, the world is divided into different economic blocks. For example, there are the common Market of Eastern and Southern Africa (COMESA), European Union (EU) etc. If the product originating from a member country of a block, it may benefit from preferential tax treatment compared to a similar product originating from another region. For example, a product originates from Ethiopia will get a preferential tax treatment in COMESA than a similar product that originated from China because Ethiopia is a member to COMESA while China is not. Thus, if the particular product has

⁷⁸ **Ibid**

⁷⁹ **Ibid**

a demand in COMESA, Chinese investor may want to invest it in Ethiopia to be a beneficiary of the COMESA.⁸⁰ Market pull factors are the most important determinants of FDI especially in host economies. Large Markets that are emerging in developing countries will be more attractive. However, the size of the market depends on the type of the product. Thus, the capacity of the consumers to buy the product is crucial.⁸¹

2. **Resources:** An investor needs natural and human resources in a reliable manner to produce or manufacture. Thus, the investor could be attracted by the abundance of natural and human resources available in developing countries. An investor will prefer to invest in a country where natural resources needed for the manufacture of his/her/its produce are available in a large quantity and at a cheaper in price.⁸² In addition, an investor will be attracted to invest in a country where skilled, disciplined and cheap labour force is found, other factors being equal.⁸³
3. **Policy frameworks** of a host country also determine the direction of FDI. Liberalized economic policies and privatization policies of a host country attract FDI. Regulations and inducements encouraging FDI and investment treaties (bilateral or multilateral) facilitating FDI are pull factors.⁸⁴
4. **Political and economic stability:** Investors are investing with a view to gaining profit which would be realized through time. Thus, to gain profit, the political and economic stability of a country are essential. Therefore, investors will be attracted to invest in a country where there is political and economic stability.
5. **Existence of relevant clusters :-** The nature of investment requires the existence of some inputs from other enterprises. A group of enterprises feeding each other within put are known as a cluster. For example, a textile factory needs an enterprise that spins cotton and produces raw material to produce clothes. An investor will be attracted to invest in a country where inputs are available for him/her/it to produce.
6. **Growth:** An investor wants to invest in a country where there is a demand for the product because this may reduce cost to transport the product to such country by producing it in the country. This definitely will increase the profit from the investment. Investing in the country where there is demand for the product will also enable the investor to adapt the product to local needs and taste. The point here is that the foreign investor prefers to invest in the country if customers of a given product grow in number, the other factors being same.

⁸⁰ See **Ibid**, Pp. 28-9

⁸¹ United Nations, **FDI from Developing Transition Economies: Implications for Development**, World Investment Report, 2006, P.155

⁸² Mark, **Ibid**

⁸³ United Nations, **Ibid**

⁸⁴ **Ibid**

Lax Environmental Laws –Developed states require investors to ensure that their investment does not affect the environment negatively. For example, they may require investors to reduce their carbon emission to a specified level. In short, the investment law of developed states is very strict in protecting their environment. On the other hand, developing countries have less strict laws in this regard. Consequently, investors would invest in developing countries to reduce additional costs due to strict environmental law.⁸⁵

Push factors that repel FDI in developing countries include:

- 1) **Market push factors**- Developing countries have limited home market that may not expand as required by investors. Thus, this is a push factor since the investor may wish to go out to find market.⁸⁶
- 2) **Increases in production costs** are also driving factors. Increase in production costs may be the result of rapid economic expansion, or scarcity of resources or inputs. Increase in labour costs is a crucial factor that pushes investors. In addition, inflationary pressures also are pushing factors.⁸⁷
- 3) **Home country business conditions**-may be the cause for the investor to opt for international investment. For example, if the competition in the home country is stiff, the investor may need to move into a foreign market.⁸⁸

MOTIVATION AND STRATEGIES

- A. Market-Seeking** – FDI is the most common type of strategy for TNCs in their places of internationalization. This was confirmed by a study conducted by UNCTAD as the most significant motive for FDI. Particularly NTCs in developing countries invest to open or secure markets since the resources, like oil gas, are available in their home countries.⁸⁹
- B. Efficiency-seeking** –FDI is an important motive. In Asia FDI investments in electrical and electronic products, garments and IT services are made based on the principle of efficiency seeking. They mostly consider efficiency to mean low-cost labour but for Indians it means

⁸⁵ Ibid: 30

⁸⁶ United Nations, **Ibid**, p. 155

⁸⁷ **Ibid**

⁸⁸ **Ibid**

⁸⁹ United Nations, World Investment Report, **FDI from Developing and Transition Economies: Implications for Development**, New York and Geneva, . 2006, p, 158

“primarily the synergies to be gained through the international integration of production and service activities, rather than “low cost inputs”.⁹⁰

Efficiency seeking investments depend on the nature of the product and the particular type of global production network in which it is located. The two main types of networks are:⁹¹

I. Buyer driven – Large buyers control branding, marketing and access to markets and strive to organize, coordinate and control the value chain in industries such as agro-industries, garments, furniture & toys.

II. Product driven – Key companies own crucial technologies and other firms in the network, especially suppliers e.g. Electronic & automobiles. **Industry clusters** are also an important aspect of product-driven global production networks.

C. Resource-seeking:- is of moderate significance. FDI may be made to secure material resources abroad, e.g. China, India, Turkey.

- Due to competition, TNCs are extracting resources in countries beset with civil wars, ethnic unrest or other difficult conditions e.g. China National Petroleum Corporation (CNPC), ONGC and Patronas (Malaysia’s national oil company), are heavily involved in oil exploration and production in the Sudan where a number of conflicts are raging.⁹²

QUESTIONS

1. How do you evaluate the trends of investment in developing countries?
2. Analyse the motivation to invest in developing countries

⁹⁰ **Ibid**

⁹¹ **Ibid**

⁹² **Ibid**, p. 161

1.7 INVESTMENT LAW

1.7.1 Definition and Nature of Investment Law

Law of investment, in general, is a branch of a law consisting of set of rules that regulate investment. Investment law may be either international law on foreign investment or national law.

International law on foreign investment may be defined as a set of rules that govern international investment. International law on foreign investment has been and is being shaped by on interplay of various economic, political and historical factors. It is generated by the eventual resolution of conflicting national interests. The interests of capital-exporting states have clashed with those of the capital-importing states. The international law on foreign investment is a resultant resolution to such conflicts. It is a field by which economic theories, political science and related areas have helped to shape the arguments in the field.⁹³

It is a field of international law which calls for a creation of alternative theory because

it cannot be explained in accordance with any existing theory of international law.⁹⁴ Now, the rules are not clear.⁹⁵

National investment law -Investment is a commercial or business activity. Business activities are governed by Commercial Code/law. Commercial law cuts across both the law of obligations and the law

⁹³ M. Sornarajah, **Ibid**, Pp. 2-3

⁹⁴ **Ibid**, P-3

⁹⁵ **Ibid**, P-4

of property. That means commercial law includes some part of the law of obligations and the law of property.⁹⁶

For instance, the transactions of business in general and investment in particular require the application of the law of contract since it involves contractual transactions. Properties are the subject of contracts in investment.

Let us consider another example. An investor may import or export products or other goods that are related to his/her investment. An investor should import machineries and equipment for his/her investment. Those machineries and equipment should be transported to Ethiopia. In such a case, a bill of lading may be used. A bill of lading is a receipt for the bailment of a specific object and possesses the quality of being 'negotiable'. Thus, it represents the goods in some way. It is also a document that contains a contract for the carriage of the goods.⁹⁷ In short, it both includes contract and property. This shows that an investment involves the application of the law of contract and property.

Further, we have seen that investment activity is governed by commercial law. Commercial law developed through practice by merchants and the state 'received' it into a legal system.⁹⁸

Recently, state regulations grows to regulate the industry and with the creation of public utilities owned by the State have led to the intrusion of public law into the realm of commerce.⁹⁹ This shows that commercial law is also a public law. Do you remember what public law means?

Public law is a body of law dealing with the relations between individuals and the government.¹⁰⁰ Investors are individuals and the government regulates investment. Therefore, law of investment is a public law.

One of the purposes of our Commercial Cod is, as indicated under the preface as follows:

⁹⁶ George Whitecross Paton; **A Text Book of Jurisprudence**,(third Edition),Oxford, London, 1967,pp. 245-46

⁹⁷ **Ibid**, p. 246

⁹⁸ **Ibid**

⁹⁹ **Ibid**

¹⁰⁰ Bryan.; **Ibid**, p. 1267

---We have directed that in the expansion and consolidation of our commercial laws, great attention should be given to the control of all trading, ...

This clearly shows that commercial code is public law by its nature because the government regulates the transaction of investment as a commercial activity.

Investment law regulates investment in general and among others addresses the following issues among:

- A. It defines important terms like **investment** and **investor**. International investment agreements are international investment law that define these terms. National laws also devote certain provisions to define investment and investor.¹⁰¹ In so doing, the investment law regulates investment. For example, many international agreements define investment as something established according to the laws of the host country.¹⁰² The main purpose of such definition is to ensure that investment has been properly registered and licensed in accordance with the laws of the host country. As was have discussed earlier, investment law classifies investment in to varies categories, such as foreign direct investment, portfolio investment, domestic investment etc.
- B. **Admission and Establishment of Investment** – Investment law regulates the entry of foreign investment in a host country. Each state may wish to restrict investment in certain sectors of the economy to the state or to domestic inventors. Investment law puts requirements to establish enterprises to undertake investment activities, and the forms of enterprises. It also includes ownership restrictions and related issues.
- C. **National Treatment** – A host country is required by international investment law to treat foreign investors in the same manner as national/domestic investors. However, the host country may not treat foreign investors equally with domestic investors. It is worth noting that a customary international law does not necessarily require states to extend national treatment to foreign investors. Such national treatment is provided by bilateral investment treaties or/and national laws.

¹⁰¹ See for example Proc, No 280/2002, **Ibid**, Art.2

¹⁰² UNCTAD, **International Investment Agreements**: Volume 1(2004), P.122

- D. **Guarantees**- Investment law provides guarantees to investors. International investment law is aimed at guaranteeing foreign investors. History has shown nationalization and expropriation of foreign direct investment. Thus, customary international investment law guarantees investors against those and other forms of expropriation of investment.
- E. **Environmental Issues**:- are also addressed by investment law. Today, it is realized that economic activities are closely linked to the protection of the environment. Thus, investment treaties have begun to include provisions addressing environmental protection.
- F. **Labour Issues** –The inclusion of labour provisions in investment treaties is growing although they are always included. The International Labour organization’s Tripartite Declaration of Principles Concerning Multinational Enterprises and social policy (1977) and the DECD’S Guidelines on Investment and Multinational Enterprises (1976) are the two international agreements that address labour issue. Promotion of employment of host country’s nationals is one of the labour issues treated by the investment law. For example, the Ethiopian Investment Law requires, in some cases, that foreigners be replaced within a specified period of time by Ethiopians who have been trained by the investors (employer).¹⁰³ Investment treaties may provide for minimum standards as to wages and working labour conditions. It may also address the right of workers to organize labour union.

We will treat these points under this subject.

QUESTIONS

1. Define international investment law in your own words.
2. Analyse important areas investment laws governs.
3. Define investment law from domestic investment point of view?
4. Analyse the nature of investment law in Ethiopia.

1.7.2 HISTORY OF INVESTMENT LAW

¹⁰³ See Proc. No 280/2002, **Ibid**, Art. 38.

Throughout the history of capitalism, investment has been primarily the function of private business; during the 20th century, however, governments in planned economies and developing countries have become important investors.¹⁰⁴

Before the 1930, investment was thought to be strongly affected by the growing rate of interest, with the rate of investment likely to rise as the rate of interest fell. Since then, empirical investigation has shown business investment to be less responsive to interest rates and more dependent on business men's expectations about future demand and profit, technical changes in production methods, and the expected relative costs of labour and capital.¹⁰⁵

Foreign investment, as one form of investment, was necessitated to ensure raw materials for productions in the Western states continued. At the time of colonization, resources were transferred from colonies to the metropolitan powers so that they could be converted into manufactured products or used to fuel the industries in these states. In the earlier stages, the petroleum sector was the most prominent sector for foreign investments. At that time, concession agreements were used to tie up resources for foreign investments.¹⁰⁶

As time went, on the concession agreements ceased to be the norm in investment and were replaced by the production sharing agreements. These agreements reflect the shift in the power equations that have taken place within the investment, particularly in oil industry. Indonesia was a pioneer in the field of devising new arrangements for the oil industry. Such a shift was aided by the formulation of international law doctrines such as the doctrine on the permanent sovereignty over natural resources. The doctrine of the permanent sovereignty over natural resources has been translated into national legislation. Thus, constitutions and foreign investment legislation incorporated the doctrine. It was also possible to draft investment contracts that ensure the host state having greater control over the process of the exploitation of the mineral resources. As a result of this development, it was recognized that host states have the

¹⁰⁴ Encyclopedia of Britannica, Volume6 p. 365

¹⁰⁵ **Ibid**, p. 363

¹⁰⁶ Sornarajah; **Ibid**, p. 31

power to control their natural resources.¹⁰⁷ Thus, international agreements which have provided significant rights for investors were begun in 1959.¹⁰⁸

1.7.2.1) HISTORY OF INTERNATIONAL LAW ON FOREIGN INVESTMENT

International Law on Foreign Investment has passed through some history. The first attempt to create rules to govern the conduct of foreign investment was made by the United Nations conference held in Havana after World War II. At that time, it was felt essential to reconstruct the damage caused by the war. Having in mind this reconstruction purpose, a general attempt has been made to create an International Trade Organization (ITO). The proposed law of ITO under Article 12 provides provisions for the conduct of foreign investment that include the host states' ability to regulate investment. This provision was opposed by some countries, particularly the United States of America. Such countries argued that the provision is contrary to liberal economic principles and public international law. The opposition contributed to the demise of the ITO.

In place of ITO, the General Agreement on Tariffs and Trade (GATT) came into being. However, GATT deals with a reciprocal tariff reduction agreement and it does not directly deal with foreign investment. In addition, the provisions of GATT will only be applicable if states have concluded agreements to govern international trade between them.¹⁰⁹

When countries became free from colonization during the early 1960's, they wanted to control their resources. Consequently, there was a conflict between the interest of host countries and the principles of international law that determined the relations between investors and host states.

What do you think is the cause of such conflict? The newly independent developing countries desired to control their natural resources in order to realize their dreams of development. On the other hand, the rules of public international law concerning foreign direct investment lacked a development-focused

¹⁰⁷ **Ibid**, pp. 32-33

¹⁰⁸ Howard Mann and Etal; IISD Model International Agreement on Investment for Sustainable Development.<https://www.iisb.org>. April 2005, p. V

¹⁰⁹ Edmund Kwaw; **GATT and the Debate about Investment Liberalization**, p. 113

approach. Consequently, there emerged a conflict between the interest of the host states and the rules of international law on the field. Developing countries wanted rules of international law that would promote their desire to develop by sharing fair profits from foreign investment. Thus, developing countries advocated the reconstruction of international economic order in a manner that would expedite their economic growth and development. They succeeded in having the Charter of Economic Rights and Duties of States by using their majority at the United Nations. According to this Charter, the right of all states to regulate, supervise, expropriate and nationalize foreign investment has been reasserted. Nevertheless, the developed states argued that the resolution contradicts the rules of public international law on foreign investment.¹¹⁰

The evolution of international rule making in the field of foreign investment is marked by the growing prominence of bilateral, regional and plurilateral agreements aiming at encouraging foreign investment. Such arrangements have also an advantage in providing substantive standards with regard to the admission and treatment of foreign investment by host states.¹¹¹

1.7.2.2 HISTORY OF INVESTMENT LAW IN ETHIOPIA

Coming to Ethiopia, though it is not possible to pin point the date investment was started, it is not new to Ethiopia.

I. The Imperial Era

The Ethiopian economy after the war with Italy was described as a mixed economy in which the private and public sectors worked hand-in-hand to achieve economic progress. The private sector was having good ground during this period since there was no any law that limited the private business.¹¹²

¹¹⁰ **Ibid**, p. 114

¹¹¹ **Ibid**

¹¹² Lubo Teferi, **A Critical Evaluation of Ethiopian Investment Laws with specific Reference to Proclamation No 116/1998 and Regulations No. 36/1998**, (un published), Addis Ababa University, Faculty of Law, An LL.B thesis, May 1999, P.12

In the Imperial era, Proc. No 60/1944 and 107/1949 were enacted to promote foreign investment in Ethiopia. In 1950, the Minister of Finance gave an income tax exemption notice with a view to encouraging investment.¹¹³ After that, in 1956, the Income Tax Decree which provided for income tax exemption to encourage investment was promulgated. However, this Decree was replaced by the Income Tax Proclamation of 1963.¹¹⁴ This Decree was the first proper law to regulate investment transaction in Ethiopia. After three years, i.e. in 1966, the Investment Proclamation No. 242/1966 was enacted.

What is special to those laws was that they did not provide investment areas for the government. Thus, investors could invest in all areas of the economy with no restriction. They also provided investment incentives which included: import export income tax exemptions, income tax holidays. It was also possible for foreign investors to own land required for their investment.¹¹⁵

Though the private sector was in good condition, the share of the domestic investors was very small due to lack of entrepreneurship.¹¹⁶

II) The Derg Regime

Then, the 1974 Revolution got rid of the concept of private property including private investment. This retarded the development in the sector. During the Derg regime, it was only the state that invests. After all that was considered investment proper.

The Derg regime adopted a socialist economic policy through National Democratic Revolution (NDR), which disfavours private investment. During this period, it was witnessed that nationalization was exercised repeatedly.¹¹⁷

Proclamation No 26/1977 heralded the start of nationalization. The proclamation clearly stated that it was necessary to transfer to government ownership all resources that were crucial for economic development.¹¹⁸

As a result, the government had controlled all private investments and the private sector was restricted to small industrial activities.¹¹⁹ However, the government allowed investment through

¹¹³ Timothy P. Padman; "Income Tax Exemption as an Incentive to Invest in Ethiopia", **Journal of Ethiopian Law**, Volume VI, No. 1, 1969, P. 215

¹¹⁴ **Ibid**, pp. 216-17

¹¹⁵ A.A Fatours in Lubo, **Ibid**, P.12

¹¹⁶ Lubo, **Ibid**

¹¹⁷ **Ibid**, P.13

¹¹⁸ Proclamation No 26/1977, preamble

joint venture, i.e. investment in Cooperation with the Ethiopian Government.¹²⁰ The intention of the government was to introduce capital know-how, and technology into the country. But the law was taken as a disincentive to the private investors since the share of the government could grow from 51-99% while that of private investors could fall down from 49-1%.¹²¹

The government felt the necessity to change the economic policy in the late period of the Derg Regime and adopted a mixed economic policy by adopting the Multilateral Investment Guarantee Agency (MIGA) of which Ethiopia became a member.¹²² Then, this economic reform was reiterated by the transitional Government of Ethiopia in 1992 after the down fall of Derg Regime.

III) The Period after Derg

The Derg regime was replaced by the Transitional Government. The Transitional Government, which was established in 1991 adopted an economic and investment policy directly opposite to that of the Derg regime. The policy emphasised the role of private investment in the development of the Ethiopian economy. In 1992, Ethiopia embarked up on the liberal economic policy which is deemed to be a favourable condition for investment. To implement this policy, the Transitional Government enacted Investment Proclamation No 15/1992 so as to open the door to private investment.¹²³ The proclamation also reserved some sectors such as large scale eclectic power and postal service to the government. It also provided for joint investment with the Ethiopian government.

The proclamation provided for incentives to attract and promote private investment. It also guaranteed against nationalization and expropriation. Thus, “no assets of a domestic or foreign investor may be expropriated or nationalized wholly or partially except in accordance with the due process of law”.¹²⁴

¹¹⁹ See Lubo, **Ibid**, P.14

¹²⁰ Proclamation to provide for the Establishment of Joint Venture, Proclamation No 275/1983, **Negarit Gazeta**, - 42nd Year, No 6.

¹²¹ Mellion Alemu, in Lubo, **Ibid**, P.14

¹²² See Council of State special Decree No 17/1990, **Negarit Gazeta**, 49th Year, No 12 and Council of State Decree to Ratify the MIGA Convention, Council of State Decree No 39/1990, **Negarit Gazeta**, 50th Year, Number -12

¹²³ Assefa Ali, **The Problems of Incentives Regimes of Private Foreign Investment in Ethiopia: the law and the practice**, a Master thesis, Addis Ababa University, Faculty of Law,(un published), 2005, p. 29

¹²⁴ Proc. No 15/1992, Art

The Investment Office was established by the proclamation to regulate and supervise investment activities.¹²⁵ The proclamation imposed a higher capital requirement for foreign investors and proclamation No 37/1996 was enacted to rectify this problem.

Thus, the following are essential developments¹²⁶ in Proc No 37/1996 and Regulations No 7/1996.

3. The minimum capital required from foreign investors has been reduced from 500,000 USD to 300,000 USD to establish joint venture with our government.¹²⁷ The minimum capital of retained profit and dividends reduced to 400,000 USD for expansion. Further, the capital requirement for foreign investors to invest in engineering and consultancy was reduced from 500,000 USD to 100,000 USD.
4. Foreign investors were relieved from the obligation to deposit 1258,000 USD in blocked account.
5. Foreign investors were also allowed to invest in building construction equipment, and in hotels whose standard was below the four star and five grades.
6. Foreign investors were allowed to repatriate capital from sale, liquidation or transfer of residence to their home country, in addition to profits, dividends, interests and payments arising from technological transfer.
7. It also provided for internationally accepted investment dispute settlement procedures where it was not possible to solve the dispute amicably.
8. Investment incentives were also extended to additional sectors such as education, hotels, tourism and health. Further, the period of incentives was extended from 3 to 5 years.
9. Banking and insurance, electricity generating up to 25 MW, air transport with the capacity of up to 20 passengers or 2,700kg. were reserved for Ethiopian nationals.

¹²⁵ **Ibid**, Art

¹²⁶ See Lubo, **Ibid**, Pp-17-19

¹²⁷ Proc. No 37/1996, Art

10. Both domestic and foreign investors were allowed to borrow money from abroad provided that they are registered with the NBE.

11. It was also provided under the proclamation that investors should be provided land within sixty days from the date of application for land.

In general, despite its constraints and drawbacks, the law seems to be attractive to the private investment when compared to the past regime's restrictive policy.¹²⁸

Investment (Amendment) Proclamation No 116/1998 and Regulations No 36/1998

These laws were enacted with a view to encouraging and facilitating investment (both domestic and foreign). Thus, the amendment was made with the aim of opening more investment areas to the private sector. It also aimed at providing additional investment incentives.¹²⁹

These laws resulted in the following essential changes to the proclamation No 37/1996 and Regulations No 7/1996.

1. The status of foreign nationals of Ethiopian origin: A number of Ethiopians were forced to leave Ethiopia and went abroad for political and other reasons (especially in the past regime).

It is felt important to give them a chance to invest in their country and to contribute in the economic development by investing their capital and know-how that they acquired abroad. Thus, Proclamation No 116/1998 provides that foreign nationals of Ethiopian origin are at liberty to choose to be treated as domestic investors or foreign investors.

If they opt to be considered as domestic investors they must apply to the then Ethiopian Investment Authority (EIA) and fill a form which is taken as a promise not to be considered as a foreign investor.¹³⁰ Thus, they are relieved from a capital restriction on a foreign investors and be able to take part in investment with a capital of 250,000 Ethiopian Birr rather than 500,000 USD, 300,000 USD or 100, 000 USD.

¹²⁸ See Lubo, *Ibid*, P.19

¹²⁹

¹³⁰ Lubo, *Ibid*, P.21

In addition, they will acquire a right to invest in areas exclusively reserved to domestic investors by Regulations No 35/1998. On the other hand, they will lose the rights of foreign investors. Thus, they may not claim to repatriate their profits and capital outside Ethiopia, because such a right is given to foreign investors.¹³¹

Once an investor is considered a domestic investor, s/he/it may participate in investment areas exclusively reserved for Ethiopian nationals such as banking and insurance.

Employment of Expatriates

According to Proclamation No 37/1996, there were restrictions in employing expatriates imposed on investors both domestic or foreign. First, they must ascertain that a person of the required qualification cannot be found in Ethiopia. Second, they must arrange to replace such foreigners by Ethiopians within a limited period.¹³² Nonetheless, Proclamation No 116/1998 avoided these restrictions with regard to foreign investors while maintaining the restrictions for domestic investors.

However, it is worth noting that Proc. No 116/98 gave a discretion to the EIA to allow or refuse the recruitment because prior consent of the Authority is a requirement. The restriction is also limited to top managerial positions though the term top managerial position was not defined by the law.

Ownership of immovable properties by foreigners to create conducive atmosphere for foreign investors and to make them feel at home in Ethiopia, Proclamation No 116/1998 allows foreigners to own immovable property required for their investment.¹³³ Immovable property in this context means buildings only since land is not the subject of private ownership but is made available for investors by lease.

Areas of Investment

One of the achievements of investment Proclamation No 116/1998 was that it fully opened the hydro-electric power generation for private sectors. However, the distribution of the electricity

¹³¹ **Ibid**, P.22

¹³² Proc. No 37/1996, **Ibid**, Art.37

¹³³ Proc. No 37/1996 (as amended)

was still made to continue as the exclusive monopoly of the government. Thus, private investors were allowed to generate electric power and to sell it to a state owned electric distribution agency.¹³⁴

Further, the proclamation allowed private investors to invest in the telecommunication sector jointly with the government,¹³⁵ although it which was reserved only for the government as per Proclamation No 37/1996.

Defence industries may be important to produce civilian goods and services in addition to weapons. Thus, it was felt important to allow private investors to participate in order to have the know how to efficiently run the defence industries that were inherited from the Derg regime.¹³⁶ Thus, Proclamation No 116/1998 allowed private investors to participate jointly with the government.¹³⁷

Proclamation No 116/1998 also expanded the scope of consultancy services to include accounting and auditing services in addition to engineering, architectural or other technical services.¹³⁸

Regulation No 35/1998 also recognized oil companies such as Shell, Mobil, Agip and Total as areas of investment for foreigners with a view to maintaining efficient service in supplying petroleum and its by products.¹³⁹

Another important change made to Proclamation No 37/1996 was that Proclamation No 116/1998 conferred on the Ethiopian Investment Board the power to decide on additional investment incentives other than those provided under the Investment Regulations No.

Thus, the Board was given the power to initiate and propose additional investment incentives so as to promote investment, but the power to approve was given to the Council of Ministers.¹⁴⁰

SUMMARY

¹³⁴ Lubo, **Ibid**, P.26

¹³⁵ Proc. No 37/1996(as amended), **Ibid**, Art. 5(2) (b)

¹³⁶ Lubo, **Ibid**, Pp 27-8

¹³⁷ Proc No 37/1996 (as amended), **Ibid**, Art. 5(2)(a)

¹³⁸ **Ibid** ,Art. 11(4)

¹³⁹ See Lubo, **Ibid**, p.30

¹⁴⁰ Proc. No 37/1996 (as amended), **Ibid**, Art. 28(1)

We have seen that the term 'investment' may be defined differently. However, it is possible to define investment as expenditure of capital by an investor to accrue profit. We learnt that expenditure of capital, the existence of investor, enterprise (business organization), expansion and upgrading the existing business organization are essential elements in defining the term investment under Ethiopian law.

In addition, we have discussed some important elements of investment as an economic activity. Reward is the first element that indicates a return from the investment, i.e. it is a profit. Risk and return are inseparable elements of investment. We have learnt that risk is a chance that the expected profit or return may not materialize. Return is an expected income from the investment. The third element of investment we discussed is time. We have learnt that investment needs a certain period of time to lapse to gain a profit from an investment. By its nature, investment is an activity of a long period. However, it is worth noting that a foreign portfolio investment may be made only for a short period of time compared with foreign direct investment.

Further, we have discussed the investment principles that an investor should consider carefully. The first principle is safety of investment. We have seen that the investor needs some safety since s/he/it invests fund and time to accrue profit. Liquidity is the second principle, which means that the investment can easily be converted into cash where the need arises. We have also discussed that the main purpose of investment is to accrue profit. A profit may be capital appreciation or yield.

Tax implication should also be considered by an investor. Inflation also influences investment since the value of the capital decreases. Further, the government may control some sectors of the economy. Thus, an investor may not be allowed to invest in certain economic sectors. Furthermore, we have seen that the investor should invest by fulfilling the legal requirements of the host state.

We have also seen that investment could be foreign or domestic. We have seen that foreign investment is an investment made by a foreign national while domestic investment is an investment made by a natural residing in his/her country. A foreign investment is further classified into foreign direct investment and foreign portfolio investment. The gist of foreign direct investment is that the investor has the power to control and manage the investment.

Regarding foreign portfolio investment, the investor has no power to control and manage the business organization. We saw that investment is related with capitalism. However, the economy may be state invest. Nowadays investment inflow increases in both developed and developing countries.

The final point we have considered in this Chapter is the law of investment. Law of investment, as we have seen, is a branch of law consisting of a set of rules that regulate investment. Since investment includes property, contract and business transactions, the law of investment regulates these transactions.

QUESTIONS

- 1) Discuss the history of international investment law
- 2) How do you evaluate the history of investment law during the time of Derge.
- 3) Analyse the development of investment law during the time of Imperial Haileselassie.

REVIEW QUESTIONS

I) Choice

- 1) Which of the following is not an element of the definition of investment?
A) rights *in rem* B) rights *in personam*
C) Negotiable instruments D) Industrial property right
- 2) The purpose of an enterprise under the investment law is
A) gaining profit B) maximizing social benefits
C) minimizing profit D) B and D
- 3) Which of the following is not an element of investment?
A) Time B) Risk C) Capital D) Reward
- 4) Safety is an investment principle because
A) the investor needs to ensure that he will not lose his capital
B) the investor wants to acquire profit
C) the investor needs to ensure that the investment is free from any risk
D) all E) A and B

- 5) An investment made by a foreigner in another country is
 A) domestic investment B) foreign investment
 C) A and B D) none
- 6) Kummar is an Indian who permanently resides in Ethiopia. He has invested in the horticulture sector and is managing it side by side with his teaching duty.
 Kummar is _____ investor
 A) domestic C) domestic-foreign
 B) foreign D) none
- 7) Which of the following is not an economic fact that determines foreign direct investment?
 A) Asset seeking C) market seeking
 B) political stability D) efficiency seeking
- 8) The general trend in Africa showed that
 A) countries centralize investment
 B) investment in the service sector like banking sharply decreases.
 C) countries liberalize their economic policies
 D) the inflow of FDI decreases.
- 9) A factor that repels foreign direct investment in Ethiopia is called
 A) pull factor B) push factor
 C) economic factor D) investment principle
- 10) Investment law includes
 A) international law B) national law
 C) public law D) private law E) all
- 11) The basic purpose of international investment law just after the World War II was
 A) to regulate investment that was intended to reconstruct the economy
 B) to deregulate investment for the purpose of reconstructing the economy
 C) no international law D) A and B

II) Matching

A

B

_____ 1) Eclectic pragmatism

A) Industry clusters

- _____ 2) The 1956 income tax decree B) The fires proper investment law in
Ethiopia
- _____ 3) Regulations No 35/1998 C) Recognized oil companies as areas of
investment
- _____ 4) Product driven D) Economic principle of investment
- _____ 5) Government control E) Location specific advantages
G) A decree issued to govern investment
made by government.

III) Answer the following questions

- 1) Analyze the role of investment law.
 - A) at the international level
 - B) at the domestic level in Ethiopia
- 2) Analyze the nature of investment.
- 3) Discuss the types of investment and investors.
- 4) Explain the nature of Ethiopian investment law.
- 5) Analyze briefly factors that determine the direction of investment.

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UNIT TWO: ECONOMIC THEORIES ON FOREIGN INVESTMENT

UNIT OBJECTIVES

After completing this unit, you should be able to:

- ◆ analyze economic theories on foreign investment;
- ◆ identify the applicability of the theories under Ethiopian Investment Law;

INTRODUCTION

To achieve the above mentioned objectives of this Unit, we shall discuss the various economic theories on foreign investment. Economic theories are used as justifications to defend the interest of states that have interests in the investment. Hence, it is essential to discuss these economic theories and their application.

Capital sending countries formulate economic theories that helped them to promote their interest. On the other hand, host states have come up with theories that justify how to regulate foreign investment. Under this unit, we will be discussing these theories.

2.1) THE CLASSICAL THEORY ON FOREIGN INVESTMENT

According to the classical economic theory, foreign investment is wholly beneficial to the host economy. In other words, pursuant to the classical economic theory, it is the economy where the investment is made that benefited wholly from the investment. What are the reasons up on which classical economic theory is based ?

- 1) **Capital inflow** – The first reason for the classical theory is that foreign investment makes available capital in the host state that flows from capital sending country.¹⁴¹ The proponents of classical economic theory argue that foreign investment is beneficial to developing countries by making available capital. The capital, then, is used to promote the development of the economy of the host state.

Do you believe that foreign investment is wholly beneficial to the host state? Those who reject the theory argue that the existence of capital in a host country soaks local capital. Thus, the inflow of capital to the host state is like a big fish that swallows a small one. Hence, the local capital that would be used to invest could not be invested. What is more, foreign investors will export the high profits obtained from the investment to their home state.

Therefore, the capital will benefit the shareholders who are foreigners.¹⁴² In short, the justification that foreign investment is wholly beneficial to the host state on the basis of capital flow is rejected.

- 2) **Transfer of technology:-** is the second reason on which the classical economic theory bases its justification. The proponents of the classical economic theory propagate that foreign investment transfers technology which is not available in the host state. They further argue that investment is

¹⁴¹M. Sornaryah; **The International Law on Foreign Investment**, Grotius Publications, Cambridge University Press, London, 1996, p. 38

¹⁴² **Ibid**, p. 39

beneficial to the host state since it diffuses the transferred technology to the host economy.¹⁴³ Foreign investment will help the workers who are the citizens of the host state to learn how to run the technology the investment uses. They will use their technological knowledge and skill in a similar field in their country.

Do you agree that foreign investment is wholly beneficial to Ethiopia by transferring technology?

The fact that foreign investment transfers technology could not be denied. However, foreign investors may transfer technology that is outdated. Foreign investors may need to use a technology that is already not up to date. They may not have the chance to use the outdated technology in their country because it may be dangerous to the environment, or it may not be efficient. In addition, the technology used by foreign investors may be capital intensive; using such a technology may be expensive. Further, the technology may be unsuitable to developing countries, For example, the goods that are produced may be outdated, i.e. they are replaced by other goods or products based on newer technology. Thus, the product could not be exported because it is replaced. It cannot bring foreign exchange to the host state. Some times the technology may be new and the products may be new to the society of the host state. In this case, the consumers may develop or not tastes to luxury goods.¹⁴⁴

3) **Creation of employment:-** It is argued that foreign investment creates new employment opportunities.

Accordingly, the unemployment problem that exists in a host state will be solved.¹⁴⁵

No doubt that foreign investment creates a new job. However, the fact that it creates a new job opportunity should not be taken as a benefit only to the host state. The foreign investor is highly beneficial from the creation of employment because labour is usually not expensive. Rather, the workers will not be fully paid, or the rate of wages is very low that is not commensurate with the service rendered by the workers.

¹⁴³ **Ibid**, p. 38

¹⁴⁴ **Ibid**, p. 39-40

¹⁴⁵ **Ibid**, p. 38

- 4) **Transfer of managerial skills** – Foreign investment transfers managerial skills to the host state, particularly skills in management of large projects.¹⁴⁶ The foreign investor may recruit local experts in higher managerial positions. For example, the local employees could be assistants to foreigners in structure in the business organization, marketing the product of the business organization, administration of employees etc. Hence, the proponents of classical economic theory argue that foreign investment will result in transfer of managerial skills from the foreign investor to the local professions. Therefore, they conclude that foreign investment is beneficial to host states.

Do you agree with this?

Transfer of managerial skills to local personnel is illusory because the foreign investor do not allow higher managerial positions such as departmental head for local professionals.¹⁴⁷ Therefore, local personnel who are employed can not acquire new skills.

- 5) **Building infrastructure-** It is also agued that foreign investment make sure the building of infrastructure in a host country. Fundamentally, the state builds necessary infrastructures in areas where foreign investment is made. For example, health, and education facilities are delivered by the state. The investor may also built infrastructure facilities in host countries. Therefore, proponents of classical economic theory on foreign investment argue that it is beneficial to the host state.¹⁴⁸

6)

Do you believe that a host state will really benefit from foreign investment since infrastructure could be built?

The infrastructure that is build is based on the standard of foreigners. It is only those who can pay for the facilities who could benefit from the building of the infrastructure. For example, a school fee may be high and only elites that can afford may benefit from it.

¹⁴⁶ **Ibid**, p. 38

¹⁴⁷ **Ibid**, p. 40

¹⁴⁸ **Ibid**, p. 38

- 7) **Up grades infrastructure-** It is also argued that foreign investment upgrades facilities such as transport, health, and education that will benefit the society as a whole.¹⁴⁹
- 8) **Brings economic development-** Foreign investment brings about economic development for the less developed countries. However, it is revealed that foreign investors engage themselves directly or indirectly in suppression of human rights to ensure the continued maintenance of regimes favourable to foreign investors.¹⁵⁰
- 9)

The classical economic theory does not explain other reasons for state interference in foreign investment. However, it is worth noting that it influences international law on foreign investment. For example, the preambular statements of bilateral agreement emphasize the importance of foreign investment to benefit the development of both parties. In addition, the theory is accepted by World Bank. Thus, The 1992 the World Bank guideline on the treatment of foreign direct investment incorporates the philosophy of the classical theory. The first paragraph of the guideline reads as follows:

*... that a greater flow of foreign direct investment brings substantial benefits to bring on the world economy and on the economies of developing countries in particular, in terms of improving the long term efficiency of the host country through greater competition, transfer of capital, technological and managerial skills and enhancement of market access and in terms of the expansion of international trade.*¹⁵¹

What is more, the classical theory also provides policy basis for the formulation of many documents that relate to international as well as national laws on foreign investment.¹⁵²

Nevertheless a strong criticism has been directed against this theory. It is argued that the flow of resources to a host country does not bring about the development of the state. Foreign investment only benefits the elites. It also leads to unequal development within a state because the elites benefit while the large group of the society are exploited by the foreigners. Thus, another theory has been developed with the intent of providing another reasons as justification for foreign investment.

QUESTIONS

¹⁴⁹ **Ibid**

¹⁵⁰ **Ibid**, p. 40

¹⁵¹ The 1992 the World Bank Guideline, First paragraph

¹⁵² M. Sornarajah, **Ibid**, p. 414

1. Analyse the classical theory from the investment point of view.
2. Explain the reasons for classical theory on foreign investment.
3. Analyze transfer of managerial skills as a justification foreign investment.
4. Discuss how the classical theory analyses FDI and inflow of capital to the host state.
5. FDI builds infrastructure in the host state. Comment.
6. Foreign investment upgrades infrastructure in the host state. Explain.
7. Argue in favour of foreign investment by taking development as a ground.

2.2) THE DEPENDENCY THEORY

The dependency theory is a criticism to classical theory. It does focus on an entirely different meaning of economic development. It redefines development as requiring not wealth transfer to the host state, but the development of the people of a state as a whole.

It is popular among Latin American economists. The proponents of the dependency theory analyze that the multinational corporations have their head quarters in developed countries and the branches they establish in developing countries work in the interest of their parent companies and their shareholders. Hence, development becomes impossible in developing countries since their economy is subservient/dependent to the developed countries. Thus, they propose that indigenization measures and efforts be made to control foreign investment. because Attempts to permit foreign investments through joint ventures are seen as failure and the foreign investor defeated it through his/her alliance with the elite in the host state.¹⁵³ According to the dependency theory foreign investment is a way for developed countries to gain power in developing countries.¹⁵⁴ It influenced many nationalizations of foreign direct investment.

¹⁵³ **Ibid**, p. 43-44

¹⁵⁴ Joho H. Barton and Bart S. Fisher, **International Trade and Investment: Regulating International Business**, Little, Brown and Company, 1986, p. 28

For example, nationalizations in Peru, Jamaica and Chile were the results of such theory. Further, it influences the restructuring of the economy by deriving out foreign investment and providing policy justifications for such restructuring. According to this view, there cannot be development until the people as a whole are freed from poverty and exploitation. Development becomes a right of the people rather than that of the state.¹⁵⁵

QUESTIONS

- 1) Dependency theory is a criticism to classical theory on foreign investment. Discuss.
- 2) Cite examples where the dependency theory was applied.
- 3) Cite examples where the dependency theory is popular and explain its importance.

2.3) THE MIDDLE PATH

When communism proved to be unsuccessful, free market economy was accepted as a means to marshal economic development. Then, private economy was considered essential for the development of an economy. As a result, privatization of state companies took place in developed and developing countries. Accordingly, the ideological predisposition to foreign investment was shifted the view that. Multinational corporation is a threat to the sovereignty of developing states has changed. Developing states have built up confidence in dealing with these multinational corporations. Multinational corporations, on their part, usually ceased to be instruments of the foreign policy of their home states. It was also observed that such corporations formed alliances with developing states. For example, foreign corporations in the petroleum sector formed alliance with oil exporting states to the determinant of oil importing developed states.¹⁵⁶

In addition, a research conducted by the United Nations Commission of Translational corporations contributed a lot to reduce the hostility towards multinational corporations. The study did not deny the

¹⁵⁵ M. Sornarajah, **Ibid**, p. 45

¹⁵⁶ **Ibid**, p 45

harmful results of foreign investments in certain circumstances. It also showed that multinational corporations could be engines that fuel the growth of developing states. This was supported by an influential group of European and American scholars. The study initiated a debate on multinational corporations in the 1980's. The debate has had an influence on the laws used to control foreign investment. In addition, it has an impact upon the forms through which developing countries preferred to receive investment.¹⁵⁷ Do you agree that multinational corporations could be engines that increase the development of states?

The study identified the advantages and disadvantages of foreign investment. The beneficial effects identified were similar to those identified by supporters of classical theory of foreign investment. Can you list the advantages?

It was identified that foreign investment made by multinational corporations benefits the economy of the host country through:¹⁵⁸

the flow of capital

the transfer of technology

creating new employment

creating new opportunity for export income.

The study also identified the negative effect of multinational corporations. This enabled the host states to take regulatory measures to curb harmful practices. It was possible to design codes of conduct for multinational corporations. The gist of the codes of conduct is that multinational corporations shall avoid things that are identified as harmful to the economic development of developing states.¹⁵⁹

What were the harmful acts identified by the study?

¹⁵⁷ **Ibid**, Pp. 45-6

¹⁵⁸ **Ibid**, p. 47

¹⁵⁹ **Ibid**

1. **Defeating the Tax law of the host states** was the first harmful conduct of multinational corporations. The multinational corporations find an artificial high price for an item permitted to be imported. This transfers pricing which is harmful to the host economy.¹⁶⁰
2. **Hazardous and disused technology**: The study showed that the technology that was exported was often hazardous and disused. It was identified that the hazardous and disused technology was causing potential harm to both life and the environment. For example, the Bhopal disaster which was caused by a gas leakage in a plant set up by multi-national corporation caused damage to life and property. This shows that multinational corporations export hazardous and outdated technology that was prohibited in their home countries. Therefore, it is necessary to control foreign investment and thereby ensure that the technology is suitable to the host state and up to date.¹⁶¹
3. **Lack of profits**: Multinational corporations adopt restrictive business practice on a global scale that prevents the host state from maximum export scope potential for goods that are produced within its territory.¹⁶² Do you think that such a problem could be resolved by host states only? Host states themselves cannot address the problem; it needs more effort. Therefore, efforts have been made to design codes on restrictive business practices.¹⁶³ What should be done? Is it wise to prohibit foreign investment totally?

Here, a theory is required that corrects the drawback of both the multinational corporations and the host state. Host states have taken measures to correct the defects of foreign investment. They have enacted laws and set up screening bodies that permit entry to or give incentives to approved investments. At the international level, the theory was used to control business on which codes of conduct of multinational corporations are sought to be crafted.¹⁶⁴

The theory has disproved that foreign investment was not fully beneficial to the host state because it accepted the drawbacks of foreign investment. According to the new theory, foreign investment is entitled to protection only on a selective basis. Thus, protection may be accorded to a foreign investment

¹⁶⁰ **Ibid**, p. 47

¹⁶¹ **Ibid**

¹⁶² **Ibid**

¹⁶³ **Ibid**

¹⁶⁴ **Ibid**, p. 48

depending on the extent of the benefit it brings the host state and the extent to which it has behaved as a good citizen in promoting the economic objectives of the host state.¹⁶⁵

The success of Hong Kong, Singapore, Taiwan and South Korea proved that state regulation and intervention is necessary. Nevertheless, this should not disregard the role of free market economy for development. Therefore, the middle path theory propagates that mixing regulation and openness to foreign investment should be the rule.¹⁶⁶ Thus, this seems to be the basis for most developing countries that moved from hostility to transition.

Ethiopia adopted a liberal (mixed) economic policy after socialism. At the beginning, there was a heavy regulatory regime. However, as time goes on, flexible and programmatic approaches were used with the intention to speed up foreign investment inflow.

The international law on foreign investment is based on the principle of economic sovereignty of states. In the past, the control on investment was made externally. Nevertheless, it has become possible to control foreign investment by national law through means of administrative controls and supervisions on the basis of valid theory of international law with regard economic sovereignty.¹⁶⁷

In general, both capital sending and host countries could benefit from foreign direct investment. The capital sending countries benefit from FDI because outward FDI increases their competitiveness and performance of the enterprises involved. It also contributes to industrial transformation and upgrading of value-added activities, improved export performance, higher national income, and better employment opportunities. Outflow of FDI may result in reducing domestic investment and lowering capital stock of the home state.¹⁶⁸

¹⁶⁵ **Ibid**, p. 48-4

¹⁶⁶ **Ibid**, p. 49

¹⁶⁷ **Ibid**, p. 50

¹⁶⁸ United Nations, FDI from Developing and Transition Economies: Implications for Development, **World Investment Report**, 2006, p. 169

QUESTIONS

Analyze the gist of the middle path theory on foreign investment.

Analyze the demerits of multinational corporations identified by the research conducted by the United Nations Commission of Transnational Corporations with regard to foreign investment.

Discuss the advantages of multinational corporations from the host country point of view.

How do you evaluate the Ethiopian economy in light of the middle path economic theory?

2.4) THE LIBERAL CONSENSUS

Liberal economic theory is based on the premise that free market yields maximum productivity. In the eighteenth century, Adam Smith and David Ricardo came up with the liberal economic theory and challenged mercantilism. Mercantilism argues that extensive state regulation of the economic activity is necessary to promote the interest of a nation. In the period between the 16th to 18th centuries, mercantilism was a dominant political economic theory in Europe. According to mercantilists, a national wealth may be equated with the quantity of gold held hold by the state. Hence, they sought to restrict imports and increase exports to increase the gold supply.¹⁶⁹

On the contrary, according to liberalists, the wealth of national economy could not be equated with the amount of gold in the treasury; rather national wealth is best measured by the productivity of the people. They further argued that productivity of people is best achieved by an unregulated market. Liberals opposed restrictions on national trade. Liberalism propagates for free market economy.¹⁷⁰

¹⁶⁹ Kenneth J. Vadervelde; "Sustainable Liberalism and the International Investment Regime," **Michigan Journal of International Law**, Winter, 1998, p.2

¹⁷⁰ **Ibid**

In 1947, establishment of General Agreement on Tariffs and Trade (GATT) heralded the coming into being of sustainable liberalism. In the nineteenth century, industrialization bloomed. It was possible to produce large capital surpluses, and this in turn makes the capital available for investment. Large manufacturing and transportation enterprises that were developed required major capital investments.¹⁷¹ In the nineteenth century, most of the investment was portfolio investment. For example, the investment was made on securities because securities market emerged. In short, the boosting of investment necessitates free market economy because it is free market economy that promotes investment.

The contemporary consensus emerged as a result of debates due to economic nationalism prevalent in 1990's. Nowadays, it is believed that economic development requires increased productivity and an equitable distribution of wealth. Hence, "sustainable liberalism requires that a liberal investment regime provide some measures of both growth and equality".¹⁷²

In the 1980's developing states were unable to pay their debts to their creditors. In turn, banks were unwilling to finance (through loan) to economy of developing states. Thus, foreign direct investment was taken by developing states as a means of making capital available. In addition, the collapse of the Soviet Union necessitated free market economy. Hence, the emergence of consensus requires not only free market economic policy but also competing for it.¹⁷³

In general, liberal economic theory is based on the premise that free markets will yield maximum productivity. This could work only where markets are functioning well. However, markets fail in developing countries. In such a case, a state is required to intervene to correct serious market failure. Developed states should also provide assistance, such as technical assistance with regard to the development of legal institutions and economic assistance.¹⁷⁴

QUESTIONS

¹⁷¹ **Ibid**, p. 2-3

¹⁷² **Ibid**, p. 10

¹⁷³ **Ibid**, p. 8-9

¹⁷⁴ **Ibid**, p. 10-11

Analyse the relevance of the General Agreement on Tariffs and Trade (GATT) to investment.

Discuss how the contemporary liberal consensus emerged.

Analyze how free market economy would promote investment.

Discuss the role of developed states in promoting investment in developing countries.

SUMMARY

We have discussed that classical economic theory believes that foreign investment is wholly beneficial to the host economy. This theory takes into account the capital inflow that makes capital available in the host state will be used to promote development of the economy of the host state.

Classical economy also reasoned that foreign investment transfers technology, creates employment and transfers managerial skills to the host state. It also helps to build infrastructure, upgrade the existing infrastructure and brings economic development to the country where investment is made.

The dependency theory criticizes the classical economic theory by giving meaning to development. According to the dependency theory, development is not transferring wealth to the host state, rather it is the development of the people of the state as a whole. Foreign investment is regarded by this theory as a means for developed countries to gain power in developing countries. Hence, since gaining power is not accepted by the host state, it influenced many nationalizations of foreign direct investment. According to this theory, development could not be achieved unless the people as a whole are freed from poverty and exploitation. Thus, development is the right of the people rather than that of the state, according to the dependency theory.

We have also discussed that media path theory is developed so as to make a balance between the classical and dependency theories. Market economy has been accepted as a means to marshal development of economy and thus privatization of state companies took place in developed and developing countries. The relation ship between multinational corporations and developing states (as host states) became more smothering than before.

A research conducted in the 1980's identified, the advantages and disadvantages of foreign investment confirmed the justifications for foreign investment proposed by classical theory. According to the study the following three harmful conducts of multinational corporations were identified. The first was the multinational corporations defeat the tax law of the host states by artificial high price. They also used hazardous and disused technologies that are harmful to the host states.

Thirdly, multinational corporations adopt restrictive business practice on a global scale that prevents the host state from maximum export scope potential for good produced within its territory. In general, the middle path theory has disproved the proposition that foreign investment is wholly beneficial to the host state by accepting drawbacks. Thus, foreign investment is entitled to protection depending on the extent of the benefit it brings to the host state and the extent to which it behaved as a good citizen so as to achieve the economic objectives of the host state.

The liberal consensus is the fourth economic theory on investment discussed in this unit. According to the liberal economic theory free market will yield maximum productivity and investment. The establishment of General Agreement on Tariffs and Trade (GATT) heralded the coming into being of sustainable liberalism in 1947. Then, the contemporary consensus emerged in the 1940's as a result of debates against economic nationalism. According to this theory, the state is prepared to intervene to correct serious market failure.

REVIEW QUESTIONS

I) Write TRUE if the statement is correct and FALSE if it is incorrect

- _____ 1) According to mercantilism extensive, state regulation of the economy promotes investment.
- _____ 2) The collapse of Soviet Union disproved free market economy in promoting private investment.
- _____ 3) Liberal economic theory argues that free markets will yield maximum productivity if markets function well.
- _____ 4) Economic theory that identifies the advantages and harms of foreign investment is known as dependency theory.
- _____ 5) According to the middle path, foreign investment is beneficial to both the capital sending and host states, and it has harms as well.
- _____ 6) The dependency theory argues that development is the right of all people and investment should promote this right.
- _____ 7) According to the dependency theory, foreign investment is an instrument for developed countries to be powerful in developing countries.
- _____ 8) The classical economic theory propagates that foreign investment is wholly beneficial to the capital sending state.
- _____ 9) The classical economic theory argues that foreign investment help the host state to build its own infrastructure.
- _____ 10) The 1992 World Bank guideline incorporates the dependency theory.

II) Choose the best answer from among the choices given

- _____ 1) An economic theory that argues that investment as wholly beneficial to the host economy is
- A) dependency theory B) the middle path
- C) the classical theory D) all
- _____ 2) Which of the following is not used as a point to justify foreign investment by the classical economic theory?
- A) Investment builds infrastructure

- B) development is the right of people
- C) Investment brings economic development for host states
- D) Investment transfers managerial skills to the host states.

_____ 3) According to dependency theory

- A) since the economies of developing countries are subservient to the developed countries, development becomes impossible.
- B) Nationalization of foreign direct investment occurs.
- C) Nationalization is forbidden
- D) A and C E) A and B

_____ 4) The economic theory that propagates protection for investment depending on the benefit is called _____.

- A) dependency theory B) middle path
- C) the liberal consensus D) the classical theory

_____ 5) _____ is an economic theory that requires free market economic policy and computation.

- A) The liberal consensus B) The middle path
- C) The classical theory D) The dependency theory

III) Solve the following

Assume that the Ethiopian government wants to craft an economic policy that promotes investment and development. You are given the assignment to submit a draft proposal on the required economic policy.

Which economic theories will you base your draft proposal on? State your reasons clearly.

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UNIT TRHREE: RISKS IN INVESTMENT

UNIT OBJECTIVES

After completing this unit, students should be able to:

Analyse political risks to investment;

Explain taking of investment property;

Discuss the concept of onerous contract as a risk to investment;

Analyze economic investment risks.

Introduction

There are factors that affect the chance for success of investors. Some factors could be under the control of investors while others are out of the control of them. Those factors that affect the opportunity of success of investors which are out of their control are externalities that risk investment. Those external events are risks of both loss of capital and income which arise not from poor management of the investors but the acts of the host state.¹⁷⁵

In general investment activity is not free from risks. There are various types of risks, and we will consider political risks, the taking of investment property, onerous contracts and economic risks under this unit.

The history of foreign investment has revealed depicted the fact that foreign investment has never been free from risks. The ending of colonialism has increased the risks to foreign investment because the absolute protection by the home state has changed its picture. Thus, home states of the investors cannot exercise their power to protect foreign investment made by their citizens in other countries. Investment in non-colonized countries was protected through diplomatic means which often involved the collective exercise of pressure by the home states of the investors. In addition, capital-sending countries were using force to protect their citizens who invest in foreign countries. However, the United Nation Charter has made unlawful the use of force through the means of gun bout diplomacy. Consequently, condemnation of states which resort to aggression to maintain their position in world trade and investment increases.¹⁷⁶ In this regard, the attack on Egypt after the nationalization of the Suez Canal is cited as the last instance of an overt attack against a country that interfered with foreign investment.¹⁷⁷

¹⁷⁵ John. H. Willes and John A. Willes, Q.C., **International Business Law: Environments and Transactions**, 2005, P.524.

¹⁷⁶ M. Sornarajah; **The International Law on Foreign Investment**, 1996, Pp. 55-6

¹⁷⁷ **Ibid**, p. 56

There are certain forces which result in either regime change or changes to the existing political and economic policies of the host state. States have the right to change their economic policies, which is an attribute of state sovereignty. Such a right is also recognized in modern international law. The declaration on principles of international law regarding friendly relations and cooperation among states recognized this right by declaring that “each state has the right freely to choose and develop its political, social, economic and cultural systems”.¹⁷⁸

In addition, Article 1 of the Charter of Economic Rights and Duties of States affirms that every state “has the sovereign and inalienable right to choose its economic system...”. If states have given the right to change their political, economic and cultural policies, such a change may result in the nationalization of the investment or otherwise disfavoured to it. Thus, such a change would be a threat to foreign investment.

3.1) POLITICAL RISKS

What do you understand by political risks?

Different writers define and explain political investment risks in different ways. However, a political risk may be explained in terms of work days lost (as a variable).¹⁷⁹ John H. and A. John define a political risk as capital and income losses as a result of policy choices of the host national government.¹⁸⁰ It is a risk of loss of capital and income of investment due to the government policy of the host country. In other words, political risk is the danger or possibility that the investor will have to bear the costs and expenses of the damage or destruction or otherwise of the investment property.¹⁸¹

The government of the host country may take a step to forbid repatriation of profits to home, or the currency in which the investors use may be worthless due to the act of the host country’s government.

¹⁷⁸ **Ibid**

¹⁷⁹ Hausman, Ricardo and Eduardo Fernandez-Arias, **Foreign Direct Investment: Good Cholesterol?** 2000

¹⁸⁰ John & John, **Ibid**, P. 524

¹⁸¹ See Bryan A Garner, **Black’s Law Dictionary**, 2004, P. 1353.

Besides, the host country government policy may end up in the loss of the capital for the investor. These are political risks in investment.¹⁸²

Political risk exists everywhere including the home country of the investor. Foreign investors may respond to such political risks by running away from the country where the risk is high and invest in a country where the risk is low. Political risk “stems from the turmoil of a restless population, resentful (rightly or wrongly) of those who govern them and the laws that constrain them”.¹⁸³ This turmoil may impair productivity, markets and ultimately the national economy. A risk is lower in a society where there is dissent. In a country where the life of the society is unstable, there could be a strike or workers may neglect their jobs.¹⁸⁴

If there is strike or civil strife or industrial dispute which is an indication of socio-political instability, working days will be lost, and therefore, has a direct impact upon investment since the investor incurs cost of loss production. Such a step is a major interruption in production. According to the International Labour Organization, in countries where such political risk is high, the share of FDI in GDP is low.¹⁸⁵

Political instability, as manifested in work days lost, is a significant factor that determines the flow of FDI. In a country where there are good labour relations, more FDI would be made unlike countries with bad labour relations. In general, investors take into account the political stability in deciding whether or not invest because it decreases the risk of lost working days.¹⁸⁶

If there is a political risk, imports will be more expensive and out of reach of all except the elite. The government may blame foreigners for all its problems. In addition, the government may forbid convertibility of the local currency into foreign currencies. The objectives of such a move are:¹⁸⁷

1. to halt a decline in its foreign currency reserves. However the problem here is that foreign currency will not increase again.

¹⁸² John and John, **Ibid**

¹⁸³ **Ibid**, P. 525

¹⁸⁴ **Ibid**

¹⁸⁵ Hausman and Eduardo, **Ibid**

¹⁸⁶ See, **Ibid**

¹⁸⁷ John and John, **Ibid**, P.525

2. to prop up the value of the local currency;
3. to control what is purchased abroad; this could create a black market
4. to prevent capital and savings from slipping away toward less risky places; In this case, foreign currency will not add and will remain unused, only local currency will be used in an attempt to convert it to hard goods. However, this will increase inflation and further decrease the value of local currency.

The problem does not stop there. The above mentioned outcomes drive the government to take the hard assets of foreign investors situated in its jurisdiction. Such a taking of investment properties may be made with or without compensation. The basic purpose of the government in so doing is to appease the local citizens.¹⁸⁸ What is worse is that such a step may end up in a revolution.

The host government may also exert its power on the foreign investors in the following manner. It may force re-negotiating investment contracts made before; It may also force extracting technology disclosure as a price for corporate departure; or demand repayment of loans given to foreign investors, or suspend payments owed to it. It also blocks investors' funds repatriation as part of its currency control. The investor may also face actual destruction of assets in a civil war or riot. All these are categorized under political risks.¹⁸⁹

In short, a political risk is the probability that political conditions of a country may at a certain point in time cause financial losses to investors.¹⁹⁰ According to Whiteside,¹⁹¹

- internal security system of a country;
- the status of legitimacy of the government;
- the nature of the ruling elite;
- the level of urbanization; and
- the level of socio-economic equality are essential indicators of a political risk to investment.

¹⁸⁸ **Ibid**

¹⁸⁹ **Ibid**

¹⁹⁰ Alan W. Whiteside (ed), *Industrialization and Investment Incentives in Southern Africa*, in Lubo Teferi, **A Critical Evaluation of Ethiopian Investment Laws with Specific Reference to Proclamation No. 116/1998 and Regulations No. 36/1998**, AAUFL, 1998, P.59

¹⁹¹ **Ibid**

In the past powerful countries colonized others and exploited the latter's natural resources. Such acts brought about ideological hostility, and sense of nationalism. What is more, the conflict of interest of the colonizers and former colonized nations resulted in regime change, war and conflict. Those are political risks in investment in general, and FDI in particular. Now, let us consider these points.

3.1.1) Ideological risk

According to Lodge and Vogel,¹⁹² the components of ideology are the following:

the relationship between the human being and the community, the individual and the group, and the means to individual fulfillment and self-respect;

the institutional guarantees to investment like property rights;

the most appropriate means of controlling the production of goods and services;

the role of the state;

the perception of reality and nature. Hence, the role of science and the function of education are crucial.

These elements of ideology are reflected in a given society in the socio-cultural history experience and the values of the people and its political structure. States that have communication values place importance upon the equality of results among its members. Here greater emphasis is placed on rights (such as income, health, and pensions) and duties to the group rather than individualistic values that arise from contractual relationships. The community itself determines everything instead of rather than allowing interest groups to define needs of individuals.¹⁹³

¹⁹² George C. Lodge and Ezra F. Vogel, Ideology and National Competitiveness: An Analysis of Nine Countries, in John H Willes and John A. Willes, Q.C, **International Business Law: Environment and Transactions**, 2005, P.44

¹⁹³ John and John, **Ibid**, P.45

“Values in ethnicity and culture, history, religion, language, art, literature, education science, military experience, environmental realities, material resources, and even the iconography of a nation”¹⁹⁴ must be considered so as to understand the ideology of a nation. In general, politics mirrors the national values of a nation.¹⁹⁵

In this connection, the FDRE Constitution states that

We, The nations, Nationalities and Peoples of Ethiopia:

*Strongly committed, in full and free exercise of our right to self-determination; to building a political community founded on the rule of law and capable of ensuring a lasting peace, guaranteeing a democratic order, and advancing our economic and social development.*¹⁹⁶

We observe from this that the Ethiopian people are determined for economic and social development. The ideology as stated under the constitution is that self-determination is a political value and it may be taken as an opportunity for investment in general.

From an economic point of view, a communist ideology is opposed to private capital and private means of production. This is a threat to foreign investment since the investment could be nationalized. It is as clear as day light that the communist ideology has been done away with but that does not mean that it is totally extinguished. There are some countries which stick to communism, and there are political parties in many countries that adhere to socialism.¹⁹⁷

Former communist countries opened their doors to foreign capital accepting that foreign investment enhances their development. However, there are political elements which remain antagonistic to foreign investment. For example, in India, there was a strong socialist group which remained antagonistic to

¹⁹⁴ **Ibid**

¹⁹⁵ **Ibid**

¹⁹⁶ Proclamation No 1/1995, Proclamation of the Constitution of the Federal Democratic Republic of Ethiopia, **Federal Negarit Gazeta**, 1st year, No 1, Addis Ababa., Preface

¹⁹⁷ Sornarajah, **Ibid**, p. 57

foreign investment when a reform of foreign investment law permitting easier access to foreign investment was initiated in 1990. Similarly, a segment of a communist party still believed that foreign investment is harmful to the country when President Deng initiated an open door policy in China. Thus, it is clear that if such groups come to power, the risk to foreign investment would increase.¹⁹⁸

Coming to Ethiopia, the policy of our government seems to be directed towards private capital though it is now a mixed form of economic policy. We have also observed the existence of groups or political parties that favour communist ideology. If such groups come to power through a democratic election, the economic policy may be changed, and the political environment may be antagonistic to foreign investment.

3.1.2) Nationalism

What do we mean by nationalism? How could it be risk to foreign investment?

Nationalistic sentiments may be a threat to foreign investment. Foreign investors may prosper and control the economy and repatriate profits. In such a case, they would become easy targets of xenophobic nationalism particularly where the economy of the host state deteriorates. Thus, opportunist politicians could change the government and nationalize foreign investment. So, it would be easy to take over or divert the ownership of investments.¹⁹⁹

Religious fundamentalism has a similar character. In this case, the Iranian revolution of 1981 is a good example. The revolution was both nationalistic and fundamentalist and resulted in the taking over of American owned business.²⁰⁰

Nationalist feelings also play a dominant role in restricting the flow of foreign investment in the richer states. For example, the Foreign Investment Review Act in Canada was a response to the perception of

¹⁹⁸ **Ibid**

¹⁹⁹ Sornarajah; **Ibid**, p. 58

²⁰⁰ **Ibid**

American dominance in the Canadian economy. Similarly, the American multinational domination in France and the rest of Europe attracted attention to the issue of foreign investment.²⁰¹

Is there any nationalistic feeling in Ethiopia that could be a threat to foreign investment? Can we take the nationalization made by the Derg Regime as a measure of nationalistic feeling?

3.1.3) Changes in the Industry Patterns

There could be changes in the industry bringing about a global change in policy. Such changes may bring about change in the ownership within the industry. This would affect the interests of foreign investors. For example, there was an oil crisis in the 1970's. Due to the crisis, the oil-producing nations came together to take over control of the oil industries in their states and to fix the price of oil. Formerly, the production of oil was made by industries owned by European companies and the United States. The oil production was made on the basis of concession agreement.²⁰²

Dramatic changes took place in the oil industry. Representative governments were replacing the former imperial powers, and consequently political demands were there for the cancellation of the concession agreements. There were concerted efforts made for the creation of doctrines that would justify the cancellation of the concession agreements by the former colonies. For example, doctrines like the permanent sovereignty over natural resources were articulated. Then, this doctrine was proclaimed through General Assembly resolutions as the means through which this transformation may be achieved through the law. On the contrary, military pressures to make the host state to abide by the obligations of concession agreement were no longer feasible. Thus, the efforts of oil producing states became successful in forming the organization of oil producing states (OPEEC).²⁰³

Further, a foreign investor may benefit from windfall profits. In such a case, the state is likely to intervene and ask for changes to the contract. For example, the state would seek to absorb the windfall profits

²⁰¹ **Ibid**, p 59

²⁰² **Ibid**, p. 60

²⁰³ **Ibid**, p. 61

through taxation. The doctrine of permanent sovereignty over natural resources coined by Hassain became the basis to such a measure. In addition to taxation, the host states may need to overtake the investments unless they do not feel confident of running the investment.²⁰⁴

What is the solution in such a case? The foreign investor would change the attitude of the host government by showing that s/he is of continuous importance to the host state.²⁰⁵

3.1.4) Regime Change

There could be a change of government in the host state, and the incoming government may wish to change the contracts made with foreign investors by previous governments. Such a change of contracts is justified on the allegations of corruption in the making of the contracts. In addition, the change may be made where the legitimacy of the previous government had been doubted by the incoming government on objective grounds. For example, there was a contract for the construction of nuclear electricity generating plants in Manila. It was alleged that the contracts were obtained through improper means from the Marcos government. Thus, the incoming government rescinded the contracts.²⁰⁶

A dispute could arise between the investor and the incoming government with regard to continue the obligation assumed by the previous government.²⁰⁷

For example, let us assume that Rogger is a foreign investor in the agricultural sector in a country, say Ethiopia, during the Imperial regime. The Derg regime replaced the Imperial regime. Should the Derg regime be obliged to continue the investment contract with Rogger? (Assume that investors were allowed to invest under the Derg regime, only for this pedagogic purpose!).

²⁰⁴ **Ibid**

²⁰⁵ **Ibid**, pp. 61-2

²⁰⁶ **ibid**, p. 62

²⁰⁷ **Ibid**

In such circumstances, there is no rule of state succession in favour of individuals. It is worth noting that there is no remedy in the international law. If the investment contract is made with unrepresentative government, the incoming government can claim the right to rescind the contract justifying that the previous regime and the contract it made were not binding. The incoming democratic regime may also declare that the contracts made with military regimes could not bind it. Thus, contracts made in dictatorships may be suspected on the basis that they are not validly binding on a future democratic government. From a democratic point of view, it could be possible to argue that where the contract entered with the previous regime turns out to be detrimental to the interests of the people, it becomes defeasible.²⁰⁸

In general, contracts made with unpopular and non-democratic governments may be suspected by the incoming democratic government. In principle, our government is a representative of the nations, nationalities and peoples of Ethiopia. Thus, the government is expected to promote the interest of the people. In addition, the incoming government will be a representative of the people since it is unconstitutional to come to power through any means other than election.²⁰⁹

3.1.5) War and Conflict

War and conflict are also political risks to investment. Why are these considered political risks to investment? What are the negative impacts of war and conflict on investment?

War is an activity that causes loss to resources including the labour forces. If there is a war or conflict, the resource for economic development, capital and labour force will be mobilized. This, no doubt, will have a negative impact on investment since the resource that would have been used for investment would be directed to the war.²¹⁰

²⁰⁸ **Ibid**, p. 63

²⁰⁹ See Art. 9(3) of the FDRE Constitution

²¹⁰ See Lubo, **Ibid**, P.59

Nowadays even though the level seems to be insignificant, we are witnessing conflicts and war with Eritrea. This would militate against the implementation of investment projects and potential investors in the country in two ways. First, the war uses up the scarce resources that could have been used to implement approved investment projects (of the government). In addition, it destroys the image of peace, security and stability of the country, and consequently erodes the confidence of potential foreign investors to invest in Ethiopia.²¹¹

3.2) Taking of Investment Property

Definition

What is taking of investment property? Taking of investment property is the taking of property by the State through legislative or administrative measures.²¹² Taking of investment property by the State is one of the most important risks to foreign investment. Changes like incoming of new government shifts in ideology, economic nationalism or monetary crises may force the host state to change its economic policy towards investment in general. Thus, the host state may require to rearrange its economic structure and this would lead it to the taking of investment property of a foreign investor.²¹³

Taking of property is defined to include ‘not only an outright taking of property but also any such unreasonable interference that the owner there will not be able to use, enjoy or dispose of the property within a reasonable period of time after the inception of such interference.’²¹⁴ We can clearly understand that taking of investment property is an encumbrance on the right of ownership which cripples the *usus*, *fructus* and *abusus* rights of owner.

²¹¹ **Ibid**

²¹² United Nations, **International Investment Agreements: Key Issues**, 200.. p. 240

²¹³ **Ibid**, p.236

²¹⁴ The Harvard Draft Convention on International Responsibility of States for Injuries to Aliens, 1961, SSA JIL 554 (Art. 10), in M-Sornarajah, **Ibid**, P.284

Major phases the concept has gone through may be treated as follows:²¹⁵

First phase-17th century nationalisation began with the Russian and Mexican revolutions where there was no compensation and conflicts erupted. Capital sending countries argued that there must be “prompt, adequate and effective compensation” which is known as “Hull formula”. Developing countries on the other hand insisted that it is a high standard which could deter national action in pursuance of objectives of restructuring the economy.

Second phase-:- is related with the decolonization period. Nationalizations have been made across the board so as to wrest economic control from the foreign nationals. It was believed that only “appropriate compensation” needed to be paid for those takings of foreign investment property.

Today, nationalization could happen where there is a regime change, but it is believed passed. Hence, nationalizations on an industry wide basis are a rare phenomenon.

The concept and classification of taking of investment property is not fully clear, consistent or established. The following reasons are given for that:²¹⁶

1. the terms and concepts have their own origin in national law and practice and their translation in international law is sometimes problematic;
2. the actual practice of states depends partly on their economic development and partly on the ideologies and policy changes;
3. the topic has a long history and has gone through several phases and the particular facets of the relevant problems varied considerably.

Types

What are the types of taking of investment property?

²¹⁵ **Ibid**

²¹⁶ **Ibid**

Taking of investment property may be categorized as follows; 1) forced sales of property 2) forced sales of shares; 3) indigenisation measures; 4) exercising management control over the property; 5) inducing others to physically take over the property; 6) failure to provide protection when there is interference with the property of the foreign investor; 7) administrative decisions which cancel licenses and permits necessary for the foreign business to function within the state; 8) exorbitant taxation; 9) expulsion of the foreign investor contrary to international law; 10) acts of harassment such as the freezing of bank accounts, promoting of strikes, lockouts and labour shortages. It is worth noting that all these instances involve the state conduct.²¹⁷

It may also be possible to categorize takings into direct and indirect takings. **Direct taking** includes:²¹⁸

- A. Outright nationalizations in all economic sectors.** This measure results in the termination of all foreign investment which is usually motivated by policy considerations. It is in a sense achieving complete state control of the economy.
- B. Outright nationalization on an industry basis:** Here nationalization becomes narrower and the host state seeks to reorganize a particular industry by taking over the private enterprises in the industry and creating a state monopoly.

Indirect takings may take the following forms.²¹⁹

- A) **Large- scale taking of land by the state-** A host state may take the land with the purpose of redistributing land to the landless. In such a case, the investor may be evicted from the land s/he let and invested on.
- B) **Specific takings-** In such a case, a particular enterprise may be the subject matter of taking. For example, a firm dominating a market or industry or a specific plot of land, which is necessary to construct a road may be a target of the taking. This type of taking may not be avoided, but the legal issue is that no discrimination can usually be alleged in such a case.
- C) **Creeping expropriation** is defined as “the slow and incremental encroachment on one or more of the ownership rights of a foreign investor that diminishes the value of its investment.” In creeping expropriation, the rights of the investor to use the property are diminished as a result of the interference by the state while the legal property remains vested in the investor. According to UNC TAD, the following are examples of creeping expropriation:

²¹⁷ M.Sornarigah, **Ibid**, p.284

²¹⁸ UN, **Ibid**, P.238

²¹⁹ **Ibid**

- forced divestment of shares of a company;
- interference in the right of management;
- appointment of managers;
- refusal of access to labour or raw materials;
- excessive or arbitrary taxation.

There are authorities that assimilate creeping expropriation with the first three categories of takings.

D) **Regulatory takings** are those takings of property that fall within the police power of a state. It may also arise from state measures like measures to regulate the environment, health, morals, culture or economy of a host country.

To day, creeping expropriation and regulatory taking present new and difficult legal issues. In general, a taking by a host country destroys the ownership rights of an investor in its tangible or intangible assets.²²⁰

Is it not possible to take investment property by a state?

Taking of a foreign property by a state is prima facie lawful. However, taking of property is conditional and the following requirements must be fulfilled.²²¹

According to customary international law, taking of investment property must fulfil the following requirements:

- It must be made for public purpose;
- There should be no discrimination;
- The taking must be accompanied by payment of compensation;
- There must be due process;

1. **Public purpose**

We do not find universally accepted definition of public purpose. Usually, a host states determination of what is in its public interest is accepted so long as it has a reasonable foundation. Where a taking is made by way of reprisal against the act of a home state of foreign nation, it is considered illegal on the ground that it lacks public interest.

Under Ethiopian law, public purpose is defined as

the use of land defined as such by the decision of the appropriate body in conformity with the urban structure plan or development plan in order to ensure the interest of the

²²⁰ UN, Ibid,

²²¹ M.Sarnarijah, Ibid, P.315ff.

*peoples to acquire direct or indirect benefits from the use of the land and to consolidate sustainable socio-economic development*²²²

2. Non-discrimination

Taking of property should be free of discrimination on the basis of national or ethnic origin. Any arbitrary action or any action without legitimate justification is considered to be contrary to the principle of non-discrimination. The principle requires that government measures, procedures and practices be non-discriminatory even in the treatment of members of the same group of aliens.²²³

- 3. Compensation** For a taking to be legal, there must be compensation. What should be the standard of compensation? This could be the issue of dispute. Communist states historically argued that there must be no compensation since private property is not allowed. However, this stand is now changed. For example, China recognized payment of compensation by treaties. Capital exporting states argue that the Hull standard of prompt, adequate and effective compensation should be met. The standard requires that payment of full market value as compensation speedily and in convertible currency. Some developing countries, on the other hand, argue that “appropriate compensation” be made to the investor. However, this standard is criticized for being vague. Developing countries argue that a Hull standard is very high to comply and it may deter a state not to take an investment property in the interest of economic development. Thus, they opt to appropriate compensation which is based on equitable principles as a guide in assessing compensation rather than a hard and fast rule relating to market value. Though, we do not have a standard definition of appropriate compensation, it requires the a consideration of past practices, the depletion of natural resources, possible lack of foreign exchange and other factors like environmental damage. Another method of valuation adopted in treaties is the book value method of evaluation. Thus, it may take the net book value (depreciated assets value) or the updated book value (also referred to as the adjusted book value, which takes into account the inflation. The tax value of the assets may also be taken alternatively. In general, “ the Hull formula” suggests a fuller, more satisfactory to the investor type compensation, while the “appropriate compensation” formula suggests that additional concrete (historical or other) considerations may be taken into account which will result in a lower final payment.”²²⁴

²²² Proclamation No. 455/2005, A Proclamation to provide for the Expropriation of land holdings for public purposes and Payment of Compensation, **Federal Negarit Gazeta**, 11tjh Year, No. 43, Addis Ababa, 15th July, 2005, Art. 2(5)

²²³ UN, *Ibid*, P.239

²²⁴ UN, *Ibid*, P.239

An appropriate compensation may be defined as “compensation calculated on the basis of recognized principles of valuation”²²⁵

Which standard is adopted under the Ethiopia Investment law?

4. Due Process Requirement

The compensation due to a foreign investor should be assessed by an independent host country tribunal. This is recognized in bilateral and some regional agreements. Thus, it is important to provide for the mechanisms of the assessment of the compensation by law. The due process requirement may be met by other kinds of regular administrative procedures other than courts of law. However, there is uncertainty as to the interpretation of the term “due process” in international law.²²⁶

What are the mechanisms given in the Ethiopian law to guarantee the due process requirement?

3.3) ONEROUS CONTRACTS

What do you understand by onerous contracts?

There could be a situation whereby the contracts become too onerous to perform because of subsequent events. This means that the obligations undertaken by the party may become too heavy to perform: they may be more than that stipulated and intended by the parties. This is a risk to foreign investment but why? Where performing such contracts become too onerous, states will seek to reduce the loss that they could suffer by interfering legislatively with the contract. For example, in *Settebello V. Banco Totta Acores* a state-owned shipyard in Portugal had made a contract to build a large oil tanker. The agreement provided penalties for late performance. The shipyard was unable to perform the contract in due time. The penalty provided was huge, and it became onerous to the shipyard. Then, the government of Portugal intervened through legislation and altered the penalty provisions of the contract.²²⁷

²²⁵ The model Agreements on Promotion and Protection of Investment of the Asian African Legal Consultative Committee (AALCC)

²²⁶ UN, *Ibid*, P.240

²²⁷ M. Sornarajah, *Ibid*, p. 64

3.4) ECONOMIC RISKS IN INVESTMENT

There are economic risks in investment. Potential risks for the home economy includes export of goods, hollowing out and balance of payments problems. TNCs may decide to relocate the most attractive jobs to other countries if the home country does not provide competitive conditions for production.²²⁸

Hollowing out-verb-to make a hole in something by removing part of it. **Balance of payments (n)(sing)**-the difference between the amount a country pays for imports and the amount it receives for exports in a particular period of time.²²⁹

Thus, it is essential to ensure that competitive economic conditions are beneficiary from FDI. In addition, TNCs may move productions if they find national economic policies are not conducive to their investment.²³⁰

What should be done to address these problems?

Countries may use various options to address the economic risks of foreign direct investment. First, countries may use policies to neutralize or alleviate the potential negative effects of the investment. For example, FDI aimed at seeking out lower- cost locations which have negative effects on domestic unskilled labour of middle income developing countries. According to the UN, in Turkey and the Republic of Korea, the search for lower production costs has been a motive for overseas investments. In this process, low-paid jobs are shifted of share while jobs that require higher skills remain at home. In such a case, it is necessary to introduce policies targeting such groups of the society. It is suggested that adult education and training programmes, as well as programmes to encourage SME development are examples of policy responses to adjust the economy without obstructing the internationalization process.²³¹

²²⁸ World Investment Report, 2006, P.218

²²⁹ **Oxford Advanced Learner's Dictionary**, Oxford University Press, 2006, p. 99

²³⁰ **Ibid**

²³¹ **Ibid**, Pp.218-19

Different measures could be taken to counter the risk of industrial hollowing out. In Korea, for example, the Government actively promotes inward FDI, particularly for its high-tech industries so as to balance or complement outward FDI by its firms.

Second, special attention is given to supporting domestic industries that produce parts and materials for export to Korean firms that have shifted some production abroad. In addition, the Government has made concerted efforts to expand and develop future growth industries.²³²

Less developing countries fear economic dominance by stronger nations if foreign investors are allowed to possess assets in the home states.²³³ The economic environment consists of forces that influence market operations, the over all economic activity, interest rates, currency fluctuations, wages, technology change, and government policies.²³⁴

Trans national Corporations (TNCs) affect business, labour markets, tax bases, politics and the fiscal affairs of the home state. There is no much discussion and code development with respect to economic impacts of TNCs all over the world.²³⁵

SUMMARY

We have seen that investment can not be free from risks. We have dealt with political risks, taking of investment property onerous contracts and economic risks in investment. A political risk is a risk of loss of capital and income of investment due to government policy of the host country. Strike or civil strife or industrial dispute is an indication of political instability which will result in loss of working days and thus has a direct impact upon investment.

²³² **Ibid**, P.219

²³³ John H. Willes and John A. Willes, **International Business Law: Environments and Transitions**, Boston,. P.M.

²³⁴ George A. Steiner and John F. Steiner, **Business, Government, and Society**, Boston, 2006, p.35

²³⁵ **Ibid**, p-36

We have seen that communist ideology is opposed private capital and private means of production which is not conducive to private investment. Nationalistic sentiments may be threats to investment where investors prosper while the host country's economy deteriorates. So, politicians could change the government and nationalize foreign investment. We have also seen that changes in the industry patterns may be a threat to investment. Thus, concession agreements in the oil industry have been replaced by governments of the country where the oil is extracted. Regime change is the other political risk we have discussed because the incoming government may wish to change investment contracts made with the previous government. Thus, having a democratic government may be professed as a solution to this problem. War and conflict are also political risks since they need to sacrifice resources. War and conflict may destroy the image of peace, security and stability of the country and erodes the confidence of potential foreign investors.

Taking of property by the state through legislative or administrative measures is the other risk to investment. Such a risk includes unreasonable interference where the investor will not be able to use, enjoy and dispose of the property.

Nationalization is a direct taking while indirect taking includes large-scale taking of land by the state, specific takings which focus on a dominant industry, creeping expropriation is a slow and incremental encroachment to the ownership rights of a foreign investor that diminishes the value of its investment. An indirect taking also includes measures to regulate the environment, health, morals, culture or economy of the host country.

We have also discussed that onerous contracts may be taken as an investment risk because the government may interfere through legislation where the investment contract is too heavy to perform.

Export gaps, hollowing out and balance of payment problems are economic risks in investment. Trans-national corporations may relocate the most attractive jobs to other countries if the home country does not provide competitive condition for production. Some of the activities may hollow out, and some part of an

industry may be removed. The country may also face a problem of balance of payments where the imports are more than the amount received by foreign currency in a particular period of time.

Review Questions

I) Write TRUE if the statement is correct and FALSE if it is incorrect.

- _____ 1) The problem of balance of payments is an economic risk in investment.
- _____ 2) The history of investment has witnessed that host country will not change the investment agreements notwithstanding that it is onerous to perform.
- _____ 3) Once industrial hollowing out exists in an economy, it is not possible to remedy it.
- _____ 4) The host country is not duty-bound to justify the existence of public purpose to expropriate investment property.
- _____ 5) Today, nationalization is a risk to investment which is prevalent in most host countries.
- _____ 6) War requires all the resources of the host state that would have been used to implement approved investment projects.
- _____ 7) The incoming government might not change investment contracts made with the previous government where both the former and the incoming governments are democratic ones.
- _____ 8) Communist ideology was taken as a risk to private investment because it opposed private property.
- _____ 9) A risk of loss of capital and income of investment as a result of policy choices of the host government is called economic risk.
- _____ 10) Externalities that would affect the investment are called investment risks negatively.

II) Choose the best answer

- _____ 1) A risk that results from the political conditions of a host country is known as:
- A) taking of investment property B) political risk
C) economic risk D) all

- _____ 2) Religious fundamentalism that resulted in the 1981 Iranian revolution is
- A) ideological risk B) economic risk
C) nationalism D) none
- _____ 3) Taking of investment property may be categorized into
- A) direct and outright B) direct and regulatory takings
C) specific and large- scale takings D) direct and indirect takings
- _____ 4) Which of the following is not a requirement for expropriation of investment property?
- A) Undue process B) compensation
C) non-discrimination D) public purpose
- _____ 5) Which of the following is not an economic risk to investment?
- A) Hollowing out B) onerous contracts
C) balance of payment problems D) export gaps

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UNIT FOUR: INTERNATIONAL LAW ON FOREIGN INVESTMENT

UNIT OBJECTIVES

After completing this unit, the student should be able to:

- ◆ Analyze international norms on multilateral corporations;
- ◆ Discuss the World Bank guidelines on foreign investment;
- ◆ Analyze trade related investment measures;
- ◆ Appreciate the reasons for bilateral investment treaties;
- ◆ Analyse the features of bilateral investment treaties;
- ◆ Identify bilateral Investment Treaties Concluded by Ethiopia

INTRODUCTION

Bilateral investment treaties are a relatively new phenomenon. The first bilateral investment treaty was the one concluded between German and Pakistan in 1959. Gradually, the number of bilateral treaties increased and by the end of 1988, 308 treaties were concluded. According to UNCTAD 1,160 bilateral investment treaties were concluded during and up to 1996. What is more, 2,096 BITs were signed by 174 countries by the end of 2001. 45 percent of these treaties were concluded between developing countries, and 31 percent were concluded between developed and developing countries.²³⁶

In this unit, we will deal with the reasons for bilateral investment treaties. Then we shall discuss the feature of bilateral investment treaties. We will also analyse some of the investment treaties concluded by Ethiopia. Then we will summarise important points and look at some questions which will help you to test your progress in learning the content of the unit.

²³⁶ Carlos Correa and Nagesh Kumar; **Protecting Foreign investment: implications of a WTO regime and policy options**, 2003, Pp. 134-135

4.1. SOURCES OF INTERNATIONAL LAW ON FOREIGN INVESTMENT

According to Article 38(2) of the statute of the International Court of Justice (ICJ), treaties, customs, general principles of law, judicial decisions and writings of scholars are sources of international law.

4.1.1. TREATIES

Multilateral treaties evidence an acceptance of a principle as international law by the parties to the treaty. Therefore, multilateral treaties are sources of international law. However, there are no relevant treaties that furnish a comprehensive code of law on foreign investment. There was an attempt made by the Abs-Shawcross convention to formulate a code on foreign investment. It was not accepted by states. It sought to state principles which were entirely favourable to capital-exporting states.²³⁷

Recently, there is an increasing activity on making bilateral investment treaties. These bilateral treaties provide certain more comprehensive statements of treatment which will be accorded to investment by the parties. The same rule could be repeated in a number of similar treaties among different nations, and such repetition could create international law on foreign investment.

On the other hand, bilateral treaties vary in many respects, and it would be hard to accept them as a source of international law because they may not create a general law. However, others argue that they create a customary international law.²³⁸ In general, bilateral treaties are sources of international law on foreign investment.

²³⁷M. Sornarajah, *The International law on Foreign Investment*, 1996, p. 73

²³⁸ *Ibid*, p. 74

4.1.2. CUSTOM

A widespread custom expresses an *opinio juries* within the international community, and it is a source of international law since the principle involved in the custom is obligatory. For example, it is a general rule of custom to pay compensation where foreign property is nationalized or expropriated.²³⁹

There is a view that principles contained in the General Assembly resolutions constitute “instant customary law” in that they are evidence of *opinio juries* of the international community. On the contrary, there is a tendency to dismiss the norms that are incorporated in those resolutions as “soft” law or as *lex ferenda*. It is argued that they are only expressions as to what the law ought to be in the future.²⁴⁰

The General Assembly resolutions accepted the state sovereignty since the birth of a system of state based on territorial sovereignty. Thus, the state’s sovereign power to control events political, economic or otherwise in its territory is recognized according to this principle. Consequently, one can argue that the resolutions of the General Assembly establish an economic sovereignty of states that is applicable to foreign investment.²⁴¹

4.1.3. GENERAL PRINCIPLES OF LAW

General principles of law are recognized as a source of law in general, and investment law in particular. However, authorities accepted general principles of law only on a limited manner. On the other hand, many others argue that general principles of law is a source of international law on foreign investment. For example, the payment of full compensation where investment is expropriated is based on the general

²³⁹ **Ibid**

²⁴⁰ **Ibid**, p. 76

²⁴¹ **Ibid**, p. 77

principle of law on unjust enrichment. In addition, notions of equity are also applicable as a general principle.²⁴²

Arbitration tribunals apply the general principles with regard to investment contracts. The general rules that are used by tribunals have a role in shaping rules in the area of foreign investment protection. However, the tribunals are accused of tending to favour investment protection rather than promoting the interests of host states (developing states).²⁴³

Thus, the international arbitral tribunals are required to apply rules that protect investment as well as recognize the interest of developing states. Another example in the application of general law principles is the principle of sanctity of contracts. According to this norm, a state cannot change a foreign investment contract unilaterally.²⁴⁴ However, it is essential to remember the freedom of contract.

What is more, an investment contract may be changed. Thus, where public interest requires, investment contracts may be changed unilaterally, and this is an accepted general principle of international law on foreign investment.²⁴⁵

We have seen that general principle of law is a source on foreign investment. However, general principles of law are weak norms. “They cannot resist norms proceeding from sources which rely on consensual processes among states”.²⁴⁶

4.1.4. JUDICIAL DECISIONS

²⁴² **Ibid**, p. 78

²⁴³ **Ibid**, p. 78

²⁴⁴ **Ibid**, p. 78-9

²⁴⁵ **Ibid**, p. 79

²⁴⁶ **Ibid**

Judicial decisions are a source of international law. For example, the decisions of International Court of Justice (ICJ) have had an immense influence on the shaping of the principles of international law. Arbitral awards are also decisions made on disputes arising from foreign investment transactions. Thus, the decisions could be used as a source of international law on foreign investment. Such awards are made unilaterally, and their role is diminished. In addition, there is a view that awards will have limited procedural value because the tribunal is set only to settle the dispute between two parties. Further, the decision is made with a view to solving specific types of problems arising between the parties. Thus, there is an argument that such a decision cannot be used as a source of international law.²⁴⁷

However, it is important to note that the decisions will have influence on foreign investment protection. The arbitrators/ judges will use literature that could also apply to other similar types of disputes.²⁴⁸ Therefore, decisions are used as sources of international law on foreign investment, but they are taken as subsidiary sources.

4.1.5. WRITINGS OF PUBLICISTS

Like decisions, writings of highly qualified publicists are a subsidiary source of international law. There was a tendency to accept only writings of “civilized nations”. This could be unfair. However, the problem is that the writers from the host states tend to naturally favour the interest of the host states while scholars of capital exporting states tend to favour their states. Hence, opposing views could be expressed on the same point. Thus, whose writing should be accepted?

In general, objectivity cannot be expected of writers. Since there is no impartiality among writers, the value of their writings as a source of international law on foreign investment would be reduced. Furthermore, some argue that writings could not be regarded as a source of international law.²⁴⁹

²⁴⁷ **Ibid**, p. 80

²⁴⁸ **Ibid**

²⁴⁹ **Ibid**, p. 81

Should we disregard the writings of scholars? Alternatively, should we accept the writings of scholars capital exporting countries, or the writings scholars from the host states?

4.2. INTRERNATIONAL NORMS ON MULTINATIONAL CORPORATIONS

Since the Second World War, tremendous efforts have been made to come up with a code of conduct that regulates the conduct of foreign investment. Accordingly, the charter of the International Trade organization (ITO), signed at Havana on March 24, 1948 incorporates provisions with regard to foreign investment.

The developing countries have sought to influence United Nations bodies which they control to formulate rules of conduct for multinational corporations. Their efforts are associated with the move to bring about a New International Economic Order (NIEO). This concern was accepted, and at the international level, the concern was manifested by the call for the study of the role of multinational corporations in the international economy by the United Nations. A group of eminent persons were asked to study the problem (in 1972) by the Economic and Social Council of the United Nations. After conducting a study the group reported (in 1974) that “certain practices and effects of transnational corporations had given rise to a widespread concern and anxiety in many quarters and a strong feeling has emerged that the present *modus vivendi* should be reviewed at the international level.”²⁵⁰

An outcome of the report was the effort initiated by the developing counties to draft a code of conduct for multinational corporations. However, developed states disagreed with the drafts made by developing countries, and the socialist bloc had its own draft. There have been several revisions of the draft.

²⁵⁰ M. Sornarajah; **Ibid**, p. 191

With in the fourteen years that have passed since the initiation of the efforts at the making of the code of conduct, the ambivalence of the developed states towards the code has shifted to one of qualified. Developed states have become recipient of foreign investment. Thus, they anticipate problems in controlling the activities of multinational corporations. Consequently, the United States required reference to the relevance principles of customary international law in the field. The preference of the developed states is for a “balanced code” which would incorporate rights and duties of the multinational corporations²⁵¹ and the host states.

The UNCTC Draft Code

The objective of the code is to “maximize the contributions of transnational corporations to economic development and growth and to minimize the negative effects of the activities of these corporations. Nonetheless, this is against the classical economic theory.

The code addresses both private and public /state/ corporations. In addition, it includes mixed, comprising entities in two or more countries, regardless of the legal form and fields of activity of these entities.

Respect for National Sovereignty

One of the problems was that concerning the power to control the corporations or investors in the host state. To address this problem, Art. 7 of the Code states that “transnational corporations shall respect the national sovereignty of the countries in which they operate and the right of each state to exercise its permanent sovereignty over its natural wealth and resources” This would enable the host state to control multinational corporations. Thus, the transnational corporation shall not act contrary to the economic objectives of the host state. On the other hand, the host state is duty bound to fulfil in good faith the international obligations that it had undertaken. It includes obligations in multinational and bilateral treaties.

²⁵¹ **Ibid**, p. 192

Re- negotiation of contracts

The code also created an obligation to renegotiate contracts where the contractual equilibrium that existed at the time that a contract was made has been altered by a fundamental change of circumstances.²⁵² For example, Abebe agreed to construct a bridge on a river. After the contract was concluded, the area where the bridge is to be constructed was damaged by a lightning. Thus, the cost of the construction rises very much. The State could renegotiate the contract. This is inherent in the right of states to permanent sovereignty over natural resources.

Non-interference in domestic affairs – We have seen that states were accusing multinational corporations of interfering in their domestic affairs. To solve this, a duty has been imposed on Trans-national corporations not to interfere in the domestic political activities of the host state or to influence their home states to intervene on their behalf in a manner inconsistent with their obligations under the charter of the United Nations and the Declaration of Friendly Relations between states.

The interference by the multinational corporation in the politics of host state has been proven dangerous. The interference in Chile, for example, resulted in the overthrowing of the government of President Allende, who nationalized the copper mines without paying compensation.

It is worth noting that the requirement of non-interference is an established principle of international law. It recognizes the internal sovereignty of the state.

Abstention from corrupt practices

What do you think is abstention from corrupt practices?

²⁵² Article 12 of the Code

The use of bribery by investors to achieve their objectives has also caused general concern. Therefore, it is required to curb this problem. The USA passed legislation against the use of bribery by their nationals in the conduct of foreign business though the enforcement of the legislation has been eased with the increasing realization that the strict enforcement will place American business at a disadvantage. The UNCTC, on its part, had prepared a draft code on illicit payments but it was not adopted. In many legal systems, it is recognized that international contracts obtained by bribery are invalid.

Economic and other Controls

Controls on transfer of technology, restrictive business practices, labour relations, transfer pricing, consumer protection and environment protection are controls in investment addressed by the code.

Disclosure of information

Similar to the draft code, the duty to make disclosure is now a feature of many foreign investment codes that require that foreign investment should enter through joint venture. Many codes mandate that feasibility studies of the proposed foreign investment projects should be made. Such feasibility reports should contain full disclosure of material information.

Treatment of transnational corporations

The four parts included in the code are:

- a) the recognition of international legal rules and principles relevant to the treatment of transnational corporations;
- b) the requirement of compensation for nationalization;
- c) a provision on jurisdiction; and
- d) dispute settlement.

4.3. THE WORLD BANK GUIDELINES ON FOREIGN INVESTMENT

The former code of conduct emphasized the duties of multinational corporations more than the treatment of them by the host state. Thus, it was not accepted by the international community, particularly by developed states. Therefore, resorting to another option was essential. Thus, in September 1992, the

Development Committee agreed, without reservation, to call attention of the member countries to the World Bank guidelines on foreign investment.²⁵³

What is unfortunate is that the guidelines are non-binding. However, they will be used as arguments to support propositions that are advanced in the field. The standards in the guideline “do reflect emerging, rather than settled standards under contemporary international law”. The guidelines under which developed states have greater voting strength are concerned with the treatment of foreign investors by host states.

4.4. THE WORLD TRADE ORGANIZATION AND TRADE RELATED INVESTMENT MEASURES (TRIMs).

Investment and international trade go hand in hand. Market access through trade can lead to foreign investment; this in turn can lead to additional trade. Investment can be for domestic market as well as for export.²⁵⁴ In short, trade and investment are very much interrelated. Despite this, there is no a comprehensive multilateral agreement on investment.²⁵⁵

However, a serious effort was made in the 1990,s to negotiate a comprehensive treaty on investment, known as the multilateral agreement on investment (MAI). The MAI, which was negotiated by OECD, was intended for the transfer to the WTO. The MAI would have removed barriers to investment, provided protection against expropriation and instituted a dispute settlement system. However, the MAI negotiations failed in the late 1998 and were abandoned. The defeat was related to problems of workers and the environment. NGOs from 70 countries opposed it.²⁵⁶

²⁵³M. Sornarajah; **Ibid**, p. 212

²⁵⁴ Mitsuo Matsuchita, Thomas J. Schoolmarm & Peters C. Marvroidis, **The World Trade Organization: Law, Practice, and Policy**, Oxford University Press, 2003, p.522.

²⁵⁵ **Ibid**

²⁵⁶ **Ibid**, P. 523

Although investment creates jobs, foreign firms can exert too much influence on or dominate economic sectors, especially in developing countries unless they are subject to some controls. Second, there was a fear that liberalization of investment would lead to economic crises since foreign investors could pull their money out. Thirdly, NGOs argue that multilateral companies will use FDI to exploit workers in low-wage countries within adequate labour standards. They also argue that investors will threaten the environment.²⁵⁷

Investment-related measures are addressed in a general manner under Article III:4 and Article XI:1 of the GATT. The TRIMS agreements describe types of trade-related investment measures and add value to the GATT/WTO system. It also includes a transition period during which WTO members agreed to phase out WTO-inconsistent measures that were notified to the WTO under the TRIMs Argument.²⁵⁸

Export requirements – The investor usually is obliged to export a fixed quantity of its total production.

The investor may be required to earmark certain products for export to certain countries, or to produce certain products alone for export.

The investor is required to make a balance between the export and import since import inputs use scarce foreign exchange. This is a trade-balancing requirement.

Local content requirement – The investor is required to use local supplies, raw materials or services as a percentage of local value added in its final product. The investor may provide essential services to other host country industries or to make use of host country personnel.

Investment incentives – TRIMs also include the use of incentives such as tax holidays, tax ceilings and subsidies granted to the investor. Such incentives are intended to raise the profitability of the target firm and hence its competitive position.

²⁵⁷ **Ibid**, P.523

²⁵⁸ **Ibid**

Transfer of Technology Requirements – may take a variety of forms. The host government may stipulate the kind of technology to be introduced into the country or require the investor to license the technology involved in the investment to locals under a process that will phase.

The opposition to the use of TRIMs

Their use had the same effect as the use of non-tariff barriers to trade, which were considered to be inimical to the principles of a “freer” international trade. They were also considered to be inconsistent with the aim of the GATT, which is to promote undistorted competition in the international trade.

The term “trade- related investment measures” (TRIMs) is not defined in the Agreement. It “provides that such trade-related investment measures are subject to the disciplines of GATT Article III (national treatment on internal taxation and regulation) and GATT Article XI (general elimination of quantitative restriction)”.²⁵⁹

TRIMs are defined as some investment measures that are “intended to promote trade policy objectives”. They are aimed at enhancing the international trading objectives of the user countries.

Forms: Trade Related Investment Measures may take the following forms:

- Export requirements;
- product-mandating requirements;
- local content requirements;
- trade-balancing requirements, and
- incentives.

We have seen that the UN conference held in Havana was the first attempt to create International Trade Organization (ITO).

The charter of economic rights and duties to states reasserted the right of all states to regulate, supervise, expropriate and nationalize foreign investment.

²⁵⁹ TRIMs: 8-2

This was the achievement of developing countries. In attempting to attract investment as well as ensure that foreign investment promotes national development, host countries have resorted to the use of Trade-related Investment Measures (TRIMs).

- TRIMs are national policy measures of host countries.
- They are concerned with investment regulation, They affect the problem of multi national Enterprises (MNE). However, TRIMs were not free from contestation

4.5. BILATERAL INVESTMENT TREATIES (BITs)

The trend shows that concluding bilateral investment treaties is increasing. Accordingly, 2,608 agreements and 44 new bilateral investment treaties were signed in 2007.60% of the bilateral investment treaties were concluded by developing countries.²⁶⁰

4.5.1 REASONS FOR BILATERAL INVESTMENT TREATIES

As we discussed earlier, there were several unsuccessful attempts at multilateral investment treaties on foreign investment protection because the developing countries and developed ones do not agree on issues of sovereignty, exploitation of natural resources and internal economic policies.

The developing states have been striving to bring about a New International Economic Order (NIEO), one facet of which is national control over investment and make a multilateral treaty which strikes a balance between the principle of national and the developed ones.

Bilateral treaties, on the other hand, are different from multilateral treaties in that they are made on an *ad hoc* basis and their ability to give rise to general principles of international law is remote. Besides, such

²⁶⁰ United Nation, World Investment Report, **Transnational Corporations and the Infrastructure Challenge**, New York and Geneva, 2008, Pp. 14-5

treaties could be negotiated in such a manner as to suit the mutual interests of the parties, where as a multilateral treaty cannot.

However, it is worth noting that an absence of a consensus to create multilaterally acceptable norms on international investment necessitates bilateral solutions. Realizing the confused state of international law on foreign investment, states entered into such treaties so that they could clarify the rules that they would apply in case of any dispute which may arise between them.

The need for rapid development was felt due to the conflicts which were prevalent in the area of foreign investment. Hence, states had to resort to the second solution by making bilateral investment treaties to ensure that, at least among themselves, there would be definite rules relating to foreign investment.

As a result, former communist states have concluded bilateral treaties since the treaty activity may be to dispel perceptions that they are high-risk countries because of past ideological communcements that opposed the inflow of foreign investments and the notion of private ownership of property.

However, the decision to resort to BITs by various countries is not well -developed.

Often, the same state would accept various standards on areas such as compensation for expropriation, the repatriation of profits and the arbitration of disputes that arise. This would show us that we need to go further to have common rates that govern foreign investment.

The other problem is that a developing state will seek to concede as little as possible, ensuring that the treaty is consistent with its foreign investment laws and its national interests. In the reconciliation of these mutually incompatible aims, making the protection they give to the foreign investors limited. For this reason, each treaty must be taken as a bargain that has been struck between the parties depending on their relative strengths and mutual dependence. This may also explain why the terms in the treaties differ considerably.

Despite this fact it is claimed that these treaties boost investor confidence in the host state, and that as a result more investment flow takes place. However, this is uncertain claim.

In reality, attracting foreign investment rather than creating of a legal structure for its protection is preferred.

The existence of incompatible objectives between the parties to the treaties, the failure of important states to engage in such treaty practice, and the variety of formulations that are included in these treaties make them unsuitable foundations for the making of a customary international law.

4.5.2 FEATURES OF BILATERAL TREATIES

There are similarities among a number of investment treaties concluded by different parties. Let us discuss these similarities as follows;

- A. Aims of the treaty-** are usually the reciprocal encouragement and protection of investment flow between the two states, i.e. the contracting parties.
- B. Property identified** They identify the type of property which is protected, and the nature of the link of nationality to one of the parties that entitles the foreign investor to the protection of the treaty.
- C. Standard of protection-** The standard of treatment to be accorded to the foreign investor is also indicated in the treaty.
- D.** The standard of treatment to be accorded to the foreign investor is stated in an article.

National treatment-BIT includes national treatment standard. According to this standard, each party is duty bound to treat foreign investors no less favourable than that it accords, in like circumstances, to its own investors. The treatment may be with regard to the management, conduct, operation, expansion etc of investments. To determine the concept of “in like circumstances”, we should examine, on a case by case basis, all circumstances of investment including the following among others:²⁶¹

- i) its effects on third persons and the local community;
- ii) its cumulative impacts upon jurisdiction.

²⁶¹ Mann, and Etal; 2005: Art. 5

- iii) the sector the investor is in;
- iv) the main factors should be taken together to determine like circumstances.

Fair and Equitable Treatment is the other form of treatment accorded to investors according to BITs. Thus, each contracting party will be accorded fair and equitable treatment.²⁶² A dispute between the state and an investor may be resolved by negotiations.²⁶³ The dispute may be submitted to a competent court of the contracting state if the dispute is not settled by negotiation within six months. There is an option to submit the dispute to “an *ad hoc* arbitral tribunal or arbitration under the auspices of the International Centre for Settlement of Investment Disputes (ICSID)” if both states are members to the 1965 Convention on Settlement of Investments Dispute between States and Nationals.²⁶⁴ We will deal with this issue in some detail in the last unit of this material.

E. The right of repatriation- The right of repatriation of profit is asserted.

F. Compensation- There are statements on the nature of the compensation, if at all, to be provided to the foreign investor for loss occurring during wars and civil riots.

G. Standard of compensation- The standard of compensation in the event of a take-over of the foreign investor’s property is identified.

H. Settlement of disputes- The procedure for the settlement of disputes arising from the investment by arbitration is stated.

The new trend shows that environmental concerns and social issues are also important.

²⁶² Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the People’s Republic of China; Art. 3(1)

²⁶³ **Ibid**, Art 9(1)

²⁶⁴ **Ibid**, Art. 9(3)

BILATERAL INVESTMENT TREATIES CONCLUDED BY ETHIOPIA.

Ethiopia has concluded a number of BITs

Example: A proclamation to ratify the agreement on the encouragement and reciprocal protection of investments signed between the Great Socialist People's Libyan Arab Jamahiriya Proc. No 406/2004 was signed in Addis Ababa on 27 January 2004. Accordingly, the House of People's Representatives' of the Federal Democratic Republic of Ethiopia ratified the treaty at its session held on the 15th of June 2004.

Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the peoples Republic of China concerning the Encouragement and Reciprocal protection of Investments was also concluded.

1) Aim of the agreement

The intention is to create favourable conditions for investments (see preamble of the agreement)

Admission of investments

Most of BITs, provide that admission of investments should be made according to the laws (legislation, regulations and or administrative practices) of contracting parties.²⁶⁵

Standard of treatment of investment

BITs provide for the obligation of the parties to admit foreign investments, to facilitate the transfer of proceeds of investments. They also impose a duty to agree to a reasonable mode of settlement of dispute arising out of them.²⁶⁶

²⁶⁵ Mehamed I.K khalil, "Surveys of Existing Instruments: Treatment of foreign Investment in Bilateral investment Treaties", **ICSID Review Foreign Investment Law Journal** Vol.7 Number 2, Fall 1992, International Center for settlement of investment disputes, p.350

²⁶⁶ **Ibid**, p.351

2) **Protection of Investment**²⁶⁷

According to the agreement, each contracting party shall encourage investors of the other contracting party. Applicable laws are those of the contracting party. Thus, Ethiopia is required to apply its laws to protect Chinese investors in our country.

3) **Standard of Treatment**²⁶⁸

There must be fair and equitable treatment and protection be given to the investor(s). The treatment shall not be less favourable than that accorded to any third state. What does that mean? Let us assume that the treatment accorded to state A by state B under their bilateral agreement is more favourable than what is accorded by state B to state E. Could state E claim favourable treatment at the level accorded to A instead of what is in the agreement? Or otherwise?

Nevertheless, one party cannot claim a preferential treatment accorded by the other party on the basis of customs union, free trade zones, economic union, etc (Art. 3(3)). This is an exception to the standard of most favoured nation treatment.

4) **Repatriation**²⁶⁹

The investor has the right to transfer his/her/its investments and returns held in the territory of the contracting party. This is a form of guarantee to foreign investment.

5) **Compensation**²⁷⁰

²⁶⁷ Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the peoples Republic of China concerning the Encouragement and Reciprocal protection of Investments, Art. 2

²⁶⁸ **Ibid**, Art. 3

²⁶⁹ **Ibid**, Art-6

²⁷⁰ **Ibid**, Art-5

The host state has the duty to compensate the investor for the loss s/he/it sustains due to war, a state of national emergency, insurrection, riot or other similar events where the state takes measures, or provides treatment less than that accorded to investors of a third state. What does that mean? Does it mean that the compensation is intended to punish (sanction) the state for its failure to protect?

1) **Standard of Compensation**²⁷¹

The contracting state shall neither expropriate the investment, nor nationalize it. The principle is that expropriation is not allowed. Exceptionally, however, expropriation may be made.

- to promote the interest of the public;
- in accordance with the legal procedures of the host state;
- without discrimination;
- by effecting compensation to the investor. Further, the compensation at the time of expropriation must be effected without unreasonable delay. Furthermore, the compensation should be convertible and freely transferable.

2) **Dispute settlement procedure**²⁷²

Any dispute arising from investment transactions must be resolved as agreed by the parties.

Ethiopia has concluded a number of BITs. The agreements incorporate provisions to protect environment. This, as we have seen, is a new trend. In addition, BITs address the issue of dispute settlement in a well defined and detailed manner.

SUMMARY

²⁷¹ **Ibid**, Art. 4

²⁷² **Ibid**, Art- 8

We have discussed in this unit that the five sources of international law indicated under Article 38(2) of the statute of the international court of justice are sources of international law on foreign investment.

Multilateral treaties evidence an acceptance of the principles of international law by the parties to the treaty and are considered as source of international law. However, we do not have a binding multilateral treaty and thus bilateral investment treaties are used. Bilateral investment treaties may create an international law on investment.

A widespread custom expressed in jurics within the international community is the second source of international law on investment because the principles are obligatory. General principles of law are the third source of international investment law. Accordingly, payment of full compensation where investment is expropriated is a good example that is based on the general principle of unjust enrichment.

Judicial decisions inducing arbitral awards are the fourth source of international investment law because they consist of literature that is relevant to solve the case at hand. Writings of highly qualified publicists are the fifth source since they use principles. Judicial decisions and writings of publicists are subsidiary sources of international investment law.

We have seen the efforts made to develop international norms on multinational corporations. Thus, developing countries, socialist countries and UNCTC have come up with their own respective codes (drafts) to regulate the behavior of multinational corporations. However, none of these draft codes were not accepted by all the nations of the world and are not binding.

In 1992, the World Bank introduced guidelines on investment, which were not binding. The guidelines incorporated emerging standards under contemporary international law.

Then, a serious effort was made to introduce a comprehensive treaty on investment called the multilateral agreement on investment (MAI) in 1990's. MAI was intended to remove barriers to investment, provide protection against expropriation and set up a dispute settlement system.

Trade related Investment measures (TRIMs) are also some issues related to investment addressed under the general agreement. However, TRIMs were criticized for being inconsistent with the aim of the GATT.

We have also discussed that the trend shows that the number bilateral investment treaties (BITs) has increased and are intended to regulate foreign investment BIT, and boost investor confidence in the host state to invest. BITs are aimed to encourage investment and protect the investment flow between the parties. Ethiopia concluded BITs to promote and attract foreign direct investment and to regulate the same.

Review Questions

I) True /False

- _____ 1) Bilateral investment treaties concluded by Ethiopia encourage expropriation of investment property.
- _____ 2) Today bilateral investment treaties indicate systems of dispute settlement and the procedures.
- _____ 3) Bilateral investment treaties came into being since there is no binding multilateral investment treaty.
- _____ 4) The 1992 World Bank investment guidelines are binding Ethiopia.
- _____ 5) The code of conduct prepared by the developing states was accepted by the United States of America.

II) Answer the following questions

1. Discuss the reasons for the absence of binding multilateral investment treaties in the world.
2. Analyze the concept of trade related investment measures.
3. What were the reasons behind different codes of conduct? Compare each of them.

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Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the Peoples Republic of China concerning the Encouragement and Reciprocal protection of Investments.

UNIT FIVE: REGULATING AND ADMINISTRATION OF INVESTMENT IN ETHIOPIA

UNIT OBJECTIVES

After completing this unit, students should be able to:

- ◆ define regulation;
- ◆ analyse the principles of good regulations;
- ◆ rationalise the need to regulate foreign investment;
- ◆ discuss the role of the Ethiopian government in controlling, supervising and regulating investment;
- ◆ analyse the applicability of the rules of investment in Ethiopia.

INTRODUCTION

In Unit Three, we discussed the international efforts made to regulate the conduct of transnational corporations in the area of investment. In this unit, we will be discuss the issue of regulating investment by the host states (national regulation).

Investors are traders, who may be individuals or those organized in the form of a business organization. Thus, as traders relevant laws regulating trade are applicable to them. In this unit, we will discuss the nature and definition of regulation in general, and the regulation of investment in particular. Regulation of investment must be based on the principles of good regulation. In other words, there must be a good regulation of investment, and therefore, we will consider this point under the second topic.

Why we need to regulate investment? This is an important inquiry which will be addressed under the third topic of this unit. Further, we will discuss the issue with regard to regulation of investment in Ethiopia. Under this topic we will consider the constitutional frame work of investment and our economic policy. In addition, we will discuss the areas that are reserved for domestic investors, Ethiopian nationals, and our government. Next, we will consider the restrictions imposed upon foreign direct investment. The section is also devoted to the procedures of investment permit in addition to issuance of business licence. We have questions on each topic. Finally, we have included review questions after summarizing essential points considered under this unit.

5.1) DEFINITION AND NATURE OF REGULATION

What do we mean by regulation? Regulation is a normative standard that should be obeyed, and a violator must be forced to comply where there is non-compliance. Investment regulation may be defined as control of the government on investment.²⁷³ There are three types of regulation: market regulation; industry regulation; and government regulation. Each type of regulation has its own advantages and

²⁷³ See George A. Steiner and John F. Steiner, **Business, Government, and Society: A Managerial Perspective, Text and Cases**, 2006, p. 287

drawbacks. A market regulation is aimed at guaranteeing efficiency, flexibility, and low costs. However, market regulation provides uncertainty and instability for participants, notwithstanding that they are producers, employees, or consumers. Thus, market regulation has a drawback of instability and uncertainty because it is the market which leads the sector.

Industry regulation may be cooperative or imposed by dominant enterprises. Industrial regulation has the advantage to eliminate the instability for both the business organizations and the employee. However, this could be achieved at the cost higher than necessary profits and inefficient allocations of a product. On top of that, there is no guarantee that the products' quality will be kept high.

Governmental regulation aims at fairness, non-discrimination, consumer protection and quality maintenance. The problem with government regulation is that it may be inflexible in guaranteeing efficient allocation. There should be governmental machineries that are necessary to provide regulation and to monitor compliance with appropriate budgetary allocation to run them. Thus, it is necessary to have qualified personnel in sufficient number to make governmental regulation effectively functional. These personnel must be salaried; they need on the job trainings and so on. The industry being regulated also needs to set up personnel and procedures to guarantee compliance with government regulation, which involves additional costs. Therefore, government regulation is costly.²⁷⁴

Nowadays there is a need to regulate business due to failure of various businesses as a result of incompetent management, or fraud or a mixture of both or any other reason. Thus, it is essential to regulate the business in general and the investment in particular. Why do we need to regulate investment?

Governments and regulators need to ensure stable and competitive markets for services and goods, and conducive atmosphere for companies to be successful and reputable in the business. Failure of companies, particularly, as a result of fraud or mismanagement would damage the trust of the market as a whole and has a negative impact upon the confidence of people in general, and the growth and economic stability of a nation. Therefore, there has been a growing need to regulate business by governments and regulators to

²⁷⁴ **Ibid**

establish formal standards and rules for traders to abide by and thus to protect consumers.²⁷⁵ Investment, as a business, cannot be an exception to such regulation and supervision.

Concerning this the Commercial Code of Ethiopia of the 1960 in its preface provides that “...We have directed that in the expansion and consolidation of our commercial laws, great attention should be given to the control of all trading, ...” which shows that regulation of traders in general is needed to control their activities.

Governance system

The quality of government policies and institutions is a determining factor in ensuring sustainable development gains from investment. Policy making may be aimed at short term gains rather than long-term development objectives in developing countries. The distribution and use of host countries share on revenue maybe determined with little attention to development considerations. In general, these factors underscore the importance of developing a legal system based on the rule of law as well as an intuitional environment in which enterprises have incentives to invest in productive activities.²⁷⁶

According to Proclamation No. 280/2002, the system of administration of investment should be transparent and efficient.²⁷⁷ Therefore, the main purpose of regulating investment is to ensure transparency and efficiency in the investment administration. In general, the need for governments to control, regulate or participate in investment springs in part from political philosophy, and in part from economic necessity. We may also find a mixture of both types of reasons for regulating investment.²⁷⁸ In this unit, we will discuss issues related to investment regulation.

In general, a regulation that fosters investment and free market competition is said to be a good regulation

²⁷⁵ **Ibid**

²⁷⁶ Robert Pretchard (Editor), **Economic Development, Foreign Investment and the Law: Issues of Private Sector Involvement, Foreign Investment and the Rule of Law in New Era**, 1996, p.

²⁷⁷ Proclamation No 280/2002, preamble 3rd paragraph

²⁷⁸ K. G. Friedmann, **Legal Aspects of Foreign Investment**, 1959,p. 750

Questions

- 1) What do we mean by regulation?
- 2) Explain the concept of market regulation.
- 3) Do you believe that governmental regulation helps to achieve fairness and maintain quality? Reason out.
- 4) Discuss, how industry regulations are imposed by cooperative.
- 5) Discuss the necessary conditions that must be fulfilled to implement governmental regulation properly.

5.2) PRINCIPLES OF GOOD REGULATION

In regulating investment, it is imperative to focus on how to constructively harness the innovative power and motivating business enterprises so that they could meet the needs of society without weakening the unique characteristics of a free society.²⁷⁹

According to study by the World Bank, a country that wishes its economy to perform well should take the following five steps.²⁸⁰

- A) **Simplify and deregulate in competitive markets-** The regulation should be based on the principle of competition, and it should be simple. In addition, it is required to be deregulated so as to give the responsibility to the investors.
- B) **Focus on enhancing property rights-** Business in general, and investment in particular, requires the rights of property of the persons to be protected and enhanced. In other words, the law of investment must enhance the right of property so that potential investors could invest safely.

²⁷⁹ George and John, **Ibid**

²⁸⁰ **Ibid**, p. 306

- C) **Expand the use of technology**- For an investment to be effective in bringing development to a country it must use recent technology. Therefore, the regulation should ensure this.
- D) **Reduce court involvement in business matters**-Settlement of disputes in court may develop a sense of hostility between the parties. To avoid such unwarranted relationship, the regulation of investment is required to reduce the involvement of courts.
- E) **Make reform a continuous process**- Once a regulation is made, it must be reformed so as to fit to the new changes to investment.

In the UK, the following are recognized as principles of good regulation.²⁸¹

- A) Using resources **most efficiently** and **economically**;
- B) **Being proportionate**, This means the role and actions of the regulator must be proportional to the significance of the issues and risks under consideration. By the principle of proportionality, minor issues should be given less attention while major issues significant attention;
- C) **Responsibility of firms' own management**. The company management should take responsibility for running the business in a proper manner and maintain adequate financial resources. Here, it is emphasized that it is not the role of the regulator to run companies; it is the responsibility of the company management to take responsibility for complying with the rules and guidance that are established by the regulator in the most appropriate manner.
- D) **Competition**- The market needs competition among investors, and the regulation should foster that.
- E) **Facilitating innovation**- The regulations and standards should facilitate innovation of investors in their activities.

Questions

1. Efficiency is a principle of good regulation. Discuss.
2. A good regulation facilitates innovation. Comment.
3. Explain why competition is considered as a principle of good regulation.

5.3) THE NEED TO REGULATE INVESTMENT

²⁸¹ Derek Atkins and Ian Bates, **Risk, regulation and capital adequacy**, (2004), p. 11/8 , See also Tesfaye Abate, **Insurance Intermediaries in Ethiopia: The Law and the practice**, 2006, p.58

Foreign investment often appears to be both real and psychological infringement on sovereignty. There are special concerns that the foreign firm will operate without adequate consultation or to the detriment of local interests in such areas as labour policy or willingness to create export revenues for the host nation.

At the same time, foreign investment is often seen as a way of bringing technology and employment. Thus nations have a variety of laws dealing with foreign investment. Some seek to attract foreign investment through tax holidays and special privileges. Some others seek to regulate it. They may control the areas of investment, for example, in order to keep foreign investment out of sensitive areas like telecommunications or the media; they may control the terms of investment, by restricting rates at which profit may be expropriated; or they may protect specific local concerns for instance those the deal with labour.

States need to maintain effective control over their economic environment.²⁸² Investment is an economic activity and, therefore, the government should regulate it. Thus, the right of a state to control entry of foreign investment flows from sovereignty is unlimited. Hence, entry of any foreign investment can be excluded by a state. However, once an alien enters a state, both s/he and his/her property are subject to the law of the host state. This stems from the fact that the foreign investor had voluntarily subjected him/herself to the regime of the host state by making entry into it.²⁸³ But, this does not mean that international law on foreign investment is excluded: it is also applicable.

Therefore, conditions could be attached to the entry of a foreign investor into a host state. Conditions could also be attached to the manner in which s/he operates his/her business. The proposition applies equally to a foreign corporation which makes the investment. The draft code of conduct on transnational corporations states a similar proposition in the following terms:²⁸⁴

States have the right to regulate the entry and establishment of transnational corporations including determining the role such corporations may play in economic

²⁸² John Barton and Bart H. Fisher, **International Trade and Investment, Regulating International Business**, 1986, pp. 858-861

²⁸³ M. Sornarajah; **The International Law on Foreign Investment**, 1996, p.83

²⁸⁴ **Ibid**, p. 84

and social development and prohibiting or limiting the extent of their presence in specific sectors.

In short, states have the power to control foreign investment in their jurisdictions. This is a universally recognized rule. The conflict between the liberal idea of free flow of investment with the notion of sovereign rights to control the entry of investment is evident, however. Powerful states which see benefits in maintaining the stance of economic liberalism, have not been able to adhere to such liberal ideas in their own policies. Economic liberalism has remained an ideal whereas the prerogative power of the sovereign state to exclude aliens or to impose condition on their entry is an accepted principle of the law.²⁸⁵

On the basis of the principle that conditions may be imposed upon alien entry, the whole process of foreign investment under the host country jurisdiction may be controlled by the host state's laws. The law of the host state may specify the legal vehicle through which the foreign investment should be made; the nature of the 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 the termination of the foreign investment; and other similar matters. While regulating the entry of foreign investment, a state may also seek to attract foreign investment into its territory by holding out incentives attractive to such investors. Generally, such legislation takes the form of a code or a single piece of legislation which states all the pertinent rules relating to the making of a foreign investment in a state. Besides facilitating the promotional purposes behind such codes, the existence of a single code enables the foreign investor to acquaint him/herself with the laws on foreign investment of a state more easily.²⁸⁶

What is the purpose of domestic laws in regulating investment? The objective of the domestic laws regulating both the entry as well as the operation of foreign investment in the host country is to enlarge the scope for domestic control. As a result, the role, if any, which international law plays in the process of foreign investment is restricted. It is worth noting that the techniques and the degree of control adopted in such legislation may differ. Nevertheless, they all aim to subject the process of foreign investment to the administrative control of the host state. In some legislation, the vehicle through which foreign investment

²⁸⁵ **Ibid**, pp. 85-6

²⁸⁶ **Ibid**, p. 86

could make entry is identified. The host state seeks to increase its leverage over the foreign investment by limiting entry through devices over which control could be more easily exercised. Thus, the foreign investment laws could indicate that entry could be made only through a joint venture with a local partner and specify the type of shareholding that the foreign party could have. In many instances, the joint venture could be made only with a state entity, thus ensuring that the government policy in a particular industry is given expression at every stage of the venture in which the foreigner participates.²⁸⁷

There are some emerging patterns with respect to regulating foreign investment. A United Nations report described the trends relating to foreign investment legislation in developing countries in the following term:²⁸⁸

In the early 1970s, fortified by their strengthened bargaining position as the centres of economic growth and as recipients of investments by transnational corporations in the developing world, most of these countries introduced rigorous regimes for foreign investment and technology. The basic objective of such regimes was not to discourage or diminish the flow of foreign resources but to regulate them. These regulations provided, inter alia, for the screening and registration of foreign investment; the prohibition or restriction of foreign participation in specified sectors; the control of take-overs; the restriction of foreign capital to minority holdings in certain sectors; specific regulation of technology agreements; the prohibition of restrictive business practice; and performance requirements for subsidiaries of transnational corporations, such requirements relating to exports and integration with the domestic economy. However, since the mid-1970s, many of these countries have initiated policies and strategies that depart in certain significant respects from these early regimes. These new policies on the whole portray a more flexible and pragmatic approach aimed at facilitating and speeding up foreign investment inflows.

We can observe that the developing countries are getting stronger in regulating the inflow of foreign investment through laws. Thus, they could regulate the entry by screening and registering. Further, they could identify sectors in which foreigners may invest. The form of investment in terms of whether to

²⁸⁷ **Ibid**, p. 89

²⁸⁸ **Ibid**, p. 91

invest with local investors, government or by themselves. Recently, they adopted pragmatic approach with the intention of encouraging the inflow of foreign investment. Hence, foreign investment comes to be made not only based on a contract of investment as in the past but also on the basis of licenses granted by the regulatory body. The process of entry ceases to be a private law measure alone and assumes features of public law.²⁸⁹

Furthermore, since the early 1980s we have witnessed widespread a tendency towards liberalization of national laws and regulations relating to foreign investment, especially in developing and transition countries. In many cases, this liberalization of foreign investment policies and regulations has been part of broader market-oriented reforms of economic policy and corresponds with trade liberalization, deregulation and privatization.

The recent trend to formulate more open investment policies has been particularly evident in the removal or relaxation of regulatory barriers to the entry of Foreign Direct Investment (FDI). Screening procedures involving prior authorization have been eliminated or reduced in scope. Closely related is the liberalization of sectoral restrictions on the entry of foreign investment and of limitations regarding foreign shareholding in local companies. There has also been a shift away from the imposition of performance requirements and a liberalization of regulations concerning the transfer of funds. In addition, there has been increasing acceptance of standards of non-discriminatory treatment of foreign investors and of international standards on matters such as compensation in case of expropriation. Finally, international arbitration mechanisms for the settlement of disputes between foreign investors and host states have gained widespread acceptance.

At the same time, there are several qualifications to the liberalization trend. First, the trend has not been homogeneous and significant differences between foreign investment regimes persist. Second, virtually all countries maintain some restrictions, often of a sectoral nature, on the entry of foreign investment. In this connection, an issue that has attracted attention is the existence of reciprocity requirements with regard to the entry and treatment of foreign investment.

²⁸⁹ **Ibid**, p. 92

The liberalization of national laws and regulations has been accompanied by a rapid proliferation of intergovernmental arrangements dealing with foreign investment issues at the bilateral, regional and plurilateral levels. Unilateral liberalization of national legal frameworks has not been found sufficient, and states around the world have increasingly recognized the crucial importance of international commitment to securing a stable and predictable legal environment for FDI.

In Ethiopia, foreign investment is regulated by legislation. In Ethiopia, the investment legislation has been amended now and then to incorporate changes at the international arena and to tune the laws in line with the concept of liberal economy. Today, Proclamation No 280/2002, Investment Proclamation, as amended by Proclamation No 375/2003, Investment (Amendment) Proclamation, is intended to regulate investment in general, which include foreign investment. To apply this parent legislation, Council of Ministers Regulations No 84/2003, Regulations on Investment incentives and Investment Areas Reserved for Domestic Investors, is enacted. The fundamental reasons for enacting this those legislation are provided under the preamble of the legislation as follows:²⁹⁰

UHEREAS, the encouragement and promotion of investment has become necessary so as to accelerate the economic development of the country and to improve the living standards of its peoples;

WHEREAS, in addition to that of domestic investors, it is deemed essential to widen the scope of participation of foreign investors and to facilitate conditions thereof with a view to enhancing the country's investment activities;

WHEREAS, the system of administration of investment needs to be transparent and efficient;

In general, host states have the right to regulate investment activities which are internationally recognized. There is a need to foster the economy of the host state by allowing investors to undertake investment activities. But, it is essential to note that there are areas states need to control, on the grounds of security and other public policies.

²⁹⁰ Proc. No 280/2002 and 375/2003

Questions

- 1) Why do government want to regulate investment in general?
- 2) Analyze the power of government to regulate foreign investment.
- 3) Do you believe that the role of international law should be restricted in regulating foreign investment in a host state? Give your reasons.
- 4) There is an argument for the liberalization of national laws and regulation relating to foreign investment. On the other hand, governments want to secure some activities. What should be done?
- 5) Which law regulates foreign investment in Ethiopia?
- 6) How do you assess the regulation of investment in Ethiopia?

5.4REGULATION OF INVESTMENT IN ETHIOPIA

We have seen that regulating investment is essential in general. Ethiopia also regulates investment activities under the Constitution, the economic policy and other laws. In this section of the material, we will discuss how investment is regulated in Ethiopia.

5.4.1 Constitutional Framework of Investment in Ethiopia

In the United States of America, the Commercial Clause of the Constitution grants Congress the power to regulate foreign commercial transaction and among the several states. The clause is intended to foster the development of national market and free trade among the states.²⁹¹ According to 18 of the US Constitution, the Federal Government has the power to regulate inter state investment. The modern rule allows the federal government to regulate investment activities that affect interstate. Pursuant to this,

²⁹¹ Henry R. Cheeseman, **The Legal and Regulatory Environment: E-commerce, International, and Ethical Environment**, 2002, p.58

the regulated activity does not itself have to be interstate. Therefore, any local activity that has an effect on interstate incitement is subject to federal regulation.²⁹²

Coming to Ethiopia, the Federal Government is duty bound to ensure that all Ethiopians are given equal opportunity to improve their economic conditions and to promote equitable distribution of wealth among them.²⁹³ The Government is granted the right to own land and other natural resources on behalf of the people and to deploy them for their common development and benefit.²⁹⁴ Thus, the federal government is required to regulate land and other natural resources use for investment. Without regulation, these natural resources could not be used effectively and efficiently to bring the development of the people. The Federal Government is also duty bound to formulate policies which ensure that all Ethiopians can benefit from the legacy of intellectual and material resources of Ethiopia.²⁹⁵ This indicates the power of the government to regulate investment activities that enable people to use the intellectual and material resources.

The FDRE Constitution grants the House of Peoples' Representatives the power to legislate law on the utilization of land and other natural resources.²⁹⁶ We have seen that land and other natural resources are essential for investment. Granting the power to enact law on how to use natural resources, at least by implication, means granting power to regulate investment.

The Constitution further grants power to the Federal Government to enact law on interstate commerce and foreign trade under Article 55(2)(b). The Commercial Clause, of the United States of America discussed above, seems to be incorporated in our Constitution. Therefore, it would be safe to conclude that the Federal Government has the power to regulate inter-state commerce in general and investment in particular. The Constitution also grants the power to regulate foreign trade. What is more, the federal government has the power to enact Commercial Code.²⁹⁷ We discussed, the first unit that Commercial Code (law) is a law that governs investment and, therefore, the federal government is given the power to enact investment law. In other words, the federal government is granted the power to regulate investment: interregional and foreign investment.

²⁹² **Ibid**, P.59

²⁹³ FDRE Constitution, Art, 89(2)

²⁹⁴ **Ibid**, Art. 89(5)

²⁹⁵ **Ibid**, Art.89(1)

²⁹⁶ **Ibid**, Art.55(2)(a)

²⁹⁷ **Ibid**, Art.55(4)

5.4.2 Economic Policy of Ethiopia

What do we mean by economic policy? The term economic policy is coined from two concepts: economy and policy. Policy is defined as “the general principles by which a government is guided in its management of public affairs”.²⁹⁸ Economy means “the management or administration of the wealth and resources of a community”.²⁹⁹ Combining the meanings given to the terms, economic policy may be defined as the general principles by which a government is guided in the management or administration of the wealth and resource of a country. In other words, economic policy embraces the principles by which a given government is guided to administer the resource of a country. Simply stated, economic policy is a set of rules that may lead to some desired end of the society.³⁰⁰

Economic policy has three main parts: objectives of the economy; economic instruments; and economic models. Policy makers and governments always speak about economic objectives and instruments; they do not often economic models.³⁰¹

A. Economic Objectives are the desired results and goals by the policy. Economic objectives, in poor countries like Ethiopia include the following two.³⁰²

- I) **Macroeconomic stability** concentrates on the balance of payment and the saving investment balance of the government. The main ones that play a great role in macroeconomic stability are components of aggregate demand, volume of credit, wages and profits, prices and foreign exchange.
- II) **Growth and development** concentrates on issues that play pivotal role in the development process of a nation. Production structure and development, citizen’s opportunity to employment and investment determine the process of development and include rural urban migration,

²⁹⁸ Bryan A. Garner, **Black’s Law Dictionary**, 2004, p-1196

²⁹⁹ Ibid, P.553

³⁰⁰ Ne-Thi. Somashekar, **Development and Environmental Economics**, 2003, p.634

³⁰¹ Alemayehu Syoum Tafesse, “**Economic Administration and the Ethiopian development: some perceptions,**” Ethiopian Economic Professionals Workshop paper (in Amharic), 1996 (EC), P.222

³⁰² Dervis, Kemal, Jaime de Melo and Sherman Robinson in Alemayehu, **Ibid**, P-223

increase the number of the worker, development in productivity, trade structure, allocation of investment and demand structure.

B. Policy instruments are methods by which we implement policy objectives. Detailed policy instruments of a given country are partially determined by the structure of the government itself. Policy instruments in a free market economy include finance administration policy, (type of taxes, government expenditure), monetary policy (provision of money, reserve requirements), interest.

C. Economic models deal with how the economy is transacted (the structure, opportunities and challenges), how the policy instruments are interconnected with the economic policy objectives and other similar matters. It may indicate the economic theorizing and empirical evidence of the perception.

The goal of the economic policy must be to improve the life of citizens. To achieve this goal the economic policy is required to persuade the participants in the economic development (individuals, family members, economic enterprises).³⁰³

The Ethiopian economy at the time of Derg regime was based on socialist principles where the government controlled the economy. During the transition period, Ethiopia issued an economic policy that would lead the economy to free market. The policy underlines that saving and investment play a critical role in the economic growth of Ethiopia, the expansion of employment opportunities and the improvement of the living standards of the people. It also underscores the decline in investment may be attributed among other to wrong policies of the past government.³⁰⁴

The transitional economic policy clearly indicates that the past economic policy violated the rights of individuals to work and own property because it gives total control of the resources of the country to the government. This old policy must be replaced by an appropriate new economic policy since the former prevented the public from playing an active role in the economy.³⁰⁵ Thus, it was felt necessary to

³⁰³ Alemayehu, **Ibid**, P-224

³⁰⁴ The Transitional Government of Ethiopia, **Ethiopia's Economic policy during the Transitional Period**, 1991, P.7

³⁰⁵ **Ibid**, P.14

change the role of the state in the economy, so as to embark on economic recovery. To this end, the role of the government is .³⁰⁶

- To design economic policies; to promulgate laws and regulations that increase the speed of economic development;
- To invest jointly or alone in areas that are considered essential and in areas where the private sector is not willing to invest.

In general, the economic policy is intended to promote and encourage private capital participation in investment. and the role of government is to create enabling conditions for the mobilization of both domestic and foreign private capital in various economic activities.³⁰⁷ Further, the policy makes clear that adequate guarantee will be given to private investors.³⁰⁸ It is also indicated that sectoral policies, laws, regulations and detailed implementation procedures will be issued to implement the economic policy.³⁰⁹

Then economic reform was made in Ethiopia in 1992 with the support of and pressure from the World Bank /IMF and various donors including UNDP to free market economy.³¹⁰ The reform was made with the following main aim:³¹¹

...to bring about macroeconomic stability and socio-economic recovery as well as create a conducive environment for private sector participation, so that the private sector becomes the main actor in the productive sectors of the economy while the public sector concentrates on the social sectors and infrastructural development....

An economic reform, i.e. liberalizing and deregulation is not peculiar to Ethiopia. Kenya, for example, adopted an economic policy that emphasized the need to liberalise and deregulate the economy in order to create a conducive environment for the development, stability and growth of enterprises. In 1993, the government of Kenya issued a policy document jointly with the UNDP in which the role of the government was indicated to be regulatory and policy environment supportive of entrepreneurship in

³⁰⁶ **Ibid**, 1-1

³⁰⁷ **Ibid**, 1-2

³⁰⁸ **Ibid**, 3-2-1

³⁰⁹ **Ibid**, 9

³¹⁰ UNDP **Development Cooperation Ethiopia**, 1998, p.6

³¹¹ **Id**

general. The policy re-examines and tackles “the inhibiting general policy framework; inadequate infrastructure; poor access to technology; limited markets; cumbersome laws and regulations, affecting the economic sector”.³¹²

The governments of Tanzania and Uganda have promulgated similar comprehensive policies. This indicates that a government can play a role in the development, in reshaping the structures of power, production and distribution. Thus, if the laws and regulations are changed and simplified they will have a potential for catalysing growth.³¹³

Privatization is the transfer of assets and functions from public to private hands by selling or contract.³¹⁴ The basic argument for privatization is that the private investors can do the activities more cheaply and efficiently than state and local governments. However, that is not always true: it is confirmed by research that sometimes the costs and efficiency are about the same.³¹⁵

Privatization has been made in Ethiopia but it faces problems. For example, corruption in the process has been identified. Privatization may be whole or part.

Deregulation is also essential in market oriented economy. It refers to the removal or substantial reduction of government regulations of entire investment.³¹⁶ Proponents of privatization argue that it brings competition and lowers prices. They further claim that it stimulates innovation and stops government abuses. However, it may result in high prices, proper service, and lower productivity.³¹⁷

5.4.3 Areas Of Investment Reserved For Domestic Investors

³¹² Gok-UNDP-1993 in Paschal B.Mchy, “The Regulatory Framework and small-and micro enterprise Development in Eastern Africa,” **Eastern Africa Social Science Research Review**, vol.13 No 2, June 1997, p.46

³¹³ Paschal B.Mchy, “The regulatory Framework and small-and micro enterprise Development in Eastern Africa,” **Eastern Africa Social Science Research Review**, vol.13 No 2, June 1997, p.46

³¹⁴ Demelash Habte, “Experiences of privatization: Lessons for Africa”, **Ethiopian Journal of Business and Development**, vol.1 No 1, 2006, P.55

³¹⁵ George A. Steiner and John F.Steiner, **Business, Government, and Society: A Managerial perspective, Text and Cases**, 2006, P.321.

³¹⁶ **Id.**

³¹⁷ **Ibid**, p. 322.

We have seen that investors could be categorized into domestic or foreign investors. This classification has consequences, among which, is that there are areas of investment reserved for domestic investors only. can you guess what activities are reserved for domestic investors? Well, you can refer to the schedule attached to regulations No 84/2003.

It includes wholesale trade and distribution (except fuel and the domestic sale for locally produced goods from foreign direct investment); importing (excluding material inputs for export production); exporting raw coffee, oil seeds, 'chat', pulses, hides and skins, live sheep, goats, and cattle (not fattened); construction companies (except grade 1); tanning of hides and skins up to crust level; hotels (except star designed ones), motels, pensions, bakery and pastries; car here, taxi, road and inland water transport services; grinding mills, saw milling, timber making; customs clearance services; museums, theatres and cinema hall operations; and printing industries.³¹⁸

It is only Ethiopian nationals who can invest in the financial sector (banking, and insurance) forwarding and shopping services, broadcasting services and air transport service with the capacity of up to 20 passengers.³¹⁹

What are the reasons for excluding foreigners from investing in the abovementioned areas?

In general, the motives behind restrictions vary. Nationalism and the desire to exclude foreign interests from controlling and exploiting natural resources may be another justification for excluding foreigners.³²⁰

Under the Ethiopian law, the exclusion of foreigners from the economic sectors may be justified in that vital public services should not fall under foreign control.³²¹ It is essential to note that areas of investment we considered above are exclusively reserved for domestic investors³²². How do you see this restriction from the liberal economic policy point of view? We have discussed earlier that there are some qualifications made by countries in the application of liberal economic policy, and we find some restriction. The Ethiopian laws may also be seen from this point.

5.4.4 Sectors Open To Ethiopian Nationals

It is observable that foreign investors are not allowed to invest in economic sectors. What are these sectors? Banking, insurance, broadcasting air transport with capacity of up to 20 passengers and

³¹⁸ Schedule 1

³¹⁹ **Ibid**; p 2

³²⁰ Friedmann; 1959: 746

³²¹ **Ibid**

³²² Art. 3 of Reg. No. 84/2003

forwarding and shipping agency services are reserved only for Ethiopian nationals.³²³ The government reserved these sectors only for Ethiopian nationals because they are strategic.³²⁴

5.4.5 Sectors Reserved To The State

There are sectors exclusively reserved for the state. Can you enumerate these sectors?

Pursuant to Article 5(1) of the Investment Proclamation No 280/2002 (as amended), our state has an exclusive right to invest on the following sectors.

- i) **Electric power** –the Ethiopian government is given the right to invest on transmission and supply of electric power through the integrated national grid system; and
- ii) **Postal services** –Only our government is allowed to invest on postal services. However, courier postal services are excluded. Therefore, such a sector is open to other investors. The security is probably the reason for the exclusion of others.
- iii) **Air transport**- The government is also given the power to invest on air transport services using air craft with a capacity of more than twenty passengers.³²⁵

5.4.6 Sectors Open To Joint Investment

Three are also areas open to joint investment. Thus, investors (domestic and foreign), in cooperation with the Ethiopian Government, are allowed to invest on the following economic sectors.³²⁶

- i) Manufacturing of weapons and ammunition; and
- ii) Telecommunication services (Proc. No 280/2002 Art. 5(2)].

In general, according to Article 12(3) of Proclamation No 280/2002, (as amended), an investor of Ethiopian national or foreign national has the right to invest in Ethiopia in conformity with the relevant laws of Ethiopia, in areas not eligible for incentives or if s/he waives the privileges for incentives. Thus, his/her rights are not affected by the provisions of Article 12 of the Investment Proclamation, which deals with investment permit.

Does that mean that such investors are not duty- bound to have permission for investment?

³²³ Regulations No. 84/2003; Schedule 2

³²⁴ Booz, Allen and Hamilton; 2007: 81

³²⁵ See **The Business of Excellence Investment Guide to Ethiopia**, 2007, P.30

³²⁶ See USAID; 2007:81

Pursuant to Article 12(1) of the Proclamation, investors who are required to obtain investment permits are:

- i) Foreign investors;
- ii) Foreign nationals who are considered to be domestic investors for they permanently reside and invest in Ethiopia with their will (see Art 2(5) of the Proclamation) except Ethiopian by birth;
- iii) Domestic investors investing in areas eligible for incentives;
- iv) Investors (domestic & foreign) making investment in partnerships.

In case of portfolio investment, a foreign investor must obtain an approval from the Ethiopian Investment Commission (EIC) to purchase shares in Ethiopian enterprises.³²⁷ Further, prior approval is required for a foreigner to purchase an enterprise and operate it as it stands in Ethiopia.³²⁸ Thus, investors other than these stated above seem not to be required to obtain an investment permit to invest in Ethiopia. However, they are required to comply with the Ethiopian laws to carry out investment in the country, one of the requirements being license.

5.4.7 Procedures of Investment in Ethiopia

A domestic investor needs to apply to the Ethiopian Investment Commission for investment permits.³²⁹ The EIC should prepare forms to be filled by the investor, and an investor is required to fill out the form. In addition, s/he/it must submit the following documents:

- i) An agent must submit a photocopy of his/her attorney where the application is made by an agent;
- ii) An intended investor individual should submit a photocopy of his/her identity card, or a photocopy of the certificate showing the status of the applicant;
- iii) In case of investment by a business organization, photocopies of its memorandum of association and articles of association should be submitted;

³²⁷ Art 12(2) of the Proclamation

³²⁸ Ibid

³²⁹ Art. 13 of Investment Proclamation

- iv) Where the investment is to be made by newly established business organization, photocopies of memorandum of association, and articles of association, in addition to identity cards or certificates that show the status of the investor must be submitted;
- v) Where investment is made by a public enterprise, a photocopy of the regulations that established the enterprise or a memorandum of association and articles of association;
- vi) Where the investment is intended to be made by a cooperative society, a photocopy of its articles of association must be submitted.

A foreign investor, similarly, is required to submit

- i) the documents we discussed above (i-v) including copy of pass ports;
- ii) If the investment is to be made by a branch of a foreign business organization in Ethiopia, copies of memorandum of association and articles of association or a similar document;
- iii) If the investment is intended to be made with Ethiopian investors, identity card of the latter's must be submitted.

An investor may upgrade the already existing investment. In such a case, the investor is required to apply for a permit with the following documents:³³⁰

- i) Where an application is made by an agent, the attorney power document;
- ii) Where the investment is made by a business organization, photocopies of its memorandum of association and articles of association; and
- iii) Photocopy of a valid business license of the existing business organizations.

Upon receiving the relevant documents, the relevant authority must examine the intended investment activity in light of the investment proclamation, regulations and directives. Then, the authority is required to decide upon the application within five working days.³³¹ This is intended to speed up the process. Accordingly, the authority may issue the investment permit upon receiving appropriate fee where it is in the opinion that the investment is beneficial to Ethiopia. However, it may reject the application where the investment is not beneficial to Ethiopia. In such a case, it is required to provide a writer explanation as to why it rejected the application.

³³⁰ Art 15 of Investment Proclamation

³³¹ Art. 17(1) of Investment Proclamation

After issuing an investment permit, the appropriate investment organ must notify the concerned government institutions so that they can follow up the investment transaction.³³² The investor, on his/her part, is duty bound to report to the appropriate investment organ on the implementation of the project.³³³ This offers the opportunity for the investment organ to control, and follow up the investment implementation.

There could be a situation whereby the investor is delayed in the completion of the implementation of the investment project. In such a case, the investor is required to renew annually the investment permit. Thus, the investor must apply for renewal at least a month before the expiry of a year for which the permit remains valid.

The appropriate investment organ is empowered to suspend the investment permit where the investor violates the investment proclamation, regulations and directives, until it takes corrective measures.³³⁴ Further, the authority has the power to revoke the investment permit:

- i) Where the investor has obtained the permit illegally, particularly by fraud or on the basis of false information submitted;
- ii) The investor gives the permit to another person without prior authorization of the investment organ;
- iii) Where the investor misuses the incentives or transfers them to another person;
- iv) Where the investor failed to renew the permit without good cause;
- v) If the investor carried on business without a business license.

In general, we can safely conclude that the Ethiopian Investment Commission is efficient in granting investment permission. Investors also agree that the Commission is efficient in granting permission, but it could not help investors to get into the investment activities; other requirements for example are needed land. They underscore that the Commission is only facilitator.³³⁵ The 2003 revisions of the investment proclamation and the reform have made the process of investment approval simpler and more

³³² **Ibid**, Art. 17(2)

³³³ **Ibid**, Art. 17(1)

³³⁴ **Ibid**, Art. 18(1)

³³⁵ Interview with Ato Mulugeta Abate, Ato Husensayed Abdela, and Ato Yohannes, on July 3, 2008

transparent.³³⁶ However, that should not be taken as an end by itself because it does not achieve the investment purpose by doing this only; the investors should be given the chance to start the intended investment activities.

5.4.8 Business Licence

We have seen that it is important to regulate the activities of investors through the enforcement of their rights and duties. The regulation will be made effective through granting or refusing a license to carry on the functions of a particular investment.

Licensing investors means issuing of a license by the authorized government body to the person (whether an individual or a business organization) to undertake in the investment.

The principle is that everybody who needs to carry out trading must have a valid business license. A business license may be defined as a permission issued for a trader to carry out a particular business.

Act of a trade in general, and that of investment in particular, needs a profession/skill and it is performed with the interaction made with the society. Thus, license is essential to check that that the activity is legal and does not contravene the morality of the society, and to protect the rights of consumers. Through the instrumentality of license, it is possible to check persons are engaging in a lawful activity and to prevent illegal activities by refusing a license.

5.5 Restrictions On Foreign Investment

³³⁶ An Investment Guide to Ethiopia, 2004, P. 53

The trend with regard to investment regulation is liberalization. We have seen that screening procedures involving prior authorization have been almost eliminated or reduced in scope. However, there are two most common restrictions on FDI made by governments. They are restrictions on ownership and performance requirements.³³⁷

A) **Restrictions on ownership** can take several forms. In some countries, foreign investors are excluded from specific fields. For instance, in Sweden, foreigners are excluded from tobacco and mining. In Brazil, Finland, and Morocco, foreign investors are excluded from the development of certain natural resources. It is also possible to limit the ownership of subsidiary while a significant portion of a business organization must be owned by local investors. For example, in the United States of America, foreign ownership is restricted to 25 percent or less of an airline³³⁸

In Ethiopia, the investment law does not clearly indicate restrictions with regard to ownership. However, a foreign investor must obtain prior approval from the Ministry of Trade and Industry to secure shares of an existing enterprise.³³⁹ This may give the opportunity for the Ministry of Trade and Industry to restrict ownership of foreign investor.

B) **Restriction to invest on some sectors** foreign investors are often excluded from certain sectors on the grounds of national security or competition. It is felt that particularly in developing countries local enterprises might not be able to develop unless foreign competition is restricted by a combination of import tariffs and controls on FDI.³⁴⁰ This is the infant industry argument. According to this argument, newly established enterprises in developing countries cannot initially compete with well-established industries in developed countries. Thus, governments should temporarily support new enterprises (with tariffs, import quotas, and subsidies) until they grow strong to meet international competition.³⁴¹

³³⁷ Charles W. L. Hill, **International Business: Competing in the Global Market**, 2003, p. 246.

³³⁸ **Ibid**

³³⁹ Proc. No. 280/2002 (as amended); Art. 12(2)

³⁴⁰ Charles, **Ibid**; p 246

³⁴¹ **Ibid**; p. 184

Nevertheless, some economists argue against this saying that protection of manufacturing from foreign competition does no good unless the protection helps make the industry efficient. Thus, they argue that it would make the local investment in efficient. Secondly, enterprises should go through the pains of credit and be competent to borrow from the financial market.³⁴²

Coming to the Ethiopian investment law, a foreigner is not allowed to invest³⁴³

A) on financial sector, such as banking and insurance;

B) forwarding and shipping agency services;

C) broadcasting services; and

D) air transport services using airplane with a capacity of up to 20 passengers. What is more, foreign investors are excluded from investing in areas listed in the Schedule.³⁴⁴

We can observe that the above mentioned economic sectors, they are services. In general, services are subject to more restrictions than manufacturing and natural resources. The basic rationale for restriction in those areas may be that host countries view the areas as strategic or sensitive. In addition, a restriction is made taking into account the infant “entrepreneurship” arguments to discriminate against foreign investors.³⁴⁵

C) Performance Requirement- Performance requirement is the other restriction on foreign direct investment. It can take several forms. The most common performance requirements are related to local contents, exports, technology transfer and local participation in top management. The basic function of performance requirements is to minimize the cost of FDI and maximize the benefit out of it.³⁴⁶

Pursuant to Article 38(1)(2) of Proc No. 280/2002 (as amended), a foreign investor must be replaced by Ethiopians during a limited period by arranging the necessary training for the latter. With regard to top

³⁴² **Ibid**

³⁴³ Regulations No. 84/2003; Schedule 2

³⁴⁴ **Ibid**; Art 3

³⁴⁵ United Nation, **Measuring Restrictions on FDI in Services in Developing Countries and Transition Economies**, 2006, p. 9

³⁴⁶ Charles, **Ibid**; 185

management positions, a foreign investor must obtain a prior consent of the Ethiopian Investment Commission.³⁴⁷

D) Capital Requirement- One of the purposes of attracting foreign direct investment is to attract foreign capital to the host state. To achieve this, a foreign investor is required to allocate the following minimum capital.³⁴⁸

- i. 100,000 US Dollars for a single investment project;
- ii. 60,000 US Dollars for a joint investment project with domestic investors;
- iii. 50,000 US Dollars for a single investment project in engineering, architecture accounting, and auditing services, business and management consultancy services or publishing;
- iv. 25,000 US dollars for a joining investment project with domestic investors in the area of engineering, architecture, accounting and auditing services, project studies, or business and management consultancy services or publishing.

A foreign investor is required to register the capital requirements at the National Bank of Ethiopia to obtain a certificate of registration.³⁴⁹

If a foreign investor

- i) re-invests his/her profits or dividends;
- ii) exports at least 75% of his/her outputs, s/he is not required to allocate the minimum capital mentioned above.³⁵⁰

In general, Ethiopia like Saudi Arabia and Kenya is considered as a country of very highly restricting ownership over service industries.³⁵¹

Let's assume Ato Gezahegn³⁵² regretted about the restriction on foreign investors to invest in banking activities in Ethiopia: "We lose a lot", he said. Banks do not render services after the normal working

³⁴⁷ Proc. No. 280/2002 (as amended): Art 38(3)

³⁴⁸ The Business of Excellence Investment Guide to Ethiopia, 2007, P. 31

³⁴⁹ **Ibid**

³⁵⁰ **Ibid**

³⁵¹ United Nation, **Ibid**, p.p. 9-11

³⁵² Discussions held with Ato Gezahegn, 08/04/08, at 2:00 PM to 4:00 PM, Addis Ababa.

hours, no card system are there in Ethiopia, or are very limited. This became one of the arguments against Addis Ababa being the capital city of Africa.³⁵³

The argument held by some that allowing foreign investors in financial activities, telecommunication and shipping lines would harm local investors is not acceptable. Some argue that the activity that promotes the development of other countries hinders ours?³⁵⁴ We are victimized by, for example, the Ethiopian Shipping Lines, argues Ato Gezahegn.³⁵⁵

The Ethiopian Shipping Lines needs to permit to fright even out of the reach of it. In the areas where it reaches, we should pay for the Ethiopians shipping Lines. In such a case, the Ethiopian shipping lines levied a greater amount for freight. In localities where the Ethiopian Shipping Lines does not reach, it takes the contract from the investors for higher price than other shipping lines and sub-lease it to others. This is because it monopolizes the service.³⁵⁶ The Shipping Line is inefficient in rendering services. Any other shipping line could transport your goods just on the next day you while the Ethiopian Shipping Lines took a month to do the same.³⁵⁷

It would be possible to restrict the amount the foreign investor would expatriate to their home country what they gain from banking, etc transactions in order to limit the harm. Foreign investors bring foreign currency. They also propose to enforce foreigners to employ Ethiopians on higher passions, Ethiopians are also required to take necessary trainings. Technology could also be transferred. If they work, it is possible to have foreign currency. For example, in Benshangul Gumuz Region, pulp which is a raw material to produce paper is produced. This would save foreign currency and can be exported to earn foreign currency.³⁵⁸ They further argued that pre -paid mobile card is produced in Saudi; the price would be less had it been produced in Ethiopia. In Dubai there is no such a restriction. An investor is granted a plot of land if s/he can show to the relevant government organ a certain minimum amount of money. Getting residential permit for the investor and work permit for employees can very easily be given within a day. In Dubai, only telecommunication is in the hands of government. In Dubai, advanced technologies are transferred, and as are result the country developed.

³⁵³ Interview held with Ato Hussein Sayid, 08/07/08, at 2:00-40:00, Addis Ababa.

³⁵⁴ Discussions held with Ato Gezahegn, Ato Husen Said, and Ato Bahir, 08/07/08, Addis Ababa.

³⁵⁵ **Ibid**

³⁵⁶ **Ibid.**

³⁵⁷ **Ibid**

³⁵⁸ **Ibid**

Research conducted by the United Nations clearly shows a strong negative correlation between restriction measures and FDI activity.³⁵⁹ In other words, the more restriction measures are taken, the less the inflow of FDI.

We have discussed that restrictions on FDI may be on ownership or operational restrictions. Industries that are highly sensitive to national security or national sovereignty considerations are most heavily restricted. Telecommunication, transport, finance, electricity, and media are sectors with this regard.³⁶⁰

Questions

- 1) Do you believe that making investment on weapons and ammunition promotes investment?
- 2) What are the requirements under Ethiopian law, to obtain investment permits?
- 3) Why does the law require a public enterprise to submit the regulations by which it was established?
- 4) Analyze how the investment Agency can follow investment activities once investment permissions are given to investors?
- 5) What do we mean by deregulation?
- 6) Evaluate the Ethiopian economic policy from the investment point of view.
- 7) The FDRE constitution is a base for regulating investment, Analyze.
- 8) Do you believe that the economic reform in Ethiopia promotes and encourages investment?
- 9) Analyze the relevance of business license to carry out investment activities in Ethiopia.
- 10) Define business licence in your own worlds.
- 11) How do we check that investors do not violate the morality of the society.
- 12) Analyze the need to impose ownership restrictions on foreign investors.
- 13) Why are foreign investors excluded form investing certain sectors on the basis of competition?
Give reasons

³⁵⁹ United Nation, **Ibid**, p. 17

³⁶⁰ **Ibid**, p. 19

- 14) Do you believe that forbidding foreign investors to invest on banking activities would promote the sector here in Ethiopia?
- 15) Is it fair to exclude foreigners from investing on broadcasting services in Ethiopia? Evaluate the law and the practice.
- 16) Discuss the areas that are not open to foreign investor under Regulations No. 84/2003.

SUMMARY

We have seen that the government has the power to regulate and control both domestic and foreign, investment, activities. The regulation may focus be market industry or it maybe government regulation.

We have discussed that the regulation aims to achieve transparency and efficiency in the administration of investment. This could be achieved if the regulations are based on principles of good regulation which ensures efficient and economical use of resources; if it is proportional to the significance of the investment issues; if it gives responsibility for investors to their own management; if it fosters competition and above all if it facilitates innovation.

As discussed, above foreign investment should promote the economic proplem of the host state. The undertaking of both domestic and foreign investors must promote Ethiopian economic development, not harming our environment. Thus, we have seen that the Ethiopian government screens and registers investors. However, the trend is to deregulate investment though the means are different in several countries.

In Ethiopia, the responsibility of the government emanates from the Constitution. Further, the economic policy of the country emphasises on regulating investment so as to ensure that it plays a role in the development of the people.

We have seen that Regulations no 84/2003 reserved some economic sectors for domestic investors, Ethiopia nationals, and foreign investors. The regulations also clearly provides for the areas the government is allowed to invest.

Granting business licence is used as an instrument for regulating investment activities in Ethiopia. We have discussed that a business licence from the investment point of view is a permission issued to the investor to undertake a particular investment activity.

We have seen that some restrictions are imposed on foreign investors. Even though our investment law does not clearly indicate restrictions with regard to ownership, a foreign investor is required to have a prior approval from the Ministry of Trade and Industry to buy an enterprise or shares of existing enterprise. We have identified that a foreigner investor is required to allocate a minimum capital to invest in Ethiopia.

What is more, a foreign investor is not allowed to invest in the financial sector, forwarding and shipping agency services as well as broadcasting services.

In general, we have seen that the Ethiopian investment organs, particularly the Ethiopian Investment Agency, are efficient in granting investment permit. However, we have emphasised that this by itself could not promote investment since the undertakings require some other things as well. Therefore, the Ethiopian government requires improving other services for investors for the latter to be successful.

We have discussed that regulation is aimed at achieving transparency and efficiency in the administration of investment. This could be achieved if the regulation is based on principles of good regulation which ensures efficient and economical use of resources.

We have seen that regulating investment by states is an inherent power that emanates from the sovereignty of states to control their economic activities. Regulation of investment is a normative standard that should be obeyed, and a violator is answerable for violation where there is non-compliance.

The main purpose of regulating foreign investment is to control the investment so that it is possible to reject the harmful projects and give incentives to those that are beneficial to our country. Thus, the entry of foreign investment to Ethiopia as well as the manner in which investment is made are regulated. Once the investor enters Ethiopia s/he/it is governed by the Ethiopian laws.

REVISION QUESTIONS

I) Choice

- 1) Which of the following is the advantage offered by governmental regulation?
A) Consumer protection B) Perfecting the market C) Competition D) All
- 2) Industry regulation helps to
A) Eliminate stability of employment
B) Achieve stability in business organization
C) Both D) None
- 3) Which of the following is not the principle of good regulation?
A) Investment regulation must aim at achieving innovation
B) Investment regulation should protect the rich only
C) Investment regulation should promote competition
D) Regulation shall be proportional to issues in the manner of addressing.
- 4) The need to regulate foreign investment arises from
A) Political issues B) security of the host state
C) security of the capital sending state
D) B and C D) A & B
- 5) The trend all over the world with regard to investment regulation tends to be
A) Command economy B) Strict C) Liberalization D) socialization

- 6) which sectors are exclusively reserved for our state
 - A) Postal services with no exception
 - B) Telecommunication
 - C) Horticulture
 - D) All
 - E) None
- 7) Investing on ammunition in Ethiopia, is open to
 - A) State only
 - B) A Foreign investors only
 - C) Joint investment
 - D) Americans only
- 8) What spinal requirement applies to a foreigner who wishes to submit to obtain permission here in Ethiopia?
 - A) copy of pass port
 - B) A promissory not
 - C) Driving license
 - D) All
- 9) Business license is important to ensure that
 - A) the investor under takes activities that are allowed by law
 - B) the investor undertakes activities that violate the morality of the society
 - C) the investor exploits the workers
 - D) the investor is getting rich
- 10) Which of the following are not open to an investment company established in German to invest here in Ethiopia?
 - A) Shaping agency service
 - B) Producing cement
 - C) Assembling vehicles
 - D) All

II) True/False

- 1) Today, it is felt essential to introduce the theory of protectionism in some areas of investment.
- 2) There is a clear restriction on ownership of foreign investor under Ethiopian law.
- 3) Any potential investor can undertake on investment with out no license so long as the activity is beneficial to the society at large.
- 4) The Ethiopian investment law sets a mechanism for monitoring of investment transactions.
- 5) In Ethiopia, one can not obtain an investment permit through an agent.
- 6) A foreigner can invest in the transmission and supply of eclectic power in Ethiopia.
- 7) Nationalism may be the reason to exclude foreign investors from certain activities
- 8) In regulating investment transactions, the issue of reciprocity could be taken into account through bilateral investment agreements.
- 9) Nowadays, the trend in regulating foreign investment is homogenous in countries.
- 10) One of the drawbacks of governmental regulation is that it is costly.

III) Matching

A

B

- | | |
|--|--|
| _____ 1) Responsibility for own management | A) Liberalizing investment activities |
| _____ 2) Privatization | B) in prove the life of citizens |
| _____ 3) Deregulation | C) Principle of good regulation |
| _____ 4) Economic policy | D) creates competition |
| _____ 5) Economic modes | E) ensure the wellbeing of investors |
| | F) Indicates how the economy is structured |

IV) Solve the following.

- 1) Mr John is a British investor who come to Ethiopian to invest in agricultural sector. He decided to grow flowers and export to the European market. However, he has no any idea how to obtain a permit.
 - A) Advice him an what he should fulfill.
 - B) Advice him an what documents he must submit to the relevant investment organ.
- 2) Mr. George is an American investor who wants to invest in Ethiopia. He has been informed that Ethiopia has made an economic reform and he wants to know the impact of this economic reform on investment. Write him to offer a piece of advice about it.
- 3) Assume that you are an advisor to a relevant government investment organ and the organ wants to know good principles of investment regulation. Provide a written advice for the organ on the issue of good principles of investment regulation.

B THE INSTITUTIONAL FRAMEWORK FOR THE ADMINISTRATION OF INVESTMENT IN ETHIOPIA

OBJECTIVES

After completing this part, the student should be able to:

- analyze the role of the Ministry of Trade and Industry in the administration of investment;
- discuss the power and duties of the Investment Board;
- explain the roles of the Investment Agency;
- analyze the power of Regional Investment Organs;
- discuss the role of Ethiopian Civil Aviation Agency;
- commit himself/herself to apply the roles that govern the administration of investment; and
- apply the rules

INTRODUCTION

In the previous section, we discussed issues related to regulating investment. To ensure regulation of investment, we need administrative organs. Accordingly, there are institutions established to administer investment. This unit is devoted to analyzing the structure and power and responsibilities of these institutions.

First, we will discuss the Ministry of Trade and Industry. Second, we will consider the powers and duties of the Investment board in the administration of investment. Next, we will discuss the Investment Agency. There are regional investment organs that are established to administer investment in their jurisdiction. Thus, the fourth section is devoted to this topic. The last topic will consider other bodies which are empowered to administer investment.

As usual, we will have questions for each topic, and revision questions for the unit after summarizing essential points of the unit.

5.6 THE MINISTRY OF TRADE AND INDUSTRY

We have seen that investment is a trade or commercial activity, and the investor is a trader. The Ministry of Trade and Industry is authorized to administer/regulate commercial activities in general.³⁶¹

The Minister of Trade and Industry is the Chairperson of the Investment Board.³⁶² This could help the Minister to administer investment in line with trade or commerce. However, this does not mean that the Minister will administer the investment transaction in a similar fashion with other trades. The investment transaction/activity should be administered taking into account the special features of investment.

Questions

- 17) Analyse the role of the Ministry of Trade and Industry in investment.
- 18) How would the structure promote investment objectives of Ethiopia?
- 19) Do you believe that the Minister could control investment transaction?

5.7 THE INVESTMENT BOARD

The Investment Board is a body that is entrusted with important power and responsibilities with regard to investment in Ethiopia. The Board shall be established by members from the government and private

³⁶¹ Proclamation No. 471/2005, Art., 15(5).

³⁶² Proc. No 280/2002 (as amended), Art. 28 (2)

sector.³⁶³ The minister of trade and Industry must lead the Board as chairperson.³⁶⁴ The Board has also a secretariat.³⁶⁵

What are the powers and duties of the Investment Board? Article 29 of the Investment Proclamation (as amended) provides the powers and duties of the Board.

- 1) **Supervisory authority**-Pursuant to this provision, the first and important power of the Board is its supervisory authority. Thus, the Board has the power to supervise and follow up the investment activities.³⁶⁶
- 2) **Power of decision** – The Board has the power to decide on policy issues with regard to the implementation of the investment proclamation.³⁶⁷
- 3) **Legislative power** – Issuing some directives may be necessary to implement the investment proclamation. Therefore, the Board is given the power to issue such directives. Further, the Board may identify the necessity and areas where investment incentives should be given. It may also decide amend the investment incentives to promote investment in Ethiopia. In such a case, the Board is empowered to make the necessary amendments and submit the same to the Council of Ministers for approval.³⁶⁸ For example, if the Board felt the necessity to extend the time of income tax exemption for those who invest in less developing regions, it can propose amendment to the Council of Ministers. Furthermore, the Board has the power to submit a proposal on new or additional incentives and submit the same to the Council of Ministers for approval.³⁶⁹ Why is it necessary to grant the Board such a power? The Board is an essential and appropriate organ that follows and supervises investment transaction and the implementation of the investment law. Thus, the Board may feel from the experience that additional incentives may attract and promote investment. What is more, it may propose completely new incentives because it is an appropriate organ in the sector.
- 4) **Fees**-The Board is given the power to determine the amount of service fee to be charged³⁷⁰ by the Investment Agency.

³⁶³ Proc. No 280/2002 (as amended), Art. 28(3)

³⁶⁴ **Ibid**; Art. 28(2)

³⁶⁵ **Ibid**; 28(5)

³⁶⁶ **Ibid**; Art. 29(1)

³⁶⁷ **Ibid**; 29(2)

³⁶⁸ **Ibid**; Art. 29(4)

³⁶⁹ **Ibid**; Art. 29(9)

³⁷⁰ **Ibid**; Art. 29(6)

- 5) **Giving Information** –We have seen that the Board has the power to issue investment directives. such investment directives should be implemented. It is only if they are known by investors that they be implemented properly. Thus, the Board should release information to familiarise the investors with the directives.³⁷¹

The Board may have regular or an extraordinary meeting so as to fulfil its duties and to exercise its powers. As per Art. 30(1) of the investment Proclamation, the Board holds its regular meeting once in a month. If meetings are to be held, it is essential to determine the quorum. According to the proclamation, where more than half of the members present, there shall be quorum.³⁷²

How should decision be made? The Board shall decide on the basis majority vote.³⁷³ Sometimes there could be a tie in the sense that we cannot identify which idea wins. In such a case, the decision favoured by the chairperson shall be taken as a decision because the chairperson is given a casting vote in case of a tie.³⁷⁴

Questions

- 1) The Investment Board has been given the power to issue directive on investment. Evaluate the appropriacy of this practice.
- 2) Analyze the supervisory authority of the Board.
- 3) Discuss the constituency of the Board.

5.8 THE INVESTMENT AGENCY

³⁷¹ Ibid; Art. 29(8)

³⁷² Ibid; Art. 30(2).

³⁷³ Ibid; Art. 30(3)

³⁷⁴ Ibid

The Investment Agency is the other body that implements investment laws in our country. The Investment Agency has been re-established recently being accountable to the Investment Board.³⁷⁵

What are the power and duties of the Agency?

- 1) **Enhancing investment-** One of the important powers and duties given to the Investment Agency is enhancing investment in Ethiopia. The first step the Agency should take is to promote and coordinate investment activities.³⁷⁶ In addition, it is required to serve as a liaison between investors and public offices, Regional Governments and other relevant organs to enhance investment.³⁷⁷ For example, it serves as a liaison between the government and chamber of commerce. This would enable the Agency to carry out its duty to prepare and distribute pamphlets, brochures, films etc to enhance investment,³⁷⁸ and this power is given to it.
- 2) **Issuing investment permits-** The Agency is the body that is directly involved in the implementation of the investment laws. To implement the investment laws, it is essential to issue investment permits.³⁷⁹
- 3) **Monitoring** – The Agency is empowered to monitor the implementation of investment projects that are given permission.³⁸⁰
- 4) **Promote investment-** The Agency is also empowered to organize exhibitions, trainings and seminars that help to promote investment.³⁸¹ In addition, it is duty bound to give appropriate advice and support to investors.³⁸² To perform such activity, the Agency should have qualified personnel in a required number. Is the Agency actually competent enough to give appropriate advice to investors?
- 5) **Building capacity-** It is also duty bound to build up the capacity of the regional investment organs. Thus, it is required to advise and give technical support to regional investment organs.³⁸³ The Agency has built strong work relationships with Regional Bureaux, which allows it to provide investors with specialists to offer them professional advice.³⁸⁴

³⁷⁵ Proc. No. 280/2002 (as amended), Art: 31

³⁷⁶ Proc. No 280/2002 (as amended), Art 32(1)

³⁷⁷ Ibid; Art 32(5)

³⁷⁸ Ibid; Art. 32(6)

³⁷⁹ Ibid, Art. 32 (7)

³⁸⁰ Ibid, Art. 32(8)

³⁸¹ Ibid, Art. 32(4)

³⁸² Ibid

³⁸³ Ibid, 32(1)

³⁸⁴ Business of Excellence, 2007, p. 27

- 6) **Disseminate information** –The Agency is duty bound to collect, compile, analyze and disseminate information on investment opportunities in the country. It should also offer investment projects. Further, it should find and bring together partners to invest together.³⁸⁵
- 7) **Policy and directives** – The Agency is empowered to initiate policies and implementation measures that are necessary to create conducive investment climate. Then, it should submit it to the Investment Board and follow up the implementation of same upon approval.³⁸⁶
- 8) **Signing treaties**- The Agency is empowered to negotiate bilateral investment treaties and sign the same. However, it is worth noting that it can sign bilateral investment treaties only if the negotiation is approved by the Council of Ministers.³⁸⁷ Is that in line with the FRDE Constitution?
- 9) **Serving as one stop- shop** – The Agency serves as one stop shop because all necessary matters should be completed in it to invest. For example, it has the power to give permit to investors, register the establishment of business organizations, issue business licenses.³⁸⁸ It is reported that the Investment Agency can issue permits in less than an hour and with business organisation registrations taking no more than four hours.³⁸⁹

Questions

- 1) Explain the concept of one stop shop.
- 2) Analyze how the power of the Agency to issue investment permit promote investment.
- 3) Discuss how the Agency signs a treaty?
- 4) Do you believe that building capacity would promote investment in Ethiopia? Give your reasons.

5.9 THE REGIONAL INVESTMENT ORGANS

³⁸⁵ Proc No. 280/2002, Art 32(3)

³⁸⁶ Ibid, Art. 32(2)

³⁸⁷ Ibid; Art. 32(10)

³⁸⁸ Ibid; Art. 26 (1)

³⁸⁹ Business Excellence; Ibid

The regional investment organ is another implementing organ.³⁹⁰ The regional investment organ has the power to register, and license investors.³⁹¹ Thus, it has the power to license investors upon the investor signing an undertaking to transact investment to the relevant investment laws.³⁹² In addition, the Regional Investment Organ is duty bound to notify to the relevant governmental office to which investment license is granted, so that the later can conduct the necessary follow up.³⁹³

In **Addis Ababa**, Investment Authority is established having legal personality. It is one of the executive organs of the city.³⁹⁴ The Authority is established with Head, Deputy'Head(s), and the required units staffed with personnel.³⁹⁵ It is accountable to the Bureau of Trade and Industry Development.³⁹⁶ The Bureau of Trade and Industry Development has the following power and functions:

- 1) to initiate investment policies and laws that are consistent with the investment policies and laws of the Federal Government;³⁹⁷
- 2) implement the investment policies and laws of the Federal Government as well as its own;³⁹⁸
- 3) issue investment directives;³⁹⁹
- 4) encourage wide participation of local investors in trade and industrial activity of the City;⁴⁰⁰
- 5) to render technical and counselling services to investors;⁴⁰¹
- 6) to issue license to local investors engaged in trade and establish medium size industries in the city and supervise same,⁴⁰²

The Investment Authority is also empowered to:⁴⁰³

³⁹⁰ See Art. 25(3) of Proc No 280/2002

³⁹¹ Ibid; Art 26(1)

³⁹² Ibid; Art 26(5)

³⁹³ Ibid, Art. 26(8)

³⁹⁴ Addis Ababa city Government Executive and Municipal Service Organs Establishment Proclamation, Porc. No 2/2003, **Addis Negari Gazeta**, Art.4 (2) (g)

³⁹⁵ Id, Art. 3(4). 3. Id. Art. 3(b)

³⁹⁶ Id. Art 3(b)

³⁹⁷ Id, Art. 6(1) Cum. Art. 13(3)

³⁹⁸ Id, Art. 6(2) cum 13(3)

³⁹⁹ Id, Art 6(2)

⁴⁰⁰ Id. Art 13(2)

⁴⁰¹ 4 Id

⁴⁰² Id. Art 13(6)

- encourage coordinate and promote investment activities ;
- render necessary advice and technical support to investors;
- publicize favourable investment opportunity after conducting detailed studies (Art. 17(2));
- issue investment license for investment permits (17 (3));
- transfer the matter to the Bureau for issuance of trade and industrial license (17(3));
- Guarantee tax exemptions (17(3) according to investment law;
- facilitate for investment such as infrastructures, raw materials and machines at a Low price etc for investors (17(4));
- facilitate for investment such as infrastructures. raw materials and machines at Low price etc for investors (17(4)).

Amhara Region –The Investment Office is accountable to the Trade, Industry and Urban Development Bureau.⁴⁰⁴ Its power is:

- to ensure the implementation of Investment policies and laws;
- issue investment license where conditions are fulfilled as provided under the Federal Government investment Proclamation;
- to revoke investment license where the law is violated or the activities are harmful;
- decide on applications for incentives. The investor is required to fulfil the conditions provided under the Investment Proclamation.
- To collect information an investment opportunities and disseminate it to investors after organizing In addition, it is empowered to introduce objective projects to them;
- To coordinate and control investment activates;
- To render services with regard to investment;
- to submit report on the investment opportunities and investment activities to the Region and the Relevant Federal Investment Office;
- to supervise the activities of foreign and domestic investors who have been granted investment permit by the Federal Investment Agency.

Questions

⁴⁰³ Ibid, Art., 17

⁴⁰⁴ Proc. 4/88 (as amended), Art.3, sect.4 Chapter 1

- 1) What are the powers of regional investment organs?
- 2) Do you believe that the powers given to regional investment organs would promote investment?
Give reasons.

5.10 OTHERS

A) The Ethiopian Civil Aviation Authority

The Ethiopian Civil Aviation Agency is another investment-implementing organ. According to Art 25(3) of the Investment Proclamation (as amended), the Ethiopian Civil Aviation Agency has the power to issue, renew and cancel investment permits for air transport services representing the Agency. Thus, the Aviation is delegated power of the Agency. However, why is it necessary to delegate such power? The Ethiopian Civil Aviation is a body working on air transport services. Thus, it is as appropriate organ with the technical know how and necessary personnel experienced in the job. The Commission may have no necessary staff. Therefore, delegating power is essential in this regard. The Ethiopian Civil Aviation is duty bound to send photocopies of investment permits it issued and other relevant documents to the Agency.⁴⁰⁵ This will enable the Agency to supervise and follow up the Ethiopian Civil Aviation.

B) The Ethiopian Electricity Authority

The Ethiopian Electricity Agency is another investment-implementing organ. According to Art 25(2) of the Investment Proclamation (as amended), the Ethiopian Electricity Authority has the power to issue, renew and cancel investment permits for generation or transmission or supply of electrical energy representing the Agency. Thus, the Authority is delegated power of the Agency. However, why is it necessary to delegate such a power? The Ethiopian Electricity Authority is a body working on electric power. Thus, it is an appropriate organ having the technical know-how and necessary personnel experienced in the job. The Agency may have no necessary staff. Therefore, delegating power is essential in this regard. The Ethiopian Electric Agency is duty-bound to send photocopies of investment permits it

⁴⁰⁵ Ibid, Art. 41(b)

issued and other relevant documents to the Agency.⁴⁰⁶ This will enable the Agency to supervise and follow up the Ethiopian Electricity Agency.

SUMMARY

We have seen that since investment is an economic and trade activity, the Minister of Ministry of Trade and Industry is the chairperson of the Investment Board. We also said learnt that the Investment Board is a supervisory body, empowered to issue directives, and release information needed to implement investment laws.

The other administrative body we have considered is the Ethiopian Investment Agency which among others is empowered to monitor and issue investment permits. The investment activities are undertaken in the regions practically and we have considered the power and duties of regional investment organs in this regard.

We have also learnt the Ethiopian Electricity Authority and the Ethiopian Civil Aviation Authority have roles in the administration of investment in their respective sectors.

Review Questions

I) True/False

- _____ 1) Regions have been given the power to implement laws of investment.
- _____ 2) The Ethiopian Electricity Authority is a government body that administers investment in Ethiopia
- _____ 3) The Investment Agency has no the power to initiate investment policies.
- _____ 4) The Investment Board has the power to enact a proclamation on investment.

⁴⁰⁶ Ibid; Art. 41(b)

_____ 5) The Ministry of Trade and Industry administers investment activities.

II) Choose the best answer

- 1) Who chairs the Investment Board?
 - A) The Prime Minister
 - B) the Minister of Trade and Industry
 - C) The Vice Prime Minister
 - D) All
- 2) Which body issues investment permits at the Federal level?
 - A) The Investment Agency B) The Board
 - C) The Prime Minister D) None
- 3) If the investment transaction is to be made in Addis Ababa, _____ issues the investment permission.
 - A) The Addis Ababa Investment Commission
 - B) The Oromya Investment Commission
 - C) The Federal Investment Agency
 - D) All
- 4) _____ is an organ responsible for building the capacity of regional investment commissions.
 - A) The Board
 - B) The Addis Ababa Investment Commission
 - C) The Ethiopian Electricity Authority
 - D) The Ethiopian Investment Agency

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UNIT SIX: INVESTMENT OPPORTUNITIES AND OPTIONS IN ETHIOPIA

UNIT OBJECTIVES

After completing this Unit, students should be able to:

- identify major investment opportunities in Ethiopia;
- analyze favourable situations to invest in Ethiopia;
- compare and contrast areas of investment reserved for domestic investors with foreign investors;
- analyse the options to invest in Ethiopia;
- compare and contrast joint venture and joint investment;
- commit themselves to apply the rules and principles;
- apply the rules as principle

INTRODUCTION

In Unit Five, we discussed the institutional framework for the administration of investment in Ethiopia. In addition to the administration of investment, we need to consider the investment opportunities and options. Thus, this Unit Six is devoted to the discussion of two issues: investment opportunities in Ethiopia and investment options in Ethiopia.

In the first section of this unit we will discuss major investment opportunities in Ethiopia. Then we will look at the favourable situations to invest in Ethiopia. Further, we will consider the investment opportunities at the regional level. Furthermore, we will consider practical problems that persist in the area of investment.

The second topic in this unit is deals with the investment options in Ethiopia. An investor, domestic or foreign, is given options to invest solely or by establishing business organization(s). Investors are also given the option to invest in some areas with our government. The Ethiopian government has the option to invest through public enterprises. There are also cooperative societies as an option to undertake investment. Therefore, we will discuss these investment options under this unit.

We will have reisew questions following the main topics and at the end of the unit. We will wind up the discussion by summarizing important points.

6.1. INVESTMENT OPPORTUNITIES IN ETHIOPIA

There are investment opportunities to invest in Ethiopia. What are the opportunities? We will discuss them in this part of the material.

6.1.1. Major Investment Opportunities In Ethiopia

Ethiopia, being a virgin land, offers many opportunities for investment. Let us consider some of these opportunities. Can you guess what the important opportunities for investment in Ethiopia are ?

A) ECONOMIC POLICY

The first investment opportunity is related to the Ethiopian economic policy. But, what opportunity does the economic policy offer to investors?

We have seen, that the Ethiopian economic policy adopts a liberal economic thought. Liberal economic thought is favourable for investment because it is possible to acquire private property. Further, privatization is implemented in Ethiopia. The Privatization program has enabled our Government to privatize state-owned enterprises since 1995.⁴⁰⁷ This clearly indicates the commitment of the Ethiopian Government to transfer public ownership to private ownership, which is a fertile ground for investment.

B AGRICULTURE

It is clear that agriculture is the backbone of the Ethiopian economy. It contributes about 45-50 per cent of the GDP, and 63 per cent of the total exports.⁴⁰⁸ The statistics shows that coffee alone accounts for 39.4 per cent of total exports in 2001/2002. What is more, the local industries get these raw materials from agriculture.⁴⁰⁹

⁴⁰⁷ Ethiopian Business Development Services Network (EBDSN), **Investment Guide for Ethiopia**, Addis Ababa, 2004, p.21

⁴⁰⁸ MDI; 2004: 127

⁴⁰⁹ Ibid

Ethiopia grows all types of cereals, fiber crops, oil seeds, coffee, tea, flowers, fruits, and vegetables since it is endowed with wide ranging agro-ecological zones and diversified resources. Therefore, Ethiopia offers opportunities to invest on food crops, beverage crops and cotton.

Ethiopia has the largest livestock population in Africa and the ninth largest worldwide. We have around 40 million cattle, 25 million sheep, 23 million goats, and 2.3 million camels. These cover 30 percent of the agricultural sector.⁴¹⁰

I) Forestry and Agriculture

Ethiopia has designated 58 areas as National Forest Priority Areas (NFPA). Out of these, 13 are managed under integrated forest management systems. Thus, about 80,000 hectares of industrial forest have been established for limited sustainable exploitation. What is important is that investors can invest on producing structural timber, pulp wood, matchwood or even fuel wood. In addition, it is possible to produce rubber and natural gum.⁴¹¹

II Fishery

There are also opportunities for fresh water fish farming and processing using artificial ponds. It is also estimated that water bodies of the country have a production capacity of 30,300-40,000 tones. Only less than 10% is presently being exploited.⁴¹² Therefore, an investor can invest on the area.

III Agricultural services

⁴¹⁰ Joseph Barnes, **the Business of Excellence Investment Guide to Ethiopia**, 2007, Mono 2000 Plc, Addis Ababa, Ethiopia, p. 93

⁴¹¹ MDI, 2004, Ibid

⁴¹² **Ibid**, p. 23

On what type of agricultural services could an investor invest?

Agricultural services include pest and disease control, technical consultancy, agricultural machinery, cold storage, transport and marketing services. The farmer needs services to be rendered by professionals in the above mentioned areas. Thus, an investor has the option to invest on this filed.⁴¹³

IV) Manufacturing

Manufacturing is at its infant stage of development in our country. It accounts for only about 7% of the GDP and 5.3% of employment. Which areas of manufacture offer potentials for prospective investors?

According to the Ethiopian Investment Agency, the textile and garment, food and beverage, leather, building materials, electrical and electronic products, metallurgy are some of the important ones

V Mining

Ethiopia also offers an excellent opportunity to invest in mining. According to the Ministry of Mines and Energy, Ethiopia has a great potential in mining in general, and gold in particular. For example, it is known that more than 500 metric tones of gold deposits has been identified by Government exploration efforts. In addition, more deposits of gold are expected to be identified in at least seven regions.⁴¹⁴

Ethiopia has also a good potential in deposits of tantalum, platinum, nickel, potash and soda ash. In addition, marble, granite, limestone, clay, gypsum, gemstone, iron ore, coal, copper etc are found in Ethiopia. The Ogaden, the Gambella, the Blue Nile and the Southern Rift Valley sedimentary basins also offer significant opportunities for oil and natural gas⁴¹⁵

⁴¹³ **Ibid**, p.24

⁴¹⁴ EBDSN; **Ibid**, p. 25

⁴¹⁵ **Ibid**, p. 26

V Tourism

What opportunities does tourism offer to investors? Ethiopia is known for its potential to invest much on tourism: it is an awaiting paradise. Ethiopia is a virgin territory for tourists looking for some special place to explore.⁴¹⁶ The Elkerie living volcano is an example. The landscapes historical sites and events of the country have the power to attract tourists. In addition, the scenery and wild life of Ethiopia attract tourists. The country has a wide variety of wild life and numerous bird species, both endemic and common. Further, Ethiopia is a place where we find the magnificent Tis Issat Falls on the Blue Nile (Abay) River, the endemic wildlife in Semen Mountains, the Sof Omar cave in the Southeast.

Furthermore, the rock-hewn churches in Lalibela, the ancient buildings of Yeha and the obelisks in Axum, the medieval palaces in Gondar and the monasteries of Lake Tana, Debre Damo and Debre Libanos are the main tourist attractions.⁴¹⁷

What is more, private investment in hotels, lodges and international restaurants represent further potential areas to invest on.⁴¹⁸

With regard to Oromia Region, Ato Alemu Simie said that Oromia possesses unique social assets and ecological diversity that are real opportunities for many to experience and seize it.⁴¹⁹

VII Infrastructure

We can say that the infrastructure of the country is inadequate. The Ethiopian Government recognizes that the delivery of infrastructural services, such as transport (rail and air), telecommunications and postal services, energy and water have a long way to go before they meet the demand of investors. Thus, the Government is working on the sector. What is important is that the Government is widening the

⁴¹⁶ Joseph, **Ibid**, p 111

⁴¹⁷ EBDSN; **Ibid**, p. 26

⁴¹⁸ **Ibid**

⁴¹⁹ Joseph, **Ibid**, p. 43

opportunities for private investors' participation in the sector.⁴²⁰ Therefore, there is an investment opportunity to invest on infrastructure in the country.

6.1.2. Favourable Situations to Invest in Ethiopia

Investment needs favourable situations to invest. What favourable situations are there to invest in Ethiopia?

A) political Stability

First and for most, an investor needs to make sure that the political climate is stable and predictable because it has a direct impact upon investment. Ethiopia has stable political climate with the prevalence of consolidated peace and democratic governance.⁴²¹ Relatively speaking, we may say that the political situation in our country is stable. This will decrease the threat or the risk in investment. However, what is most important is that the political environment should guarantee the absence of nationalization and compensation to be made where investment is nationalized exceptionally.

Nowadays, Ethiopia has embarked upon the liberal economic policy. This, in principle, will promote investment since it encourages private ownership right. Nevertheless, one cannot be sure that this economic policy is a lasting one. Ethiopia being a country of multi parties, one would accept the existence of socialist ideology promoted by one or some of these political parties. Where these political parties come to power through election, there could be a threat of nationalization as a result of the political ideology. Thus, this could be taken as a political risk of investment. In addition, we witnessed an attack on Chinese citizens in Ogaden. There are also some tension and threats from Eritrea, and Oromia Region. Hence, it may be difficult to conclude with the stable political climate in Ethiopia.

B Raw materials

⁴²⁰ EBDSN; Ibid: p, 27

⁴²¹ M.I.I.; 2006: 63

We have seen that Ethiopia is a country where domestic raw material is reliable for virtually every investment area.⁴²² This is a good opportunity for investment. However, it is essential to make sure that the raw material is really reliable.

Work force is another area that offers a good opportunity for investment in Ethiopia. Workforce is abundant in Ethiopia. In addition, it is inexpensive.⁴²³ The daily labours is paid Birr 10 on average per day. This is almost equivalent to one USD. Further, educated Ethiopian citizens are familiar with the English language, which is one of the international languages. This offers an opportunity to train them easily because they can understand English language.

B) Market

The Ethiopian population is increasing. What is more, the capacity to buy is presumed to increase. Therefore, there is a potential for growth of the domestic market with the growing number of consumer populations. In addition, Ethiopia has an advantageous geographical location providing a strategic market access to Africa, the Middle East, Asia and Europe.⁴²⁴ Thus, the investor can export the products to these countries and sell then easily.

Further, Ethiopia has preferential market access into common markets for Eastern and Southern Africa (COMESA). COMESA is an extended common market area covering 23 countries of Africa. Therefore, it offers a market opportunity for investors. Furthermore, Ethiopia has given access to the export markets of the European Union under the “Everything but Arms” trade opportunity. This opportunity offers for an investor to export all products except arms to European countries. What is more, Ethiopia has favourable market status provided by AGOA of the United States of America.⁴²⁵ Thus, an investor in Ethiopia has the opportunity to benefit from the Us market.

⁴²² **Ibid**

⁴²³ **Ibid**

⁴²⁴ **Ibid**

⁴²⁵ **Ibid**; p 64

C Legal protections

An investor is given protections and guaranties through Ethiopian laws and agreements. Legal protections are provided through bilateral and multilateral investment promotion and protection agreements. Hence, an investor in Ethiopia is treated by internationally accepted rules that are incorporated under bilateral and multilateral instruments. The Ethiopian laws also offer a multiplicity of options to set up business organizations in Ethiopia to invest. In addition, there are lucrative packages of incentives under the Ethiopian laws.⁴²⁶

Further, the Ethiopian law creates an efficient one-stop shop administrative arrangement facilitating all the pre-and post- investment requirements.⁴²⁷ The nation treats foreign investors friendly. Ethiopian are friendly and welcome foreigners in general and this is extended to foreign investors as well. The Government also depicts its commitment for investment promotion in the country by privatizing state owned industries. Further, it is investing to expand infrastructure and facilities that are the basis for investment.⁴²⁸

6.1.3. Investment Opportunities at the Regional Level

Oromia Region is one of the most naturally rich areas of our country which offers various opportunities for investors. As we discussed in Unit 5 of this material, the Region has established investment commission so as to implement the investment vision for the horn. Foreign Direct Investment in the Region has made a leap, especially in the industries of horticulture and floriculture, over recent years.⁴²⁹

The Region has extensive natural resources which offer the most significant opportunity for investment. In addition, the Oromia Region has a large internal market. The fact that Addis Ababa, the most populous city in Ethiopia, is situated at the centre of the Oromia Region maximizes the market potential for

⁴²⁶ **Ibid**

⁴²⁷ Art. 26 of Proc. No 280/2002 (as amended)

⁴²⁸ **Ibid**

⁴²⁹ Joseph, **Ibid**, P.43.

investors. The Region is also legated along the trade route to Kenya that passes through its southern most tip. Moreover, the Investment Commission has launched an Investment study centre which is empowered to identify, refine and disseminate high-potential investment opportunities of the Region.⁴³⁰

Floriculture and leather sectors have been given much attention in the Region so as to focus on industries that focus on value-added exportable commodities, labour intensive production, mass consumption products, and insider to raise national productive capacity. Manufacturing and tourism have also been encouraged by the Investment Commission. In the Region, preferential treatments have been made available to the agricultural, agro-processing and apparel sectors taking into account their social role.⁴³¹

one important reason for the success of this Region in attracting investment is the transparency that the Commission has achieved in the application process. This has been enhanced by the Business Process Re-engineering project undertaken in 2005 that focused on streamlining service delivery in finalizing decisions, investment licensing, and registration and land preparation. The Region also has been successful in discharging its investment –promotion duties, which in turn contributes to the success in investment.⁴³² In the regions resources are abundant, but it is very difficult to get necessary data. There is no good research and it is very difficult to access what is available. Coming to the Southern Nations, Nationalities, and Peoples Region(SNNP), even though, the Region is the second rich in natural resources next to Oromia Region, it has not done enough as expected.⁴³³ In SNNP, there are investment opportunities in hotels, recreational sectors around lakes, agriculture-coffee. However, the organs do not release data. In addition, the professionals do not have detailed knowledge of the investment opportunities.⁴³⁴

6.1.4. Current Practical Problems

⁴³⁰ **Ibid.**

⁴³¹ **Id.**

⁴³² **Id.**

⁴³³ Discussions made with Ato Bahir Abdela, BSC in Management, Manager Nalawi Consultancy PLC; Ato Gezahn , an investor in import, Quarry, hotel and transport sector; And Ato HussienSayd, BSC in Management and Economics, General Manager Shaza Oil and Delicious Food Processing Plant and Royal Tour and Travel Operations enterprise; 08/07/08, Addis Ababa, 2:00-4:00 PM.

⁴³⁴ **Ibid**

The first investment problem with regard to the follow up and the implementation of investment projects is attributable to investment organs. The main problems are the following:⁴³⁵

The first problem the organization of the investment organs including insufficient structuring, lack of work force, shortage of budget, vehicles and materials. The second problem is lack of knowledge and experience to regulate and to permit incentives. Thus, investment organs need to train their personnel to upgrade their knowledge and skill to regulate investment projects. The third problem concerns failure to formulate and implement strategies for regulations and to give incentives for investment. The fourth problem relates to data. There is lack of experience to systematically gather data and make it available for the required purpose and goal. Fifth, there is also a problem in the coordination among investment organs. The organs are not properly coordinated in regulating investment. The sixth problem is failure of investment organs to check the correctness of particular information given by investors in the due process of licensing. The last drawback is that there is no information network to link all the investment organs with one another.⁴³⁶

Problems Attributable to Investors

The second group of investment problems is related to the investors themselves. The main ones include:⁴³⁷

- A. Some investors do not reveal correct information when they come to the investment organs to obtain investment license or different services related to investment;
- B. Many investors are blamed for not informing the investment authorities of the change of their personal address after they have obtained investment permission;
- C. Based on the Proclamation, investors do not report every six month of their investment progress and those few, who report do not reveal sufficient and complete information;
- D. Sometimes investors change the place of their investment. What is surprising is those few investors who change the locality of their investment do not inform this fact to the relevant authorities.

⁴³⁵ Asefa and Etal; 2007:3

⁴³⁶ Ibid

⁴³⁷ Ibid

Problems Attributable to Service Rendering Organs

The third group of problems in relation to investment is associated with service rendering bodies of the government. The most significant ones include:⁴³⁸

- A) The service rendering bodies of the government fail to organize different investment desks to facilitate the services rendered to investors;
- B) The service rendering organs are not able to work in collaboration with other service rendering organs. There is also no effort by the service providing organs to provide their services at a grass root level to facilitate their task;
- C) Due to their misconceptions of the national responsibility and institutional obligations they are charged, the service providing organs take too much time in handling the investment affairs of licensed investors.
- D) The service providing organs do not perform their tasks in accordance with their annual work plans. In other words, investment organs do not meet their annual plans.

Infrastructural problems –

Even though Ethiopia has lots of strengths as an investment location, there are also practical problems.

1) **Poor infrastructure** is the first practical problem of investment in Ethiopia. This problem is very much related to the country is being a least developed one. Foreign investors in our country demand that of the Government give attention to the infrastructure facilities. The Ethiopian Government tries to respond to the problem: it improves roads and air ports; however, the problem is not resolved. Telecommunication and power are areas in which investors are complaining about. Although mobile phones have been in use in our country, there is still huge problem in terms of uneven distribution and poor network problems are paramount. What is more, power disruption is becoming a serious problem to investors because investors are required to furnish themselves with generators to cope with the power failure.⁴³⁹ This problem increases costs because investors are required to pay for generating power. This in turn may be the reason to increase prices of commodities and services.

⁴³⁸ Ibid

⁴³⁹ Ibid

The availability of social and economic infrastructure like road, telecommunication; water supply, power, education and health are the major factors accelerating economic development of a country.⁴⁴⁰ The absence, or in adequacy of infrastructure retards the development. In addition to this, the tedious bureaucratic procedures have the power to discourage potential investors.

There is a problem with regard to roads, telephone, electricity, water etc through out the country. Most of the Regions do not have well inter-connected roads and do not have sufficient electric power supply.⁴⁴¹

Bureaucratic problems- There is a bureaucratic problem, particularly lack of efficiency and transparency in the administration of investment.⁴⁴² Further, the concept of one-stop-shop service is not implemented. Thus, investors need to go to the relevant organ of the Ministry of Trade and Industry to register their business organization, for example. In short, no necessary bureaucratic services are rendered by a single investment organ.

Privatization – The process of privatization of public enterprises has become so slow over the last several years, and nearly stalled. Hence, some investors began to question the commitment of the Government to the market economy.⁴⁴³

Privatization of public enterprises has been one of the measures taken to develop private-based competitive sector around the world. Privatization in western economies aimed at transferring public enterprise working with relative profit to a much better performing private entity.⁴⁴⁴ Free market economy in turn is a fertile ground for investment. And the existence of privatization indicates the commitment of the Government for investment. The contrary would show the reluctance of Government, and that is why some investors began to question the commitment of our Government. However, some argue that the

⁴⁴⁰ Lubo Teferi, **A Critical Evaluation of Ethiopian Investment laws with specific reference to proclamation**, No, 116/1998 and regulations No, 36/1998, 1999, p.

⁴⁴¹ Shiferaw and Etal; 2007, p. 3

⁴⁴² Ibid

⁴⁴³ EBDSN, **Ibid**, P.2.

⁴⁴⁴ Demelash Habite, Experiences of Privatization: Lessons for Africa, **Ethiopian Journal of Business and Development**, (2006), Vol.1, P. 58.

duration of the prevailing Government in power is not long to question its commitment.⁴⁴⁵ But, social market is as old as free market economy (the existing one)

3. Un skilled and unqualified man power. The workforce in Ethiopia is considered honest and cheaper in the eyes of investors. The skills and qualifications of workers remain low, however. In addition, the industrial relations are sometimes a problem.⁴⁴⁶ The fact that there are too many labour cases in courts may be taken as an indication of the fact that industrial relations are not smooth. What is more, investors see labour unions and some parts of the civil service are ill-equipped to promote the idea of market economy.⁴⁴⁷

4. Inefficiency of Investment Organs-The investment law has introduced the concept of one-stop-shop-service.⁴⁴⁸ The main purpose of this concept is to reduce effectively the time spent by investors moving around different offices to get business operation license, power, telephone, land, water, and access to land.⁴⁴⁹ However, it is reported that there is lack of communication as to what is needed by each department in addition to duplications between departments.⁴⁵⁰ According to Mr. David Shin, the American Ambassador to Ethiopia, “it is the bureaucracy in the governmental office that discourages many potential American investors to invest in Ethiopia and look elsewhere.”⁴⁵¹

The other problem related to investment organs is the inefficiency in evaluating and approving transfer of technology.⁴⁵² It has been asserted that investment organs lack relevant appropriate experts to evaluate and approve investment projects.⁴⁵³

Road – constriction is better today. *Investors include the development of infrastructure in their plans.

⁴⁴⁵ EBDSN, **Ibid**, P.2

⁴⁴⁶ **Ibid**

⁴⁴⁷ **Ibid**

⁴⁴⁸ Proclamation No 280/2002, Art. 26

⁴⁴⁹ Addis tribune in Lubo, **Ibid**, P.52

⁴⁵⁰ **Ibid**, p52

⁴⁵¹ **Ibid**

⁴⁵² Lubo, **Ibid**

⁴⁵³ **Ibid**

In Tigri, 100 projects are studied and one could access them by paying 300 Birr. This could help the investor as a preliminary source of information. However, the study must be updated every year. One could face a problem to make a huge investment; some officers say that the land will be given to huge investors even in the absence of their petition.⁴⁵⁴ The practice is poor unlike the explanation given by higher officials on different occasions. In Oromia, Some Ethiopian Diaspora went back disappointed by investment organs. There In Harari, there were persons who could not know how land is granted to investors within their stay for 15 days.⁴⁵⁵

Questions

- 1) Explain how tourism offers opportunities to investors.
- 2) Do you believe that the infrastructure of the country offers enough opportunity to invest in the agricultural sector? Give reasons.
- 3) Political situation of a host state determines the direction of investment. Assess the extent to which the exiting political situation in Ethiopia is conducive for investment.
- 4) Evaluate the legal protections provided for investors from the investors point of view here in Ethiopia.
- 5) Discuss investment problems attributable to investors in Ethiopia.
- 6) Analyze investment opportunities in your locality.

6.2. INVESTMENT OPTIONS IN ETHIOPIA

What are the modalities allowed for the investors(s) to invest in Ethiopia under our laws?

According to Article 10 of Proclamation No 280/2002 (as amended), investment may take place in one of the following forms:

- Sole proprietorship
- Business organization

⁴⁵⁴ Ibid

⁴⁵⁵ Ibid.

- Public enterprises; and
- Cooperative societies

Let us now discuss the investment options in detail.

6.2.1. Sole Proprietorship

Pursuant to Article 10(1) (a) of Proclamation No 280/2002 (as amended), an individual can undertake investment transactions. Persons who engage in a business without involving others to share ownership of the business are known as sole traders. They are also called traders or businesspersons.

Sole proprietorship is business in which only one individual owns all the assets, and operates in his/her personal capacity.⁴⁵⁶ It is also called an “individual proprietorship”, which is the simplest and the most common form of business organization in some countries.⁴⁵⁷ Our Commercial Code, it may be said, does not recognize one-person business organization. It does not recognize one person company.

In fact, a one-man company is becoming more popular in German, Greece, Spain, Finland, Italy, Netherlands, and Sweden to avoid “false members” required by law.⁴⁵⁸ It also regarded as a good start to begin business.⁴⁵⁹

It is easy to establish because no formalities are required in principle. An individual may simply start trade by his/her initiative. Thus, a sole proprietorship is a form of business which offers a distinct advantage in this respect over other forms of business organizations. However, certain formalities are imposed, in America, where the sole proprietor operates a regulated business, hires employees, uses a

⁴⁵⁶ Bryan Garner, **Black’s Law Dictionary**, 2004; p. 1427

⁴⁵⁷ John. E Moyer, **The Law of Business Organisations** (Fourth Edition), 1994, p. 16

⁴⁵⁸ Yohannes Seifu, **Business Organisations in Ethiopia**(in Amharic), A Paper Presented to a workshop to amend the 1960 Commercial Code of Ethiopia, Ministry of Justice, 2005, p 33

⁴⁵⁹ **Ibid**

trade name, or expands into other states.⁴⁶⁰ A license is required to carry out a particular business [Ibid]. However, in Ethiopia for a business organisation to exist there must be at least two persons associating.

One essential characteristic of a sole proprietorship is that it is established and managed by an individual. Thus, it can be regarded as an extension to the life of an individual.⁴⁶¹ This type of business organization has some advantages. The first and the greatest advantage is that it is easy to form and it offers a greatest degree of flexibility in managing the business. The individual proprietor, as a sole owner, may operate the business as s/he wishes and chooses. S/he has the power to decide on all affairs of the business. Thus, s/he may decide to employ persons who can help him/her in the operation of the business. In general, management is usually flexible and informal in a sole proprietorship.⁴⁶²

The sole proprietor is the complete owner and as a consequence of this, s/he has the power to control the business organization (firm).⁴⁶³ The fact that the owner controls and runs the firm implies unlimited liability. Thus, the sole proprietor is liable personally for all debts of the business organisation. Thus, there is a risk of investment, which would extend to all personal assets, including the proprietor's home, car, furniture and so on. Insurance is regarded as a device to diminish the risk of unlimited liability to some extent. However, it would be costly and impractical to ensure against every conceivable business hazard.

An other way to eliminate unlimited liability is contract. Therefore, the sole proprietor, in the USA. can limit his/her liability only to the assets of the firm and does not extend to other his/her personal properties by agreement. However, such an agreement provides little advantages. Particularly in cases where the sole proprietor has contributed his/her personal assets as collateral to secure loans for the firm.⁴⁶⁴

The unlimited liability of the sole proprietor is a disadvantage, which discourages one to establish one's own business organization because a wealthy person may hesitate to take the risk of liability which would extend to the other personal assets.⁴⁶⁵

In principle, sole proprietorship terminates by law upon the death of the proprietor. Exceptionally, however, the death of the proprietor may not terminate the sole proprietorship. For example, it is possible

⁴⁶⁰ John E. Moye; **Ibid**; p. 19

⁴⁶¹ **Ibid**, p 16

⁴⁶² **Ibid**

⁴⁶³ Daniel V. Davidson and Etal, **Business Law: Principles and Cases**,(fourth Edition), 1993; p. 716

⁴⁶⁴ John. E Moye; **Ibid**, p 17

⁴⁶⁵ **Ibid**

to enter into an agreement with an employee or relative to buy and continue the trade upon the death of the owner. The owner may also assign the sole proprietorship to others by will. What is surprising is that such acts are rare and there is no assurance of continuity of the trade in case of sole proprietorship in countries where such a business organization is practiced.⁴⁶⁶

A person who carries out a trade individually may have the following advantages:

- I) **Management-** S/he can manage the trade in a manner it suits him/her;
- II) **Quick decision-** It offers the opportunity for quick decision making with regard to the affairs of the trade;
- III) **Employment-** Only s/he determines the number of people to be employed and their qualifications, to needed to run the trade.

There are also disadvantages in managing trade individually. Most importantly, it is only the individual trader who is liable to all his/her creditors. In other words, his/her liability is unlimited, so that creditors may claim even from his/her pocket or property, which is not destined for the trade. What is more, it lacks the advantages of carrying on trade through business organization(s) together with others.

The advantages of trading ingroup may include:

Legal personality-A business organization that is intended to be formed may acquire legal personality. Thus, the business organization itself may sue and be sued or own property.

Liability- Some business organizations enjoy the privilege of limited liability. Thus, creditors of such business organizations cannot stretch their hands to the personal property of the members of the business organization. This is a very crucial advantage to members or partners.

Management-It offers the possibility of management of the business organization by those who have time and knowledge to manage the same. Thus, those who are busy and have no profession in the management of the business organizations will benefit from this opportunity.

⁴⁶⁶ Ibid

6.2.2. BUSINESS ORGANISATIONS

According to Article 10 of Proclamation No. 280/2002(as amended), investors have options to invest through business organisations. The following types or forms of business organizations are recognized under our Commercial Code (Art. 212):

ordinary partnership;

 general partnership;

 limited partnership;

 joint venture;

 share company; and

 private limited company.

Ordinary partnership, general partnership and limited partnership are partnership while Share Company and private limited company are companies. Hence, it is possible to reclassify these business organizations into three as follows:⁴⁶⁷

 partnerships;

 joint venture ; and

 companies.

A) PARTNERSHIPS

Partnership (societe en nom collectif, socie dad colectiva, or offene Handelsge//schaft) is a type of business organization seldom utilized by foreign investors. Partnership arises from a partnership Agreement. Partnership agreement is essential for all business organizations under our law. Article 211 of our Commercial Code provides that

⁴⁶⁷ See Tesfaye Abate, **Insurance Intermediaries: The Law and The Practice**, LL.M Thesis, Addis Ababa University, Faculty of Law, 2006, Pp. 41ff

A partnership agreement is a contract whereby two or more persons who intend to join together and to cooperate undertake to bring together contributions for the purpose of carrying out activities of an economic nature and of participating in the profits and losses arising out thereof, if any.

The important elements of this definition are:

- There must be two or more persons;
- These persons must have the intention to join together and cooperate;
- They must contribute to the purpose of the trade;
- They must carry out economic activity;
- They must share the profit and losses arising out of their activities; and
- They must agree upon the above and other points, so it is a contract.

It is possible to carry out activities ranging from a small one to a large business through a partnership. Partnership is different from sole proprietorship in that there are several members in partnership.⁴⁶⁸ In a general partnership, all partners are personally, jointly and fully liable to each other and to a third party.⁴⁶⁹ It has legal personality⁴⁷⁰ and can sue or be sued in its own name.⁴⁷¹

The liability of members of partnership is unlimited.⁴⁷² In addition, the shares are not freely transferable.⁴⁷³ Further, it is established by a relatively small number of members, who will not offer to raise more capital. Furthermore, the death, incapacity, withdrawal or disagreement of any partner will dissolve the partnership.⁴⁷⁴ In general, those points make partnership a less attractive option.

⁴⁶⁸ John E. Moye; **Ibid**: 32

⁴⁶⁹ Comm. C. Art. 280(1)

⁴⁷⁰ **Ibid**, Art 286

⁴⁷¹ **Ibid**

⁴⁷² See Art. 280(1) of the Commercial Code of Ethiopia

⁴⁷³ See Comm. C. Art. 282

⁴⁷⁴ Arts 260 and 295 of Comm. C

In the case of limited partnership, (societe en Commandite simple, sociedad en comandita simple, or konnanditgesell schaft), limited partners who do not participate in management have limited liability. However, the liability of the general partners or managing partners remains unlimited.⁴⁷⁵ Other disadvantages of partnership are also exist in a limited partnership.⁴⁷⁶

B) JOINT VENTURE

Joint venture is one form of partnership without having legal personality.⁴⁷⁷ Since it is not subject to registration, its formation is quicker and less formalistic.⁴⁷⁸ Joint venture is profaned because for its simplicity, flexibility and changeability. It also offers the advantage of secrecy.⁴⁷⁹ Though joint venture has its own characteristics, it is possible to categorize it under partnership. Therefore, our law recognizes partnerships and companies as forms of business organizations.

C) COMPANIES

No one form of business organization is perfect. One form has some advantages that the others lack; and it has some drawbacks the others avoid. Thus, investor(s) should careful consider the “pros” and “cons” of each form of business organization to select one.⁴⁸⁰

The existence of partnership could be limited; it lacks flexibility, and there is a potential for liability of members (partners) because the liability is unlimited.⁴⁸¹ Thus, people may not select such type of business organizations.

The first advantage of a company is longevity, i.e. there is a potential for perpetual existence. There is also unlimited access to capital and to expertise because the number of members is greater than that of partnership. The other important advantage a company offers is the chance of freely transferring of ownership.

⁴⁷⁵ see Arts. 296 and 300 of Comm. C

⁴⁷⁶ Friedmann; 1959: 759

⁴⁷⁷ Art. 272(3) Comm. C

⁴⁷⁸ Christopher Joseph Mesnooh, **Law and Business in France: A Guide to French Commercial and Corporate Law**, 1994, p. 94

⁴⁷⁹ Yohannes, **Ibid**, p 7

⁴⁸⁰ Daniel and Etal; **Ibid**: 710-16

⁴⁸¹ **Ibid**, p 716

The other essential advantage of a company is the limited liability. Thus, the liability of members is limited to the extent of their contribution.⁴⁸² On the other hand, the regulation of companies is stricter with the intention to ensure the protection of the interests of third parties.

BRANCH AND SUBSIDIARY

In general, a foreigner may have an option to invest in a foreign country through a branch allowed to do business in the foreign country concerned and the organization of a subsidiary business organization in one of the forms recognized by the host state law.⁴⁸³

What is a branch? What do we mean by subsidiary? A branch is an extension or division of an investment business organization.⁴⁸⁴ Subsidiary corporation is one in which a parent corporation has a controlling share.⁴⁸⁵

Some times, the foreign investor will have only one alternative to establish a business organization in a host state where the law says so. Thus, local law may require the nationals to own a certain percentage of a controlling portion of the enterprise capital. For example, in Mexico, certain activities such as fishing and banking may not be carried out by a branch of foreign business organization. However, such activities may be carried out by local subsidiary owned partially or totally by foreigners.⁴⁸⁶

Investing through a branch has advantages. Branch operation will avoid the requirements for the maintenance of statutory reserves by business organizations. In addition, the restrictions found in some legal systems on the number of votes which maybe controlled by a single shareholder will be avoided by a branch. Further, branch operation enables meetings of members to be held and recorded at the parent business organization. Furthermore, establishing a branch may be selected where the capital exporting

⁴⁸² **Ibid**

⁴⁸³ Freidmann, **Ibid**, p. 754

⁴⁸⁴ Bryan, **Ibid**, P. 199

⁴⁸⁵ **Ibid**, p. 368

⁴⁸⁶ **Ibid**

country taxes profits of the principal business organization. Thus, establishing a branch will avoid a tax on the profit of the new business organization.⁴⁸⁷

On the other hand, there are disadvantages of operating through foreign branches. The principal company will be liable to the extent of all its assets for the liability of the branch when the company operates through a branch. This increases the liability of the principal company and this is a serious disadvantage of operating through a branch. The other disadvantage is registration and consent of the government to operate through a branch. The state will consent only if the branch is qualified under the local law. It is very burdensome to file documents and reports which would be a more complicated and expensive process than the setting up of a foreign subsidiary. The investor is required to submit a memorandum of association and an article of association of the company. This must be translated into the language of the host country and certified by a diplomatic representative of the country in which the branch is to be established. Additional requirements may also be imposed. For example, the host state may require the law of incorporation be translated, registered, and published. This is a requirement in Venezuela. In addition, extensive reports on the company's worldwide operations may be a requirement.⁴⁸⁸

What is more, an investor may encounter substantial tax disadvantages. For instance, the net income of a foreign branch is taxed at the same rate as the net income of domestic business organization, in Brazil. In addition, the full amount credited to the home office account is again taxed as the income of non-resident, even if not remitted. In Mexico, there is direct tax discrimination against branch operation. Further, registration taxes and license fees are often levied on the establishment of a branch. These taxes may be assessed on the basis of the overall capital of the company. For instance, in Belgium a 10 percent tax is levied on the overall company capital. Nevertheless, in Brazil, the tax is imposed merely on capital allocated to the branch operations. Where the tax is levied on the overall capita, that may constitute a deterrent against establishing a branch.⁴⁸⁹

⁴⁸⁷ **Ibid**, Pp. 754-55

⁴⁸⁸ **Ibid**; p. 755

⁴⁸⁹ **Ibid**

In France, the *societe anonyme* comes to an end if all the shares come into the hands of a single entity.⁴⁹⁰ Pursuant to Articles 210 and 211 of the Ethiopian Commercial Code, business organization must be established by members of two or more than two in reasons.

The disadvantages of a branch can be eliminated by establishing a subsidiary. A subsidiary should be established according to the local law. The form of business organization which is often utilized by a foreign investor is the corporation. A corporation is a business organization whose counterpart in a Civil law legal system is the *societe anonyme*, *sociedad anonima*, or *Aktiengesell schaft*.⁴⁹¹

Corporation is selected to carry out a large scale foreign investment. What are the factors that make a corporation to be selected in a large-scale foreign investment? The *societe anonyme* offers limited liability to the members.⁴⁹² What do you understand by limited liability? Limited liability is a principle “as a result of which members of an involvement company do not have to contribute their own money to the assets in the liquidation to meet the debts of the company”.⁴⁹³

Thus, this makes a company preferred by investors. In addition, shares are freely transferable.⁴⁹⁴ Further, its continuity of existence, its adaptability to diversified ownership and centralized management make a company to be utilized in largescale foreign investment.⁴⁹⁵

Another advantage of company is that the management, organization, financing and the rights and duties of members are provided in detail under the law. Thus, the investor will have a great dense of certainty about his/her investment.⁴⁹⁶

Under our law, Share Company is managed by a board of directors.⁴⁹⁷ This gives the government an opportunity to nominate directors and exercise effective control over the company where the joint investment is made in a share company.

⁴⁹⁰ Ibid: 756

⁴⁹¹ Ibid: 758

⁴⁹² **Ibid**

⁴⁹³ Pettit ; 2001: 33

⁴⁹⁴ See Arts 333(3) and cum 523 of Comm. C.

⁴⁹⁵ Friedmann; **Ibid**, 758

⁴⁹⁶ Ibid

In Germany, the *Gesellschaft mit beschränkter Haftung* was created in 1899 and its counter part was introduced in France in 1925, in Belgium in 1935, in Switzerland in 1936, and in Italy in 1942. Limited Liability Company was introduced in Japan in 1938 and in Greece in 1955.⁴⁹⁸

In a limited liability company, there is lack of flexibility in its capital structure. Bonds and debenture are not available in Limited Liability Company.⁴⁹⁹ Under Articles 429-444 of our Commercial Code, bonds and debentures are available only to share companies.

In the former West Germany, Limited Liability Company is most widely used by foreign investors. A limited liability company is less costly to organize than a corporation (company). In addition, its administration is both simple and flexible. Further, there is no a requirement for its members to be natural persons (unlike Belgium), or that they be German nationals or residents.⁵⁰⁰

6.2.3. PUBLIC ENTERPRISES

One can say there is no one and universal definition of public enterprise. Writers do not reach agreement in defining the term “public enterprise”. For instance, an “expert group Meeting at Tangier, Morocco, from Dec. 15-20 in 1980 to look into the “conceptual and definitional issues of public Enterprises” ended up with convergence of opinion...”⁵⁰¹ In the opinion of this writer, the definition given by the Bulgarian law seems to serve the purpose. It reads as:

...Any organisation created on the basis of state property... performs economic activity in conformity with the plan for the socio-economic development of the country, operating on

⁴⁹⁷ see Art 347(2) of Comm. C

⁴⁹⁸ Friedmann, **Ibid**

⁴⁹⁹ **Ibid**, p. 758

⁵⁰⁰ **Ibid**, p. 459

⁵⁰¹ Shiferaw; 1

*the basis of economic accountability, and is a legal entity...the organisation has a separate property...and is the holder of rights and obligation*⁵⁰²

This definition works in socialist state, where the economic activity is subjected to central planning. The term is also defined in our law as follows. "... [A] wholly state owned public enterprise... carries on for gain manufacturing, distribution, service rendering or other economic and related activities."⁵⁰³ This definition is broad enough to cover activities that public enterprises cover for instance one industrial, and agricultural activities.

Public enterprises have their own inherent feature As Yadin pointed out, they are instruments of national policy and are autonomous units with legal independence. Public enterprises are, on the one hand, corporations and public bodies, on the other.

Some basic reasons are given for the creation of public enterprises. As it is precisely described in the New Encyclopaedia Britannica, the following reasons are most important. Fiscal motive is the most ancient, reason which had been exemplified by the "state monopolies" in commodities, like tobacco, salt, gunpowder and alcohol. Strategy is the second reason for the establishment of public enterprise. Military consideration is the best example for strategic reason. Cultural and educational considerations may also affect the choice in favour of public enterprises rather than private enterprises.

The role of government has paramount importance attached to public enterprise. The modern role of government is to act in commerce for the purpose of raising a living standard of its people. Hence, public enterprises are assigned "the operation of business with that of a government department aimed at promoting the public welfare".⁵⁰⁴ Public welfare means "the state of doing well especially in respect to good fortune, happiness, wellbeing or prosperity"⁵⁰⁵ of the society. In other words, the promotion of public welfare is meant to improve the living standard of the society. Government invests "where the risks were too great for private capital, or too much capital was needed and private enterprise was unable

⁵⁰² *Laptev*; 6

⁵⁰³ Proc. No. 25/1992; Art. 2(1)

⁵⁰⁴ Grey and Elloit; 1965: 213

⁵⁰⁵ Woolly; 1983: 1320

or unwilling to provide it, or the returns appeared too low for private enterprise, but the project was nevertheless necessary in the national interest.”⁵⁰⁶ Therefore, government invests in “industries that had little attraction to the private sector, that is, industries that would be characterized by small profits and heavy burdens, or whose investment could not be split up”.⁵⁰⁷

A public enterprise is established by regulations. The regulations should indicate, among others, the purpose of the enterprise, its authorized capital and the initial capital paid up.⁵⁰⁸ Once a public enterprise is established, it will gain a legal personality so that it can acquire rights and duties. With regard to liability, the public enterprise could not be held liable beyond its total assets.⁵⁰⁹

According to Proclamation No 25/1992, a public enterprise is organized into a supervising authority, management board, and managers.⁵¹⁰ The supervising authority has the power to appoint and remove members of the board, and external auditors.⁵¹¹ The board on its part has the power to decide on policy issues of a public enterprise, and appoint and dismiss the general manager.⁵¹²

6.2.4. Cooperative Society

cooperative society is defined as “a society established by individuals on a voluntary basis to collectively solve their economic and social problems and to democratically manage same”⁵¹³ It is clear from the definition that the main objective of a cooperative society is not profit. It is aimed at solving social problems as well. A cooperative society may accrue profit while it works to solve the economic and social problems of its members.⁵¹⁴

Since it is a cooperative society, members should not be fewer than ten and they should live or work within the same area.⁵¹⁵ Its liability is limited only to the extent of the assets. It acquires legal personality

⁵⁰⁶ Kaunda; 1968: 4

⁵⁰⁷ Unido; 1977:

⁵⁰⁸ Proc. No 25/1992, Art. 6

⁵⁰⁹ Ibid, Art. 7

⁵¹⁰ **Ibid**, Art. 10

⁵¹¹ **Ibid**, Art. 11

⁵¹² See **Ibid**, Art .14

⁵¹³ Proc. No 147/1998, Art. 2(2)

⁵¹⁴ See Ibid, Arts. 4 and 5

⁵¹⁵ Ibid, Art. 6

upon registration⁵¹⁶ What is worth noting is that a cooperative society may be established to carry out fishery and mining⁵¹⁷ Therefore, a cooperative society could be taken as an option to invest on fishery and mining.

6.2.5. Joint Investment(Joint Venture)

Two or more persons may come together to pool their capital, human resource and experience on the field and invest. Such an arrangement is known as joint venture. In the words of Black's Law Dictionary,⁵¹⁸ joint venture is "a business undertaking by two or more persons engaged in a single defined project." The following are necessary elements for the existence of a joint venture:⁵¹⁹

- A) There must be two or more persons;
- B) There must be a common purpose that the group intends to carry out;
- C) The group must have an agreement to carry out the purpose of the business;
- D) The group should share the profits and losses that arise from the undertaking;
- E) Each member should have equal right in controlling the project.

A Joint venture may also be described as the participation of two [or more] companies in the ownership, management, and control of a third enterprise designed to benefit both [or all]. Persons prefer to join their forces if they are going into a country through any kind of direct investment so as to fully control the investment. In practice, this is the path that most American and European companies have chosen.⁵²⁰ In general, a joint venture is an association of two or more persons who have decided to join forces and their capital to invest rather than doing it alone.

⁵¹⁶ Ibid, Art. 140

⁵¹⁷ Ibid, Art. 1(f) and (g)

⁵¹⁸ Garner; 2004: 856

⁵¹⁹ Ibid

⁵²⁰ Bhalla and Rama, 2001: 463

Joint venture is an American contribution and it has been increasingly used in international business. The modern notion of joint venture for large-scale projects was refined in the American law. Joint venture is used in the automobile industry.⁵²¹

Joint venture, as incorporated under our Investment Proclamation, is a collaborative arrangement between two or more persons (companies) to achieve a particular objective or to participate in another new project which may be more successfully pursued as a result of their pooling of resources or technology.⁵²² It is one form of business organization, in foreign jurisdiction that has gained an increasing popularity.⁵²³

Joint venture may take either of the following forms.

A) **A partnership joint venture** –Such type of joint venture is not very different from a partnership in the common law legal system. However, a partnership joint venture, one that is formed with a precise project in mind.⁵²⁴

For example, XYZ business and KYZ business organizations come together to join their financial, technological and human power to construct a road. Here, the joint venture is established to construct the road. Just after the road is constructed, the joint venture will come to an end. This is a partnership joint venture.

B) **Corporate joint venture** – Occurs where the parties agree to establish a company through which they will carry out their business objectives.⁵²⁵

Though there is no common legal definition of what a joint venture, it may also fall into two the following most common categories.⁵²⁶

- Corporate joint ventures

⁵²¹ Soranrajah; **Ibid**, p. 116

⁵²² Proclamation No. 280/2002(as amended), **Ibid**, Article

⁵²³ M Sornarajah, **Ibid**, p. 115

⁵²⁴ **Ibid**

⁵²⁵ **Ibid**

⁵²⁶ Robert Pretchard (Editor), **Economic Development, Foreign Investment and the Law: Issues of Private Sector Involvement, Foreign Investment and the Rule of Law in New Era**, 1996, p.179

- Contractual joint ventures

Corporate joint ventures are the most common ones. This type of joint venture takes the form of a company established under generally applicable company law. Thus, the participants take up their share while the assets of joint venture are vested in the company.

Advantages⁵²⁷

- The formalities to establish are known by foreigners because they are almost the same.
- The liability is limited.
- It is easy to transfer the interest of the participants.
- It offers a capacity in finance etc.

The major disadvantage is that the foreigner can not arrange it in the most taxless system.

Contractual joint venture is commonly used in the petroleum and mining industries.

The joint venture cannot own property but offer the following advantages:⁵²⁸

- Each participant can participate in the venture owned of the assets;
- Each participant can contribute its share and is entitled to deal with it separately;
- each participants will be accountable to its contribution;
- the management may be done separately by managers of delegation;
- the participants may choose the governing law and the mechanism and forum for the resolution of the dispute

Disadvantages⁵²⁹

Joint venture has the following drawbacks

- **Complexity and cost** of establishment, Joint ownership of the project and the transfer of it, requires financing it. Thus, it is complex and costly.
- **3rd party liability**- All participants involved will be held liable to a third party; all may be jointly and severally liable.

⁵²⁷ **Ibid**, pp. 179-180

⁵²⁸ **Ibid**, p.183

⁵²⁹ **Ibid**

- **Dispute Resolution**-The parties must always turn to the JVA for guidance on their relative legal position; there maybe a delay in responding by the JVA and it will be too late to approach the court or an arbitration to rewrite the JVA.

In the Ethiopian legal system, a joint venture was⁵³⁰ governed under the Council of State Decree No 11/1989(latter Proc. No 32/1989). According to Article 4 of this law, parties to the joint venture may be the Ethiopian State (including state enterprise or financial agency capital, Ethiopian cooperative), on the one hand, and foreign state, state enterprise, financial agency or private capital, on the other hand. Joint venture arises from joint venture agreement⁵³¹ that must be approved by the State Committee (at that time).

A joint venture can commence operations only upon its registration with the appropriate state organ (the then Ministry of Domestic Trade).⁵³² The Joint venture agreement should be submitted for approval and registration.⁵³³ This clearly shows that the joint venture agreement should be made in writing as opposed to the joint venture envisaged under our Commercial Code.⁵³⁴ The consequence of registration of a joint venture under Investment Law is that it will acquire legal personality, and this enables it to transact investment and to sue and to be sued in its own name.⁵³⁵ This is another distinguishing feature of joint venture under the law of investment compared to a form of business organization provided for under Arts. 212 & 277 of the Commercial Code. Pursuant to Art. 272(3) of the Commercial Code, a joint venture as one form of business organization, “does not have legal personality”.

The issue of liability is another point of distinction between a joint venture (as a form of business organization) and a joint investment (as an option to carry on investment). According to Art. 275(2) of the Commercial Code, all partners have the status of managers in the absence of appointed manager(s). Consequently, a partner who manages the joint venture will be fully liable.⁵³⁶ What is more, every partner

⁵³⁰ This law is repealed by Article 40(1)(A) of Investment Proclamation No. 15/1992. However the principles help us to understand the nature of joint venture.

⁵³¹ Council of State Decree No 11/1989(latter Proc. No 32/1989, Art 7.

⁵³² Ibid; Art. 9(1)

⁵³³ Ibid: Arts 7(4) and 9(2) (a)

⁵³⁴ See Comm. C. Art. 272(2)

⁵³⁵ Proc. No 32/19 : Art. 10

⁵³⁶ Art. 276 Comm. C.

should deal with third parties in his/her own name⁵³⁷ and may be fully liable. In the case of joint investment, however, partners are liable only to the extent of their contribution and commitments.⁵³⁸ We have seen that a joint investment has legal personality, and thus the joint venture is liable only to the extent of its assets.⁵³⁹

The management structure is another point for distinction between joint venture and joint investment. A joint venture should be managed by one or more managers who may or may not be partners.⁵⁴⁰ Where a manager is not appointed, every partner has the right to manage a joint venture.⁵⁴¹ On the other hand, a joint investment is managed by a board of directors and manager(s).⁵⁴² This is a feature of a share company as envisaged under the Commercial Code.⁵⁴³

The decision to engage in a joint venture to do foreign direct investment may be made out of preference, or necessity. A foreigner (company) may decide to invest with partners (joint venture) if it is the best way to be successful after considering all other things. In such a case, a joint venture is established as a preference. On the other hand, where it is the only option, it is done out of necessity. For instance, some countries will not permit a whole ownership of a foreigner on certain fields. In such a case, the choice of the foreign investor is either to forego the investment or to enter a joint venture if it/s/he decides to invest.⁵⁴⁴

Coming to Ethiopia, pursuant to Article 5(2) of Proclamation No 280(2002(as amended) an investor (local or foreigner) can invest in the manufacture of weapons and ammunitions; as well as telecommunication services only in joint venture with the Government. Therefore, a joint venture in these two areas is a necessity that arises out of the Ethiopian Investment law. In this case, the Government is only a partner who co-investments In the aforementioned areas.

Why is joint investment required?

⁵³⁷ Art. 276/5 Comm. C

⁵³⁸ Proc. No 32/1989; Ibid: Art 11(2)

⁵³⁹ Ibid: Art 11(1)

⁵⁴⁰ Comm. C. Art. 275(1)

⁵⁴¹ Ibid: Art. 275(2)

⁵⁴² See Proc. No 32/1989; Ibid: Arts. 20-23 and 7(2) (i)

⁵⁴³ See Comm. C. Arts 347-367

⁵⁴⁴ Ibid

From the host developing countries point of view, the following could be the reasons governments require foreign investment to be made through joint venture.⁵⁴⁵

A) Government may require a joint venture in the areas that have social goals to be achieved. For example, the government may need to increase employment, and to provide social services which are not profitable in certain localities. Thus, the government as a shareholder can decide to invest in some economic areas to achieve some public goals even though they may not be profitable.

B) The host state may also require local participation to share in the growth of the economy. The desire of developing countries is to empower local investors so as to make them competent. Thus, a government makes it mandatory to join with a local partner to invest in lucrative sectors so that local investors can share in profits of the investment.

C) There is also a desire from the host countries to involve local personnel in the ownership, management and control of the enterprise. This would offer the opportunity for locals to learn how to manage the investment project. So, it ensures the transfer of managerial skills to local investors. In addition, the local investor will reject unnecessary decisions and measures that would affect the interest of the host state and that may be decided by the headquarters of the multinational enterprises. For example, the multinational enterprise may employ an input to the production that adversely affects the environment, or the investor may wish to decrease the number of local workers, and this definitely increases the number of unemployment. If a local investor is a co-investor, s/he would fight at least to minimize such measures, hence, the decisions made by the investors may not adversely affect the interest of the host state.

D) Joint venture may also offer an advantage to the host government to address security concerns. Where the economic sector of the investment is security sensitive, such issue may be addressed properly by having a co-investor from the locality. More efficiently, the government being a partner in certain economic areas would definitely help the host state to address the fears of the government in the fields.

What are the points that must be considered in deciding to invest through joint venture?

To make partnership with a local company, it is essential to calculate the expected returns based on the following information. The first question the investor should raise is what are the costs to the company? To address this question, it is possible to consider the required finance, technology supplied, and the managerial and market costs. It is also important to consider the loss of exports or “the loss of the most economic use of resources by a loss of control”.⁵⁴⁶

Benefits to the company should also be considered. The benefits will be those related to the market. If the investment offers a good market opportunity it is advisable to invest in joint venture. The investment may accrue dividends, interest payments, marketing technical assistance and so on to the parent company.⁵⁴⁷

Percentage of ownership is the other essential point to be taken into account. Thus, the next question to ask is what percentage of ownership to the company is require A certain level of ownership could justify contributing to a joint venture. In most cases, the law of the host country determines the upper limit that a foreigner could own (in the form of share). Accordingly, the share should reflect the contribution to the joint venture.⁵⁴⁸

The other essential issue is to determine who the potential partners are, and what have they to offer Here, the foreign investor must go through a systematic selling process to determine the right partner that fits its/ his/her goals. The foreign investor should avoid making a mistake in this regard because such a mistake may not be corrected once a joint venture is made.

What are the advantages of a joint venture? From the foreign investor’s point of view, a joint venture offers some advantages. Let us consider some of them as follows.

⁵⁴⁶ Bhalla and Ramu; **Ibid**, p. 464

⁵⁴⁷ **Ibid**

⁵⁴⁸ **Ibid**

A) **Raising Capital**- A foreign investor should have sufficient capital to invest on a certain sector of the economy. However, the investor may not have the required capital to utilize the investment opportunity in a host state. In such a case, collaborating with other investor would be a solution. Thus, a joint venture enables the investor to raise the a required amount of capital to invest.

B) **Sharing Risk**: We have seen that an investment is inseparable from a risk. Thus, investing In a given sector of an economy has opportunity cost. It would be better for a foreign investor to share the risk with local investors. Thus, the investor could choose to co-invest with locals through joint venture.

C) **Obtaining Host Nation Identity** –As considered earlier, hostility to foreign investment is one of the threats to foreign direct investment. If the investor invests an his/her/its own, the local people may develop hostile outlook towards the investor. Consequently, this may damage the investor; it would be very difficult to establish good will and penetrate into the market so as to be profitable. For example, if there are butcheries, one national and the other foreigner, the people in that particular locality may prefer products of the national butchery to that of the foreign one Nevertheless, if the investor joins the local investor, such a problem could be minimized or avoided. Therefore, a foreign investor collaborates to co-invest in joint venture to minimize at least the risk.

D) **Securing Components and Market**-An investor needs inputs to its investment that are available in the locality cheaply. To secure inputs, the investor may co-invest with the local investor who produces these inputs. This way the foreign investor can make the locals dependable suppliers of the components to its/his/her investment because they will have interests as shareholders of the investment. Further, the local investors may have an established marketing chain. Thus, the foreign investor could co-invest with them to be beneficiary of the market they established. In other words, a joint venture will enable the foreign investor to share monopoly markets.⁵⁴⁹

E) **Obtaining needed managerial skills** -A particular investment should accumulate local circumstances and culture of the society. The local investors may have a managerial skill to run the investment without violating local circumstances and the culture of the people. This managerial skill is essential for the existence and continuance of the investment. Thus, the foreign investor will obtain such an advantage by co-investing with local investors through joint venture.

F) **Obtaining real property** – Some countries do not allow foreigners to own real property such as buildings and land. Thus, a foreign investor may opt for joint investment to invest.

⁵⁴⁹ Soranajah; **Ibid**, p. 116

G) Obtaining favourable Treatment –Some states offer preferential treatment to foreign investors who co-invest with locals because the host state needs to strengthen local investors. Thus, a foreign investor may benefit by co-investing with the local investor. Further, matters such as customs clearances, export permits and other administrative matters concerning the investment will be smoother where the foreign investor co invests with locals through joint investment.⁵⁵⁰ Therefore, a foreign investor chooses a joint venture.

H) Associating with Famous Individuals –Some times, it may be very difficult to invest unless the investor has the right people at the right place. Trying to break through the bureaucracy on his/her own could be too difficult for a foreigner. On the other hand, there could be local investors who have goodl connection with the government. Thus, the foreign investor would solve the problem by co-investing with local investors who are favoured by the government.

I) Obtaining needed technology-Sometimes there could be high technology that best fits the investment in the host countries. The foreign investor can benefit from that superior technology if s/he/it co-invests with the local investor who has the technology. Therefore, investment in joint venture is preferable or attractive.

In general, the abovementioned points could be considered as points that attract a foreign investor to invest in joint venture. However, that does not mean that these are the only factors that attract foreign investor to invest in joint venture.

We have seen that joint venture offers a number of advantages. However it also has same disadvantages. The main disadvantage of joint venture is that the local investor becomes so passive if he depends on foreign technology⁵⁵¹ because, the necessary technology as an in put is cams from a foreign country by the foreign investor.

Choosing a local partner

⁵⁵⁰ **Ibid**

⁵⁵¹ Ibid, p 117

What are the options for a foreign investor to invest in joint venture in a host country? A foreign investor may have the option to choose either private partners or state as a partner. **Private partners** as investor will have the same objective as a foreign investor, i.e. to maximize their profits. This would attract the foreign investor to co-invest with private partners. Further, a private partner avoids any affiliation with a government. Thus, the risk would decrease the hostility if the existing government will be replaced by another one.

State is another option as a partner for foreign investor. Being a partner with a state has an advantage of hastening the process of admission and investing within a short period of time. A state as a partner may know better how to apply for admission and address obstacles of investment permits. Further, state officials may not be as serious as in the case of private partners in providing facilities for foreign investors. In general, it would be advantageous to co invest with a state in joint venture.

However, a state as a partner has also disadvantages. The first disadvantage is that the state will seek to represent its objectives.⁵⁵² For example, the state may use it to decrease unemployment and consequently persons that are not welcome by foreign investor may be recruited. In addition, the foreign investor could not dismiss the workers as s/he/it wishes without the consent of the government. Consequently, this would at least cause the profit from the investment to decrease, or not to increase. Secondly, state policies would clash with the profit motives of the foreign investor.⁵⁵³ The basic motive of state in investment is to promote social goals rather than profits. On the other hand, a foreign investor is running for profit. Thus, their motives are contradictory

The third disadvantage of the state as partner is that the state will assign persons in the board of directors. Hence, the constant presence of directors of the state at the board meeting of the joint venture will enable the state to promote its policy.⁵⁵⁴

Disputes could arise from the investment transaction. The mechanism of dispute settlement is one factor that would attract or pull foreign investment. Where a foreign investor co-invests with a state through joint venture, the state will use legislative and administrative powers to ensure the implementation of its

⁵⁵² **Ibid**

⁵⁵³ **Ibid**

⁵⁵⁴ **Ibid**

policies in dispute.⁵⁵⁵ As discussed earlier, a decision to select a private partner or state requires care and knowledge of the result of the choice.

SUMMARY

We have learnt that the Ethiopian economic policy, being liberal, is the first opportunity to invest in Ethiopia because it offers a conducive environment. In addition, we have said that the agricultural sector offers opportunities to invest. The first important point is that Ethiopia is a country endowed with favourable climate to produce all types of crops. Regarding to fishery, we have seen that the country has the potential to produce 30,000-40,000 tones of fish. We have also discussed the agricultural services like pest and disease control, technical consultancy offer opportunity for investment invention. With regard to manufacturing, we have seen that textile and garment, food and beverage, leather, building materials and metallurgy offer the opportunity to invest.

Mining is also another sector that offers investment opportunity. Further, we have learnt that tourism is on ever sector for invest mint What is more, the infrastructure also offers opportunity for potential investors to undertake investment activities in Ethiopia.

Under the second subtopic of Topic One of this unit, we have discussed favourable situations to invest in Ethiopia. The first point we have considered is the political situation of the country which some argue is stable while others argue that it is not stable particularly the fear that war could happen with Eritrea may be considered as a repelling factor to investment. We have also discussed that Ethiopia being vigilant, domestic raw material is reliable for every investment activity. Further, we have learnt that Ethiopia offer market for investors. Above all, we have considered that there is sufficient legal protection for investors.

We have considered practical problems in investment activities. Accordingly, we have seen that some investors fail to give correct information, fail to report to the relevant investment organ, among others.

⁵⁵⁵ **Ibid**

We have also seen the problem of infrastructure like roads, telephone, and electric power. We have discussed the bureaucratic problems. The privatization process is not at the level it is expected to be and this may force investors to question the commitment of the government to investment. The man power available in the country is unskilled and unqualified to meet required level and quantity. We have also identified the problem of inefficiency of investment organs in the country. This may create inefficiency in evaluating and approving appropriate an investment project that does not harm our environment and that would help to transfer appropriate technology to Ethiopia.

The second major point we have considered under this unit is investment options in Ethiopia. The Ethiopian investment law offers potential investor to invest salary. We have seen that this offers the opportunity to manage the investment easily. However, we have identified that such an option lacks the advantages of investing in group.

The other investment option we have discussed is business organization. Business organizations are governed by the Commercial Code. Thus, an investor can establish partnerships or companies to undertake investment in Ethiopia. A company maybe either private limited company or share company. We have discussed that investors should opt for share company to undertake a huge investment.

In addition, we have seen that investors can establish a joint venture, a type of business organization under our Commercial Code which has no legal personality.

We have learnt that a foreigner may invest through a branch or subsidiary to the business organization established in his/her own country by registering here in Ethiopia.

We have identified that joint venture as provided under our Commercial Code is different from joint investment envisaged under Proc. No 280/2002 and proc. No 32/1989. A joint investment under the proclamations is a joint venture which could be established in the form of Share Company. Such a business organization is essential to undertake investment activities that require a vast amount of money, skill and other instruments.

We have also discussed that a government has an option to invest through public enterprises. We have seen that public enterprises give the government the opportunity to promote social purposes in addition to maximizing profit.

The other option we have discussed under investment modalities is cooperative societies. Cooperative societies promote the interest of their members and the society in their locality. We have also noted that cooperative societies could maximize profit for members.

REVIEW QUESTIONS

D) True/False

- _____ 1) The concept of joint venture is easy and uniformly defined.
- _____ 2) Sole proprietorship offers an advantage of making quick decision.
- _____ 3) Joint venture, as one form of business organization under our Commercial Code, is a form of partnership without having legal personality.
- _____ 4) The Amhara Regional State has offered a favourable condition to invest in tourism.
- _____ 5) Joint venture, from investment point of view, may be private limited company.
- _____ 6) Under the Ethiopian investment law one can establish one person company.
- _____ 7) Most of our regions have well inter-connected roads that favour investment.

- _____ 8) All investors are honest in revealing information about their investment activities.
- _____ 9) Addis Ababa, being the capital city of Ethiopia and the political centre of Africa, attracts investment more than other regional towns.
- _____ 10) Ethiopia offers opportunities to invest on fishery.

II) Choice

- 1) If persons wish to invest in banking transaction. they
A) must be five and more in number B) could be foreigners
C) could form PLC D) all
- 2) An investor wishing to participate in manufacturing military weapons should establish
A) share company B) partnership C) PLC D) joint venture
- 3) The option for foreigners to carry out investment activities in Ethiopia could be
A) to establish a business organization in Ethiopia
B) using subsidiary C) A and B D) none
- 4) The Ethiopian Government may undertake investment activities through
A) share company B) PLC
C) Public enterprises D) cooperation
- 5) Which of the following offers investment opportunity in Ethiopia?
A) textile and garment B) Oil
C) tourism D) all
- 6) Which of the following is a problem attribute able to investment organs?
A) efficiency B) sufficient workforce
C) shortage of budget D) All
- 7) One of the following is a favourable situation to invest in Oromia Region. Identify.
A) small market B) large market
C) less populous city D) no natural resource
- 8) Privatization in Ethiopia is taken as
A) an investment option B) a challenge to investment
C) a conducive environment for socialism D) all
- 9) Investing in a joint venture offers the advantage of
A) making liable each participant to its contribution

- B) the management may be done together
 C) the management is not easy task D) none
- 10) Joint venture, as one form of option; has the disadvantage of
 A) easy dispute resolution B) unlimited liability
 C) costly to establish D) all

III) Matching

- | A | B |
|------------------------------|---|
| _____ 1) Society anonfine | A) Two type of members |
| _____ 2) Public enterprise | B) Opportunity to invest |
| _____ 3) Limited partnership | C) favourable situation to invest in Ethiopia |
| _____ 4) Mining | D) Corporation |
| _____ 5) Market | F) All members are liable |

IV) Answer the following

- 1) Analyze the advantages of sole proctorship from the investor point of view.
- 2) Discuss the factors an investor must consider to determine the form of business organization to undertake investment activities in Ethiopia.
- 3) George (American), John (British), Wayombie (Nigerian), Dendir (Ethiopian), and Wahaye (Chinese) need to invest in the floriculture in Ethiopia. Each of them has good deal of capital. But, they are not sure how to organize themselves to transact the investment activity they have planned. Write a piece of advice for them.
- 4) Describe how foreign investors can undertake investment activities in Ethiopia through subsidiaries.
- 5) Evaluate public enterprises as an option to invest in Ethiopia from management point of view.
- 6) Cooperative societies, in principle, are aimed at promoting the interests of their members as well as the society in their locality. Do you believe that they are good option to carry out an investment activity which is aimed at maximizing profit?
- 7) Analyze the concept of joint investment under the Ethiopian investment law/
- 8) Compare and contrast the advantages and disadvantages of investing through Share Company under the Ethiopian Investment Law.

- 9) Distinguish between joint investment and joint venture under the Ethiopian law.
- 10) Do you believe that the investment options in Ethiopian are adequate to promote investment?
Give your reasons.

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UNIT SEVEN: INVESTMENT INCENTIVES AND GUARANTEES

UNIT OBJECTIVES

After completing this unit, students should be able to:

- analyse investment incentives;
- discuss investment guarantees;
- apply the rules of investment incentives and guarantees.

INTRODUCTION

In the previous unit, we discussed the investment opportunities and options in Ethiopia. After considering these areas, it would be very appropriate to consider the investment incentives and guarantees.

Under the first topic of this unit, we will discuss the incentives in general. Incentives are given because there is a purpose to achieve. Then, we will discuss the economic rationale of incentives. Next, we will consider investment incentives under the Ethiopian laws. Further, we will consider the issue about rethinking investment incentives in Ethiopia in order to foster investment and thereby development.

The second main topic we will consider under this unit is investment guarantees. The basic guarantees provided for investors are repatriation of capital and profits; and guarantee against expropriation and nationalization. We will also consider the federal and regional laws in this respect.

7.1. INCENTIVES IN GENERAL

Governments, especially industrialized countries, offer considerable investment incentives to attract investment in general and FDI in particular; to steer investment into favoured sectors, activities or regions; or to influence the character of an investment. Nowadays, most investment incentives are given to both domestic and foreign investors alike. Sometimes, incentives are geared towards large projects or specific foreign investors, for example, where advanced technologies that can only be provided by foreign investors are involved.⁵⁵⁶

What do you understand by investment incentives?

We do not find a uniform definition for the term “incentive”. It may be defined broadly covering any assistance offered by a country to investors. It may also be defined narrowly covering only specific types of assistance given to investors.⁵⁵⁷ According to SMC Agreement, “incentive” is synonymous to “subsidy” when subsidy is granted to investors. The concept of subsidiary includes financial contributions made by government and benefit is inferred.⁵⁵⁸ In short, subsidiary is an advantage given to investors and, therefore, it is an incentive. This definition is a wide one.

Incentives are any measurable economic advantages afforded to specific enterprises or categories of enterprises by a government, in order to encourage them to behave in a certain manner”.⁵⁵⁹

Investment incentive is defined by multilateral agreement on investment (MAI) as:

*The grant of a specific advantage arising from public expenditure in connection with the establishment, acquisition, expansion, management, operation or conduct of an investment of a contracting party or a non-contracting party in its territory.*⁵⁶⁰

From the above definition and explanation, we can observe that incentive is granting of public expenditure, that is a financial contribution to the investors. The main purpose of incentive is to attract investment in general. FDI may create jobs in a host country. For example, in 1991, Ford created 1900 jobs in Portugal and US 484 million was given as incentive. In addition, US \$300 million was given to

⁵⁵⁶ Bhalla and Ramu, 2001: 503-04

⁵⁵⁷ United Nations, **International Investment Agreements: Key Issues, volume II**, 2004, p. 53

⁵⁵⁸ **Ibid**

⁵⁵⁹ Bhalla and Ramu, **Ibid**, p. 502

⁵⁶⁰ Multilateral Agreement on Investment, Draft

Mercedes-Benz in Alabama in 1996 for creating 1,500 jobs. The capacity of developing countries in extending such incentives is limited. Thus, developing countries offer tax exemption or other assistance as an incentive to attract desirable FDI. Developing countries subsidized infrastructure to export-oriented investments. Governments, like Singapore and Malaysia, have employed incentives such as pioneer industry programs to attract FDI in industries that do not exist in the country. Diffusion of knowledge brought in by Multinational Enterprises (MNEs) in the host country is another area of investment that attracts incentives. Countries such as Singapore, Taiwan, Korea and Ireland, have employed protective measures in the area. Further, creating sub-national or sub-regional clusters of interrelated activities that facilitate the spillovers of knowledge through informal and social contracts among the employers in addition to traditional buyer-seller links is used to accomplish knowledge diffusion.⁵⁶¹

Incentives may include measures either to increase the rate of return of a particular FDI undertaking, or to reduce its costs or risks. The following are the main types of incentives used:

A) FISCAL INCENTIVES

Fiscal incentives may include reduction of the standard corporate income tax, tax rate, investment and reinvestment allowances, tax holiday, accelerated depreciation, exemptions from import duties.⁵⁶²

B) FINANCIAL INCENTIVES

Financial incentives include government grants, subsidised credits, government equity and participation.⁵⁶³

C) OTHER INCENTIVES

Under this category, different types of incentives are included.⁵⁶⁴

⁵⁶¹ Correa and Kumar; 2003:26

⁵⁶² Bhalla and Ramu; **Ibid**: 503

⁵⁶³ **Ibid**

Regulatory incentives include:

- Lowering of environmental, health, safety or labour standards;
- Temporary or permanent exemption from compliance with applicable standards;
- Stabilization clauses guaranteeing that existing regulations will not be amended to the detriment of investors.

Subsidized services

- Subsidized dedicated infrastructure: electricity, water, telecommunication, transportation, (a price less than the market)
- Subsidized Services like sources of finance, implementing and managing projects, carrying out pre investment studies, informant on markets, advice on production process, and marketing techniques, assistance with training and retraining, technical facilities to develop know how,

Market privileges

- It includes granting of monopoly rights, protection form import competition, closing the market to further entry, preferential government counteracts.⁵⁶⁵
 - Preferential government contracts;
 - Closing the market to further entry or the granting of monopoly rights; protection from import completion,

Foreign exchange privilege

- Special treatment with regard to foreign exchange,

Questions

- 1) Define the term “incentive” for investment in you own words.
- 2) Analyze the purpose of investment incentive.
- 3) One of the types of investment incentives is fiscal incentive. Discuss how encourages investment.
- 4) Explain market preference as an investment incentive.

7.2. ECONOMIC RATIONALE FOR INCENTIVES

⁵⁶⁴ United Nation, **Ibid**, p.51

⁵⁶⁵ Bhalla and Ramu; **Ibid**

Incentives are justified on certain economic grounds. First and foremost, incentives are intended to promote positive economic benefits. These economic benefits include, among others, job creation, technology transfer, regulation of foreign exchange. These are crucial points that Ethiopia should consider.⁵⁶⁶

According to Bhalla and Ramu,⁵⁶⁷ “the economic rationale behind incentives is to correct the failure of markets to reflect the wider benefits arising from externalities in production”. For example, the creation of widely diffused knowledge and the up grading of skills of mobile workers are the expressions of the rationale of incentives. Incentives may be justified on ground that it bridges the gap between the private and the social returns on an investment. Investment is required to offer benefits to the society and the host country. Nevertheless, market failure may occur and this in turn could discourage investors to invest. Thus, the government will intervene to correct market failure. Therefore, incentives help to correct the failure of markets to reflect the gains that accrue over time from declining unit costs. In addition, incentives are used to compensate investors for lost return due to other government interventions. For example, duty remissions on imports or performance requirements could result in loss for the investor and hence the government may correct such a problem through incentive to investors. Further, incentives are important for carrying certain public costs where a government lacks the institutional capacity to bear it itself. In general, incentives would promote a number of development purposes. Nevertheless, incentives have the potential to introduce economic distortions. Economic distortion may result where incentives are more than marginal and are analogous to subsidies on trade.⁵⁶⁸

According to Article 2 of the draft multilateral agreement on Investment (MAI), incentives may “have distorting effects on the flow of capital and investment decisions”. It is important to note that distortion could result even in the event that the incentives are granted on a non-discriminatory basis. Certain incentives may distort capital flows to the degree that they thwart comparative advantage against the interest of a host country to attract investment. This would happen particularly where incentives are only granted for certain sectors of the economy.

⁵⁶⁶ Aron Mijumdor, “Ethiopian Investment Incentives in the Light of International Investment Law”, **Ethiopian Journal of Business & Development**, Unity University College, Volume 1, number 1, April 2006, p. 3

⁵⁶⁷ Bhalla and Ramu; **Ibid**

⁵⁶⁸ **Ibid**

Pursuant to Article 4(1) of Regulations No. 84/2003, incentives are granted to investors “engaged in manufacturing or agro – industrial activities or the production of agricultural products to be determined by directives to be issued by the Board”. Thus, incentives under the Ethiopian law are not granted in only one sector of the economy. Consequently, it is unlikely significant distortions of investment to happen in Ethiopia.

Furthermore, incentives may involve financial and administrative costs. What is worth noting is that the cost of incentives should not exceed the value of the benefits to the public.⁵⁶⁹

The effect of Incentives on Investment Decisions

We have seen that incentives are granted with the intention to attract foreign investment so as to promote the development of Ethiopia. FDI can not be easily attracted; it needs competition because other countries also have their own strategies to attract foreign direct investment, one of which is offering incentives. Governments focus on manufacturing industries and try to attract with incentives. In addition, governments offer incentives in agriculture, fisheries, mining and oil exploration. We have learnt that incentives entail cost.

The general rule is that developed countries make more use of financial incentives than that fiscal ones. This is justified by the fact that fiscal incentives are less flexible and countries need to pass through more difficult parliamentary procedures to adopt them. On the other hand, developing countries adopt the reverse, That is, they adopt fiscal incentives because they lack the resources needed to provide financial incentives.⁵⁷⁰

Incentives are a policy tool in the global competition to attract FDI and benefit more from it.⁵⁷¹ Incentives can be successful only where they can attract investment irrespective of their rationale. In the era of open

⁵⁶⁹ **Ibid**

⁵⁷⁰ **Ibid**, p. 504

⁵⁷¹ United Nation, **Ibid**, p. 51

market world economy, each country competes through incentives to drive investment away from competing host countries.⁵⁷² It is crucial to be competent in every aspect (in the economy, know how and technology, etc) to come out successful in the competition to attract investment.

Do you believe that Ethiopia will be successful in attracting investment by means of incentives? The bare fact is that the poor countries are relatively disadvantaged in the game of competition for FDI.⁵⁷³

Despite the competition, incentives are said to play a relatively minor role influencing decisions about investment compared with “market size and growth, production costs, skill levels, adequate infrastructure, economic stability and the quality of the general regulatory framework.” Hence, the decision of investment is made mainly on the basis of economic and long term strategic considerations concerning inputs, production costs and markets. These factors being equal, incentives play a great role in attracting investment.⁵⁷⁴

What is Important to note is that different incentives may attract different investors. For example, the export-oriented investors seeking inexpensive labour give more value to fiscal incentives than market protection or other incentives. On the hand, market-seeking investors a value market protection more than fiscal incentives. Thus, it is important to consider different incentives to attract investors. Recently, governments are being offering variety of incentives including creating markets for investors. In general, incentives play a role in attracting investment even though they do not rank high among the main FDI determinants⁵⁷⁵

Questions

- 1) Describe how investment incentive may correct market failure.

⁵⁷² **Ibid**

⁵⁷³ **Ibid**

⁵⁷⁴ **Ibid**, 505

⁵⁷⁵ **Ibid**

- 2) Discuss the conditions in which investment incentives may distort the inflow of investment to a host state.
- 3) Explain the sectors that are eligible for investment under Ethiopian law.
- 4) Why do developing countries employ more financial incentives than fiscal ones?
- 5) Different incentives may attract different investors. Comment.

7.3. INCENTIVES UNDER THE ETHIOPIAN LAW

To promote the investment objectives set under Article 4 of Proclamation No. 280/2002, the Ethiopian government is committed to grant investment incentives.⁵⁷⁶ The regulations to be issued should determine the type and extent of entitlement to incentives.⁵⁷⁷ Accordingly, the Council of Ministers issued Regulations No 84/2003. The regulations provides for the types and extent of investment incentives. They are discarded as follows.

A) Exemption from the Payment of Customs Duty

The investor is allowed to import to Ethiopia capital goods and construction materials that are “necessary for the establishment of a new enterprise or for the expansion or upgrading of an existing enterprise”⁵⁷⁸ Further, an investor who is granted custom duty-free is also allowed to “import duty-free capital goods necessary for his [her] enterprise”⁵⁷⁹ The main purpose of such an incentive is to encourage the investor to establish an enterprise to invest or to upgrade the already existing enterprise to invest or to upgrade the already existing enterprise. Hence, necessary capitals and materials are allowed to be imported without paying custom duty. The Investment Board is given the power to ban importation of construction materials and capital goods that are produced in Ethiopia with competitive price, quality and quantity.⁵⁸⁰ This provision is based on the rationale to encourage exploitation of domestic products.

⁵⁷⁶ Proc. No 280/2002, Art. 9

⁵⁷⁷ Ibid, Article 9(2)

⁵⁷⁸ Regulations No 84/2003, Art. 8/1

⁵⁷⁹ **Ibid**, Art, 8(2)

⁵⁸⁰ Ibid: Art. 8(3)

One can imagine that if the goods are competitive in quality, quantity and price with those produced abroad, an investor would prefer to purchase goods produced in Ethiopia because this would surely offers an advantage for the two managers of the businesses for more frequent person-to-person contact. It also saves transportation cost that would have been, paid had it been exported from abroad.⁵⁸¹ What is more, purchasing capital good in Ethiopia would save the time for the investor. Thus, so long as the local producers are competitive, the investor would prefer to purchase these products to the foreign produced ones. Therefore, one can conclude that competitive local producers do not need such assistance. Do you agree with this conclusion?

What is more, the incentive to export “spare parts whose value is not greater than 15% (fifteen percent) of the value of the capital goods to be imported”⁵⁸² The capital goods that are used in the investment naturally esquire spare parts to service. Thus, the investor who is eligible to import capital goods and construction materials to establish an enterprise or upgrade the existing one is also allowed to import spare parts only with limited value.

It is worth noting that the provision provided under Article 8(3) of the regulations has a protectionist goal. That means, the existence of the provision would protect competitive local producers to see their products without facing a competition with foreign producers.

Even though the provision of Art. 8(3) Regulations is intended to encourage investors to use local materials, it does not require investors to use local material as an input in the production problem. Thus, it would be possible to conclude that our law in this regard is not in line with the TRIMs Agreement that provides that the investor is to use domestic content as stipulated in paragraph 1(a) of the Annex to the TRIMs Agreement.

What are the conditions to be fulfilled by an investor to be eligible for exemption from the payment of customs duty to import vehicles?

There are conditions required for an investor to be allowed for exemption from payment of customs duty to import vehicles? The Board is empowered to determine the conditions to be fulfilled by an investor to

⁵⁸¹ Mujumdar; Ibid: 6

⁵⁸² Regulations No 84/2003, Art. 8(3)

import vehicles. However, any investor is allowed to import duty-free “Ambulances that are used for emergency cases for employers; and buses for tour operational services” (Art. 9 Regulations No 84/2003].

Does the provision of Art. 9(b) of the Regulations No 84/2003 allow any investor to import buses? Hence, only an investor who invests on tourism is allowed to import buses duty free. On the other hand, any investor is given the privilege to import ambulances to handle emergencies so as to preserve the safety and health of employees.

An investor who is allowed to import capital goods free of customs duty may wish to transfer these goods to another person. However, such a transfer is not without limitation. An investor is not allowed to transfer such capital goods to a third party who is not entitled to similar duty free privileges. The investor could transfer the goods after the payment of the customs duty.⁵⁸³

By *a contrario* reading of the provisions of Article 11 of the Regulations, one may argue that an investor who is granted the privilege and imports capital goods without paying customs duty can transfer them to an investor who has been granted a similar privilege.

Do you agree with this? Why or why not? As to the writer, the basic purpose of the incentive is to encourage investment irrespective of who carries out it. Therefore, no interest would be jeopardized if the capital goods are transferred to an investor who is entitled to a similar privilege.

All investors are not eligible for customs duty free importation of capital goods and construction materials. There are areas such as real estate development, radio and television broadcasting services, travel agency etc which are treated an exceptional basis⁵⁸⁴

C) EXEMPTION FROM INCOME TAX

⁵⁸³ **Ibid**, Art, 11

⁵⁸⁴ **Ibid**, Art, 10

The general principle is that everybody who accrues income should pay an income tax.⁵⁸⁵ An income that is taxable may be derived from business activities.⁵⁸⁶ We have seen that investment is a business activity, so an investor is duty bound to pay income tax.

However, an investor may be eligible for exemption from income tax. An investor who is engaged in i) manufacturing, or b) agro-industrial activities, or C) the production of agricultural products that are to be determined by directives issued by the board is eligible (Reg No 84/2003, Art. 4(1)). In addition to invest in the aforementioned sectors of the economy, an investor should export at least 50% of his/her products, or if s/he is not directly involved in export, s/he should supply 75% of his/her products to an exporter as a production input.⁵⁸⁷ As we can observe from this provision, the incentive is intended to promote export, which will accrue foreign currency.

The exemption is given for a five years period. The Board may extend the sever period for seven years in special circumstances. Further, the period may be extended for more than seven years by the decision of the Council of Ministers.⁵⁸⁸

The period of exemption way be decreased to two years if the investor engages in investment sectors mentioned above and “exports less than 50% (fifty per cent) of his [her] products or supplies his [her] products only to the domestic market”.⁵⁸⁹ Under special circumstances, the board may extend the period for not more than five years.⁵⁹⁰

Example, John has invested in the manufacturing sector of the economy in Ethiopia. He produces and exports 60% of his products to England. Thus, he is eligible for income tax exemption for five years. Let us assume that John is exporting my 30% of his product. In this case, he is eligible only for 2 years exemption from income tax.

⁵⁸⁵ Proc. No 286/2002, Art. 4

⁵⁸⁶ Ibid; Art 6(b)

⁵⁸⁷ Ibid

⁵⁸⁸ **Ibid**, Art4(2)

⁵⁸⁹ Regulations No 84/2003, Art. 4(3)

⁵⁹⁰ Regulations No 84/2003, Art. 4(4)

We have seen that exemptions from paying income tax are intended to encourage export. This may be clear from the provision of the Regulations, which empower the Board to issue directives to “prohibit exemption from income tax with respect to an investor who supplies his products only to the domestic market”.⁵⁹¹

An investor who invests in less developed “Regions such as Gambella, Benshagul and Gumuz, South Omo, Afar Zones Somali, and other Regions...” must be given a privilege of exemption from income tax for an additional year.⁵⁹² This provision is intended to encourage investment in these areas more than other regions and thus accelerate development in these less developed regions. Therefore, the development between less developed and developed regions of Ethiopia will be balanced. In other words, the development gap will be reduced to the extent possible. For example, there is a deference in the level of development between Addis Ababa and Gambela. It is possible to attract investment in Gambela more than in Addis Ababa, and this will lead to the development in Gambela to be accelerated and get closer to that of Addis Ababa.

We have seen that investment is a business. In a business transaction, there could be loss. In case an investor faces losses rather than income, the exemption will not help him. Thus, the law provides 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”.⁵⁹³

An investor who expands or upgrades the existing enterprise is also eligible for exemption of income tax for two years provided that s/he exports 50% of his products and increases, in value, his/her production by 25%.⁵⁹⁴ The period of exemption will begin when the production of service of the investor, begins.⁵⁹⁵

Investors (exporters) are also given facilities of the duty-drawback scheme, the voucher, and the bonded warehouse. According to the duty-drawback scheme, investors are exempted from the payment of

⁵⁹¹ Regulations No 84/2003, Art. 4(5)

⁵⁹² Regulations No 84/2003, Art. 4(7)

⁵⁹³ Ibid Art. 7

⁵⁹⁴ Ibid, Art, 5

⁵⁹⁵ Ibid Art, 6

customs duties and other taxes levied on imported and locally purchased raw materials used in the production of export goods. Duties and other taxes paid in importing are drawn back at the time of the export of the finished goods.⁵⁹⁶

The duty draw back scheme, which was introduced in 1993, was dogged by inefficiency and long delays. The working system has been changed and the responsibility for the implementation of the duty-drawback scheme has been transferred from a high level committee to the Customs Authority since 2001. The customs authority communicates the amount of duties and taxes to the Ministry of Finance for payment to the beneficiary after making the required evaluation. Even though this new system is faster, the huge backlog from previous years continues to hamper efficiency.⁵⁹⁷

We have pointed out that a voucher scheme is a facility that is not available to investors who are exporters. What is voucher? A voucher is a printed document having monetary value which is used in bill of lading and taxes payable on imported raw materials.⁵⁹⁸

Questions

- 1) Analyze the underlining purpose of the Ethiopian government in granting investment incentives.
- 2) Discuss how incentive may encourage the exploitation of domestic resources
- 3) Analyze the incentives granted to investors under the Ethiopian investment law.
- 4) Compare and contrast the investment incentives granted to an investor who invests in Addis Ababa and in Gambella.

7.4. RETHINKING INVESTMENT INCENTIVES IN ETHIOPIA

Incentives are considered as positive encouragement for development. Hence, host and home countries are required to implement development friendly incentives so as to attract investment in developing countries and enhance development in those developing countries. For example, by the protocol amending

⁵⁹⁶ **An Investment Guide to Ethiopia**, 2004; Ibid p.59

⁵⁹⁷ Ibid

⁵⁹⁸ Ibid.

the 1998 Treaty Establishing the Caribbean Community (CARICOM) provides, among others, that member states must harmonise national incentives to investment in the industrial, agricultural, and service sectors. Incentives should promote development in general.⁵⁹⁹

According to Chapter 1 of the Common Convention on Investments in the States of the 1965 Customs and Economic Union of Central Africa, investments in agriculture exploitation of natural resources, power production, and tourism are eligible for incentives. The investment project needs to go through an examination. The criteria for examining projects are: a) importance of the investment; b) participation in the implementation of economic & social plans, c) the creation of employment and vocational training, d) the participation of nationals of the countries of the Union in the formation of capital, e) use of technology f) priority use of local materials and products.⁶⁰⁰

Home country incentives may also play a great role in encouraging and attracting investment to developing countries. Thus, home countries could give incentives to investors to invest in developing countries. The only international instrument on the point under discussion is the 2000 Partnership Agreement between the Members of the African, Caribbean and Pacific Group States and the European Community and its Members,

(the Cotonou Agreement). The Agreement reaffirms the importance of transfer of technology for development, which must be done through cooperation.⁶⁰¹

Further, according to Article 66.2 of the WTO Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs Agreement), developed country members are duty bound to provide incentives to enterprises and institutions in their territories to promote technology transfer to less-developed countries.⁶⁰² In general, investment incentives are policy instruments to promote development in host countries and it is essential to implement them properly.

⁵⁹⁹ United Nations, **Ibid**, p. 64

⁶⁰⁰ **Ibid**, p. 65

⁶⁰¹ **Ibid**,

⁶⁰² **Ibid**, p. 66

It is essential to offer appropriate investment incentives especially to investors who invest in social activities. For example, investors in the education and health sectors may need more incentives so as to attract investors to the sectors. Education sector may not be as profitable as any other kind of investment areas and needs more incentives. The participation of investors in these areas is critical to improve the standard of education and health. Taking into account the contribution to the economic development of the country, many developing countries greatly encourage private investment in education and health sectors.⁶⁰³

The government policy with regard to investment is clearly to bring about balanced economic development.⁶⁰⁴ To implement this, maximum incentives the country could afford have been directed to investments made in relatively less developed localities such as: Gambella, Somali, Afar, and Benishangul-Gumuz.⁶⁰⁵

However, the objective is not yet achieved due to the fact that the incentives have failed to attract more investment projects to those areas. The investment projects are highly concentrated in Addis Ababa, where the investment incentive scheme is less than that of the peripherals.⁶⁰⁶

This clearly demonstrates that the incentives offered do not attract investors to the peripheral of the country. The experience of several countries shows that attractive incentives is a major factor influencing the location of investment projects in regional development areas.⁶⁰⁷

Therefore, it is essential to rethink of investment incentives so as to attract investors to invest in less developing regions of our country.

Q1) What should be done to attract investment projects in peripheral parts of Ethiopia?

⁶⁰³ Lubo Teferi, A critical Evaluation of Ethiopian Investment Laws with specific Reference to proclamation No 116/1998 and Regulations No 36/1998, P. 30-31

⁶⁰⁴ Proc. No preface

⁶⁰⁵ Lubo, Ibid, p.60

⁶⁰⁶ Lubo, Ibid, P60

⁶⁰⁷ Id.

With regard to incentives,⁶⁰⁸ some investors argue that there is no any difference in the incentives given by Regions and those granted here Addis Ababa. They argue that Addis Ababa is a more attractive market compared to regions; to invest in a region is costly because it adds transport cost. They complain that the words of investment law and the practice with regard to incentives are for apart.⁶⁰⁹

One investor reputed that he faced a problem in implementing incentives while he was importing necessary materials like crusher, and loader to invest in Tigry Region. because government authorities were not in a position to allow him to import the materials without tax. Due to this problem, the crusher had to wait for two months and the loader for three months in Djibouti. This, he concludes that there are problems in the implementation of the law.⁶¹⁰ He also added that the implementation of investment in Addis Ababa is better than other regions.⁶¹¹

Questions

- 1) Do you believe that the investment incentives granted to investors under the Ethiopian law are sufficient to direct the flow of investment? Give your reasons.
- 2) Which sectors of the economy require more incentive so as to attract investment Why?
- 3) Do you believe that investors, under the Ethiopian investment law, are able to bring about balanced regional economic development? Reason out.
- 4) Assess the extent to which investors in your locality are satisfied with incentives granted to them.

7.5. GUARANTEES TO INVESTORS

⁶⁰⁸ Discussions made with Ato Gezahegn an expert in import, export and transport sectors; Ato Bahir Abdela, BCS in Management, Manager NolaWi Consultancy PLC; and Ato Hussiensayd, BCs in Economics and Management, a senior law student at Alpha University College, Faculty of Law, Manager Shaza Oil and Delicious Food Processing plant and Royal Tour and T Operation Enterprise; 08/07/08, at 2:00- 4:00 PM

⁶⁰⁹ Ibid.

⁶¹⁰ Discussions made with Ato Gezahegn, 08/07/08

⁶¹¹ Ibid.

Guarantees to investors are crucial points that are related to incentives. In this part of the material, we will deal with issues related to guarantees to investors.

7.5.1. General Remarks

We have seen that foreign direct investment (FDI) is desired by host states, and to attract FDI, incentives have been used. Despite the fact that incentives are available, investors may not decide to invest unless guarantees are available for their investment.

Multilateral or bilateral treaties have not provided comprehensive legal protection for foreign investments. No international investment code is enforced. In general, there is a genuine need for legal guarantees for foreign investors. This need could be fulfilled by the domestic law of the states concerned. The host states are in need of foreign investment and therefore, they, should offer legal guarantees to prospective investors. If the host states offer guarantees that are acceptable by foreign investors, they may be used as incentives to invest. Legal guarantees may not give a solution to all non-business risks. Hence, despite the usefulness of these guarantees they cannot be regarded as providing an over-all solution to the problem of legal security for foreign investment.⁶¹²

With respect to guarantees to investors, it is essential to grant it for both domestic and foreign investors. In other words, a host country is required to make sure that the law on investment should offer guarantees to both domestic and foreign investors without discrimination in order to encourage investment.⁶¹³

Guarantees offered to foreign investors may be found in constitutions and codes as well as in special laws. They are known as investment law and are usually assurances of fair treatment, non-discrimination, and the like. The main significance lies in the fact that they are the expression of an attitude favourable to

⁶¹² Freidmann; 1959: 709-11

⁶¹³ See Denchick; 1997: 1305. 011

foreign investment. However, investment laws may be easily altered by the government since they are unilateral by nature.⁶¹⁴

We have seen that guarantees are provided for under investment laws. This fact offers an advantage since the guarantees are given in a very precise and concrete manner. Thus, investment laws provide for guarantees against expropriation of investment and the right to transfer abroad the investor's profit and capital.⁶¹⁵ We will be focusing our discussion on guarantees to repatriation and expropriation in the forthcoming part of this material. However, first, let us consider the legal effect of contractual guarantees to investment.

Contractual Guarantees-In foreign investment, the parties to investment contract are private persons and the government. In short, the instruments are hybrids, involving elements of both private and public law. Concession contract is the instrument in foreign investment. With regard to the nature of the concession contract, there is consensus among authorities on the idea that it has "a double character; it relates to public as well as to private law". Such a view is also extended to be applicable to guarantee contract and instruments of approval of investment.⁶¹⁶

The Legal relations that arise from the instruments we mentioned above to create contracts between states and private persons are not international instruments in public international law, However they may have legal effects in international law and the violation of such instrument may be regarded as a tort under international law. This view has been accepted in a number of decisions of arbitral tribunals at the end of the nineteenth century and the beginning of the twentieth century.

However, the international principle, that were developed later rejected this principle and accepted the view that states are internationally responsible for violations of contracts with aliens only in the case as subsequent denial of justice. This view is becoming more popular in recent years. Once investment is

⁶¹⁴ Friedmann; Ibid: 711-12

⁶¹⁵ Ibid, p.712-13

⁶¹⁶ **Ibid**, p.718

made, the investor is under the influence/power of the state. Thus, the state may exert a pressure on the investor.⁶¹⁷

In general, there is a consensus that the violation of contracts is illegal in the eyes of international law. Such a view is based on the following arguments. First, the view is warranted by the general legal principle “*Pacta sunt Servanda*.” This principle is well accepted and applicable in municipal law with regard to contracts between private persons. But in contracts between state and a private person, the principles of “public law” (droit public) are applicable. Therefore, the argument based on the principle of “*Pacta sunt servanda*” has a serious weakness.⁶¹⁸

The second argument to justify the illegality of the violation of guarantee contracts is based on policy considerations rather than strictly legal considerations. It is argued that failure of international law to consider such illegal actions of state will have a negative impact upon international investment.⁶¹⁹

Do you accept these arguments? Both arguments are not unjustified but not proved. Some argue that it is true that violation of investment guaranties is illegal but there is not general rule covering all possible cases.⁶²⁰

We have seen that discrimination against the alien is illegal in the eyes of international law. In addition, denial of justice subsequent to discrimination is the second type of illegal act. Further, the principle of estoppels, which is appropriate in the case of state guarantees to investors, is applicable. It is a well-accepted general principle of international law common to many or all legal systems. The gist of the principle holds that where one by his[her] words or conduct wilfully causes another to believe the existence of a certain state of things, and induces him[her] to act on that belief so as to alter his[her] own previous position, the former is concluded from averting against the latter a different state of things as existing at the same time.⁶²¹ Some authorities argued that the principle of estoppels is broader in its

⁶¹⁷ **Ibid**, pp 719-20

⁶¹⁸ **Ibid**, p. 720

⁶¹⁹ **Ibid**, p.721

⁶²⁰ **Ibid**

⁶²¹ Lord Denman, C.J. in Freidmann; **Ibid**: 721

application in international law than its counterpart in municipal law of many states. It is argued that, under the estoppel principle, the host state, by granting special legal guarantees to foreign investors, acknowledges that these investors occupy a special position and induce them to act on the basis of this recognition. Thus, the host state is stopped from invoking other legal rules which might otherwise have been applicable.⁶²²

Another general principle of law which might be deemed applicable is that of unjust enrichment. According to the principle of unjust enrichment, a person who has been unjustly enriched at the expense of another is required to make restitution to that other person. This principle is generally accepted in both the civil and the common law legal systems. Thus, a state expropriating a foreign investor's property in violation of its own guarantees under a concession agreement is obliged to compensate the investor on the grounds that its enrichment is unjustified. In such a case, the amount of compensation to be paid to the foreign investor would be assessed on the basis of its gain.⁶²³ For example, George is a foreigner who invests in Ethiopia. Let us assume that Mr. George concluded a concession contract with our government. Later on the Ethiopian government expropriated the property of Mr. George. Hence, Mr. George may argue that the Ethiopian government has violated its contractual obligation and enriched itself to the extent of the value of Mr. George. Therefore, the Ethiopian government may be obliged to pay compensation to him. In addition, the amount should be equal to the value of the property.

The final principle that would be resorted to is the principle forbidding the "abuse of rights". According to this principle, legal rights should be exercised in good faith, so that they will not have manifestly unjust consequences, prejudicial to others.⁶²⁴ Pursuant to this principle, the host state is duty bound to exercise its rights not violating the rights of the investor.

In general, the fact that the host state guarantees foreign investment expresses its commitment and understanding of foreign investment as being essential. If the host state understands that foreign investment is essential for the development of its economy, it cannot afford, in the great majority of cases, to alienate foreign investors by failing to fulfil their promises.

⁶²² Friedmann; **Ibid**: 722

⁶²³ **Ibid**, p. 722-23].

⁶²⁴ **Ibid**; 723

7.5.2. Repatriation of Capital and Profits

What do you understand by repatriation? What is its significance as a guarantee to an investor?

The term “repatriation” is defined nowhere under the Ethiopian investment law. However, it is possible to explain it as the right to transfer capital and profits from the investment to the nation of the investor.

Any investor who invests in Ethiopia has the right to transfer to his/her country:⁶²⁵

- Profits and dividends gained from investment;
- Principal and interest payments on external loans. To facilitate the loan shall be registered with the National Bank of Ethiopia;
- The investor may have right of payment on technology transfer; s/he is allowed to transfer such payment to his/her country;
- The investor is also allowed to transfer to his/her country proceeds from the sale or liquidation of an enterprise;
- Proceeds from the transfer of shares or of partial ownership of an enterprise to domestic investor [Art 22(1)(e)]. This provision seems to encourage transfer of shares or partial ownership to Ethiopian nationals. However, an investor may transfer his/her shares to foreign investor so long as the seller is duly registered in the appropriate administrative organ. Our law is silent with respect to transfer of proceed. According to Article 10(A) (ii) of 11SD Model International Agreement on Investment for sustainable Development, each part shall permit transfer of “proceeds from the sale of all or any part of the investment...” Thus, the transfer is not limited under this model law. Dear student, should the Ethiopian law be amended to widen its scope?
- Further, any foreign investor is allowed to remit compensation paid to him/her where the investment is expropriated.⁶²⁶
- Finally, it is worth noting that our law guarantees transfer of salaries and other payment accruing from their employment to the expatriates’ employees in an enterprise.⁶²⁷

7.5.3. Guarantee against Expropriation

⁶²⁵ Proclamation No 280/2002,(as amended) Art 22

⁶²⁶ **Ibid**, Art. 23

⁶²⁷ **Ibid**, Art 22(2)

One of the threats to foreign investment is the risk of expropriation of the investment itself or the enterprise by the host state.

Expropriation is a governmental taking or compulsory “purchase” of individual property.⁶²⁸ Nationalisation is the act of bringing a property under ownership.⁶²⁹ Nationalisation has ideological overtone. Hence, it is related with the Marxist doctrine. However, expropriation exists regardless of the ideology adopted by a state. Expropriation presupposes compensation unlike nationalisation. Nationalisation is made without the view to take away property from wealthy people to minimize disparity. In other words, nationalisation is a method of eliminating the evils of private ownership.⁶³⁰

Expropriation may be lawful or illegal. A lawful expropriation is one that (international) law permits; though not necessarily encourages.⁶³¹ The law permits expropriation after just compensation. Where an expropriation is undertaken out of law, it may be regarded as unlawful expropriation.⁶³²

Thus, the host state has an obligation (contractual) to compensate an alien for injuries caused by non-performance of the contract by the state. Thus legal basis are there to justify compensation for the injured alien. The first basis is that a state is obligated to compensate aliens for any “unlawful interference with their contractual rights. As we have already noted, international law considers unlawful any interference in the form of a violation of a treaty, discrimination against foreign investor, or a denial of justice. In such a case, international law has recognized *restitutio in integrum* (or ‘specific performance’ in common law terminology) as a principal mode of reparation of a material wrong. In addition, pecuniary compensation is considered as subsidiary remedy applicable only when restitution is not possible or not claimed. However, the international tribunal and domestic practice tends to show that it is only exceptional cases that reparation is made through restitution. Thus, when compensation is not an effective means of reparation, restitution will be implemented. For example, where the foreign investor is imprisoned unlawfully the best remedy would be to rescue him/her. Effecting an indemnity in this case constitutes largely “satisfaction” for the moral wrong against the foreign investor and his/her state rather than

⁶²⁸ Garner; 2004: 621

⁶²⁹ Ibid: 1052

⁶³⁰ Alpha College of Distance Studies, **Property Law II**; 2005p.93.

⁶³¹ Friedmann; **Ibid**,p.729

⁶³² Ibid

“compensation” *stricto sensu* (in the strict sense). In general, state responsibility is discharged through payment of pecuniary compensation in most cases.⁶³³

The second on obligation to compensate may be founded on a lawful interference with a foreign investor’s contractual rights. An expropriation of foreign investment could be lawful. An expropriation is lawful if “just” compensation is offered at the time of expropriation. What do we mean by just compensation? What is lawful expropriation all about?

Expropriation should be made for the public purpose. However, writers are divided into two on the need for the requirement. For example, Freedman and Amerasinghe oppose the need for the requirement whereas earlier writers such as Worthy, Me Nair and Kunz favoured it. Despite the disagreements on the issue of public purpose, it may be said that if expropriation is undertaken by way of reprisal it lacks public purpose and is considered unlawful. However if expropriation is done for the public good, it has a public purpose. Thus, the expropriation that is undertaken by the legislature in implementing social and economic interests is a public purpose unless it is made manifestly without a reasonable foundation.⁶³⁴

There are two standards with respect to compensation in case of expropriation. The first standard requires the state to effect partial compensation. It is argued that this is based on economic necessity since full compensation were to be made, expropriation would be impossible or the expropriating state would go bankrupt. They argue that the investor is alien and should not be fully compensated.⁶³⁵ If partial compensation covers a major part of the investor’s losses, and is “prompt” and “affective” it is unreasonable.

On the other hand, some adhere to the view that compensation should be full.⁶³⁶ The prevailing standard of full compensation requires “prompt, adequate and effective compensation” in case of expropriation. ‘Prompt’ means without delay, (immediately), ‘adequate’ means the compensation must be equivalent to the fair market value of the investment immediately before the expropriation took place, ‘effective’ means that compensation must be fully realizable and freely transferable. What is more, the investor must be

⁶³³ **Ibid**, p. 726

⁶³⁴ Sornarajah; **Ibid**, p. 316-18

⁶³⁵ Friedmann; **Ibid**, p. 731

⁶³⁶ **Ibid**

given the right to have its case reviewed by a court or other independent body in the host country.⁶³⁷ Pursuant to Art. 23 of Proc. No. 280/2002 (as amended), an “adequate compensation, corresponding to the prevailing market value, shall be made...” in case of expropriation or nationalization of an investment. The word “adequate” is different from “full”. However, the spirit of the provision does not seem to take partial compensation since compensation corresponds to the market value of the investment be considered.

We have seen that an expropriation is lawful where just compensation is offered. This is the rule. However, it is disputed in the international legal literature. On the other hand, it is upheld by state practice in several recent instances of nationalization. For example, Mexico agreed to pay to the United States compensation for agrarian and petroleum properties of American nationals in Mexico expropriated some years before, in 1941. In addition, after the second World War, compensation has been paid for investments made by foreigners in the countries of South and Central Europe when they were nationalized. What is more the Egyptian government offered to compensate the shareholders of the Universal Suez Canal Company when it nationalized the canal. Then, an agreement was signed on July 13, 1958, at Geneva in which the exact amount of compensation to be made was fixed. Therefore, the rule that the host state is duty bound to pay compensation when it expropriates a foreign investment lawfully has been established under international law. There is also an obligation to compensate in unlawful expropriation. Nevertheless, it is worth noting the difference in the manner in which the amount of indemnity is assessed in lawful and unlawful expropriation. In other words, the difference between lawful and unlawful expropriation lies in the determination of the measure of compensation.⁶³⁸

Full compensation shall be paid when foreign investment is expropriated. The qualities of full compensation are usually its adequacy, promptness, and effectiveness.⁶³⁹

What is adequacy? The indemnity to be paid should correspond fully to the value of the expropriated assets. If that is so, compensation is said to be adequate. However, it is difficult to assess the value of the asset. The difficulties are partly due to the legal requirements in each case and partly to the particular character of modern expropriations and the nature of the expropriated assets. Measures of expropriation, as a general rule, affect all sectors of the national economy. Thus, their final effect is a significant change of the economic structure of the country. The subject matter of expropriation may vary in form

⁶³⁷ Correa and Kumar; *Ibid*: 116

⁶³⁸ *Ibid*; Pp. 726-27

⁶³⁹ *Ibid*, p. 27

and thus, it would be difficult to determine its exact value with any precision. What is more, enterprises may be huge or large in their size in the national economy and consequently they may have no “market value” . It would not be correct to determine the value taking into account their original value at the time of the beginning of the investment: the value would decrease or increase as the case may be. The value of an enterprise has been determined on the basis of the price of its shares on the stock exchange. This method is far from perfect but it is certainly very successful. The value of shares may differ: if for example the valuation is made before the expropriation or after expropriation.⁶⁴⁰

According to Hull formula, prompt, adequate and effective compensation must be made to foreign investor upon expropriation.⁶⁴¹ On the other hand “just and effective” compensation is used, as a standard departed from the Hull formula. This standard is used in the British treaty with Bolivia (1990).⁶⁴²

In general, the value of an enterprise depends on the surrounding legal, social and economic conditions. Any change in these conditions entails a variation of the value of the enterprise.⁶⁴³

Should the possibility of “taking a profit” be taken to value the enterprise or the amount of compensation to be paid? Why or why not? With regard, to this the permanent court of International Justice held that the possession of customers and the possibility of taking a profit” cannot be considered a vested right of the owner of an enterprise.

Good will should not be considered as part of an enterprise’s value in cases of lawful expropriation. On the other hand, good will may be considered as part of the value of an enterprise in cases of unlawful expropriation.⁶⁴⁴ In general, in cases of lawful expropriation of an investment, taking a profit in the future time is not considered as part of the value of the expropriated enterprise. This is also true with regard to good will of the enterprise.

For instance, Mark is a foreign investor in Ethiopia. He invested on food complex and produces macaroni, pasta and biscuits. He gets Birr 6,500.00 as a profit from such investment each month. Let us assume that the Ethiopian government expropriates this enterprise. The value of the enterprise should not include the

⁶⁴⁰ Ibid, p. 727-28

⁶⁴¹ Sornarajah; **Ibid**, p. 128

⁶⁴² Ibid, 256

⁶⁴³ Ibid, p. 728

⁶⁴⁴ Ibid

profit that the investor, would gain from his investment. Thus, only the actual value of the enterprise should be evaluated and be given to mark as an indemnity for the act of expropriation.

Compensation, in the case of lawful expropriation, aims at the elimination of the actual loss the investor incurs and not at the restoration of his/her exact previous condition. Accordingly, prospective profits (*lucrum cessans*) are not compensable. In lawful expropriation, the state is duty bound to pay compensation to the foreign investor to the extent of its own enrichment. Payment of profits lost would be an addition to the actual value of the expropriated assets. The fact that the foreign investor is in principle free to reinvest the sum s/he receives as compensation should also be considered. If the investor receives the future profits of the expropriated enterprise that would constitute a kind of bonus in apology for the expropriation.⁶⁴⁵

Further, one would be in severe practical difficulties if one accepts the view that an obligation to compensate for future profits. The lost profit would be very huge and that would render the host state unable to expropriate the investment enterprise. For example, the lost profits in the Anglo-Iranian oil company case would amount to huge sums many times higher than the actual value of the enterprise expropriated. Thus, compensation for further profits in all cases of expropriation would render the cost of the host country prohibitive to most states. Thus, compensation for future profits is not paid for lawful expropriation. A lawful expropriation is one that international law permits, though not necessarily encourages. Lawful expropriation should be made only when conditions laid down by law are fulfilled and only rarely done when the expropriation is lawful, the state is obligated to compensate only for the investor's actual loss. On the other hand, the compensation should also include for prospective profits in cases where expropriation is unlawful. In such a case, the state should restore the status quo ante. What is more, it is not essential to consider the possible hardship the state would face to unlawful action.⁶⁴⁶

Political considerations and bargaining are always involved in determining the amount of compensation. However, their relative importance cannot be estimated with any precision.⁶⁴⁷

⁶⁴⁵ **Ibid**, p. 728-29

⁶⁴⁶ **Ibid**, p. 729

⁶⁴⁷ **Ibid**, p. 730

In addition, compensation should be prompt. Thus, compensation must be paid either before the taking or within a short time thereafter. Further compensation should be effective. If the foreign investor has given the chance to utilize the compensation, that is effective. Thus, the compensation must be made in a precise form. In general, compensation must be adequate, prompt and effective under international law.⁶⁴⁸

7.5.4. Federal and Regional Laws

The legislation on foreign investment usually contains guarantees against expropriation of foreign investment without payment of compensation. Such a guarantee was a guarantee against the fear of expropriation without payment of compensation in the past history of states. Particularly, former socialist countries are required to give such a guarantee in their legislation to dispel any idea that they still have ideological predispositions towards expropriation. Accordingly, Article 5 of the foreign Enterprise law of China provides for a guarantee intended to remove the fear of investors concerning their investment.

Thus guarantees vividly indicate to foreign investors that past policies relating to foreign investments (particularly among socialist states) have undergone dramatic changes. According to the socialist theory, no compensation needs to be paid in the event of nationalization. Thus, the new legislation promises indemnity of the actual value of the property.⁶⁴⁹

A problem with regard to such guarantees is that the guarantees given by one government cannot be binding on a succeeding government, especially where there has been a change of government by revolution. The incoming regime may have ideological view different from the previous regime and argue that the guarantee given by the previous government is not binding on it.⁶⁵⁰

⁶⁴⁸ **Ibid:** pp. 731-32

⁶⁴⁹ Sornarajah; **Ibid**, p. 95

⁶⁵⁰ **Ibid**, p. 96

On the other hand, despite the change of a regime, guarantees that were held out to foreign investors do have legal implications. First, it is argued that such guarantees have indicated the willingness the part of the state to transfer a dispute arising from foreign investments to an international tribunal for settlement.

Thus, a bilateral guarantee against expropriation provides for support for transferring any dispute with regard to expropriation of foreign investment into an international sphere.⁶⁵¹

However there is an argument that unilateral guarantees against expropriation without full compensation have no international effect. The guarantees are directed to the investor alone.

They are directed to individual or legal entities that do not have personality in international law. They do not extend to the capital exporting state. In general, unilateral guarantees given to bodies which have no legal personality in the international law can have no legal effect in international law other than as a pious declaration of intent.⁶⁵²

It is a recognized principle that a nation has a right to expropriate an enterprise irrespective of whether it is national or foreign. However, there is a limitation that the expropriation should be made for public purposes. In addition, the state is obligated to pay compensation with a standard of “prompt, adequate, and just compensation”. Thus is the standard set by developed nations. This standard is stiff and developing nations urge a more flexible standard.⁶⁵³

Under Ethiopian law, expropriation is prohibited in principle. Exceptionally investment may be expropriated or nationalized provided that:⁶⁵⁴

- A) it is made for public interest;
- B) it is done compliance with the requirements of the law

⁶⁵¹ **Ibid**

⁶⁵² **Ibid**, p. 97-8

⁶⁵³ Barton and Fisher; 1986: 913

⁶⁵⁴ Proc. No 280/2002 (as amended), Art. 23(1)

One of the requirements of the law is that compensation should be paid. With regard to the value, the law provides that it should correspond to the prevailing market value.⁶⁵⁵ In principle, the investor should be indemnified the cost of his/her investment. Moreover, it is the market that offers the actual value of a property. However, the investment could be very huge and vary in its form. Thus, the market may not give the actual value of the investment. Therefore, this provision is not far from problem.

The other requirement of the law is that compensation should be paid in advance, where the investment is expropriated or nationalized.⁶⁵⁶ This is a requirement of promptness of compensation. In general, the compensation, under our law, should be adequate and prompt.

Further, the guarantee is granted to both foreign and national investors without discrimination. Where a foreigner receives compensation, s/he is allowed to remit the same to his/her country. Thus, a foreign investor can remit the compensation paid to him/her out of Ethiopia in convertible foreign currency.⁶⁵⁷

Investment agreements also include provisions on expropriation and nationalization. Dear student, please go to the nearest investment office in your locality and observe the investment agreement. Pursuant to the bilateral agreements to which Ethiopia is a party, expropriation or nationalization and any other similar measures against the investments are not allowed in principle.⁶⁵⁸ Exceptionally, however, expropriation may be made:⁶⁵⁹

- i) for the public interests;
- ii) under domestic legal procedure;
- iii) without discrimination;
- iv) against compensation

⁶⁵⁵ **Ibid**; Art. 23(2)

⁶⁵⁶ **Ibid**; Art. 23(2)

⁶⁵⁷ **Ibid**; Art 23(3)

⁶⁵⁸ See Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the People's Republic of China concerning the Encouragement and Reciprocal protection of Investments, 1998: Art. 4(1)

⁶⁵⁹ **Ibid**

In other words, expropriation is prohibited unless these requirements are met. The compensation should be equivalent to the value of the expropriated investment at the time of expropriation. In addition, it must be convertible and freely transferable.

Further, the compensation must be paid without unreasonable delay.⁶⁶⁰ The Ethiopian laws on guaranteeing expropriation conform with the IISD model International Agreement on Investment for Sustainable Development. Under this agreement, no party is allowed to expropriate an investment in its territory.

At the Regional Level

As per Art. 13(3) of Proc. No 2/2003 of the **Addis Ababa**, administration the Bureau of Trade and Industry Development is empowered to implement the investment policy and laws. This makes clear that it is the guarantees that are given under the federal Government Investment law that are given to investors in the Region.

The Amhara Investment Office also is empowered to ensure the implementation of the policies and laws of investment.⁶⁶¹ It is clearly provided that the office decides on the petition for investment incentives where they fulfil the requirement of the Federal Investment Proclamation.⁶⁶²

Ato Gezahegn⁶⁶³ responded to the issue of expropriation⁶⁶³ by saying that he was never worried about expropriation of his investment by the government. However, he explained that he faced problems with respect to giving a plot of land to another person (or government itself) after he is granted and has expended some money on the land. He faced such a problem in Oromia Region and Tigrai. He explained that he was granted land to build a hotel and expended some money. For building the foundation later he was evicted from the land and he was given a substitute. However, the relevant authority decided to pay

⁶⁶⁰ **Ibid**; Art-4(2)

⁶⁶¹ Proc. No 4/1988 (amended by Proc No 60/1994) Art 4-chapter 3.

⁶⁶² **Ibid**-Art-4(4)

⁶⁶³ Discussions made with Ato Gezahegn, 08/07/08, Addis Ababa, 2:00 PM-4:00PM

him back what he had paid to the government even though the payment has not yet been actually effected.⁶⁶⁴

Questions

- 1) Why do we need to think about guarantees to investors?
- 2) Do you agree with the rule that government is allowed to expropriate investment? Give your reasons.
- 3) Analyze the concept of repatriation of capital as a guarantee to invest.
- 4) Discuss the items the foreign investor is allowed to repatriate according to the Ethiopian investment law.
- 5) Explain the concept of nationalization of investment.
- 6) Analyze the concept of lawful expropriation under investment law.
- 7) Discuss the standards of compensation in case of expropriation of investment.
- 8) Evaluate the Ethiopian investment law on guarantees to investors from the internationally accepted principles.
- 9) Analyze whether it is possible to nationalize investment under the Ethiopian investment law.
- 10) Discuss the requirements of compensation that are provided under the Ethiopian investment law.

UNIT SUMMARY

We have learned that an incentive is any measurable economic advantage afforded to investors in order to encourage them to behave in a certain manner, i.e. for development. Incentives to investors may be fiscal incentive, financial incentive or market preference.

⁶⁶⁴ Ibid.

We have seen that incentives are intended to promote positive economic benefits such as job creation, transfer of technology, regulation of foreign exchange. Further, we have discussed that the economic rationale of investment incentive is to correct the failure of markets. We have learnt that investment incentives have costs and what is essential is to ensure that their cost should not exceed the value of the benefits to the public.

With regard to investment guaranties, we have identified that property right is granted under the FDRE Constitution and other laws. We have also seen that foreign investors are granted the right to repatriate capitals and profits to their home countries. Most importantly we have seen that expropriation is forbidden; this is a rule. However, exceptionally, expropriation may be made for the public interest; under the law; without discretion; against adequate compensation.

REVIEW QUESTIONS

- 1) The value of compensation to be given to the investor in case of expropriation is
 - A) Actual value of the property
 - B) Profit for the future
 - C) The value of the property at the time of the beginning of investment
 - D) All
- 2) Expropriation of investment is
 - A) A rule under the Ethiopian law
 - B) Made without effecting compensation
 - C) Made discriminately
 - D) Equivalent to nationalization
 - E) None of the above
- 3) A compensation to investment is considered as full when it is
 - A) Adequate
 - B) Effective
 - C) Prompt
 - D) all
- 4) According to the Ethiopian investment law, compensation to be made to the investor should be
 - A) Greater than the value of the property
 - B) Adequate
 - C) Inadequate
 - D) Insufficient
- 5) Guarantees to investors may be provided under
 - A) Investment Codes
 - B) Constitutions
 - C) A and B
 - D) None
- 6) Incentives under the Ethiopian investment law may be
 - A) Fiscal
 - B) Exemption from profit
 - C) Granting nationalization
 - D) All

Domestic Investors, **Federal Negarit Gazeta**, 8th Year, No. , Addis Ababa, 2nd July, 2002.

- Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the People's Republic of China concerning the Encouragement and Reciprocal protection of Investments, 1998.
- Multilateral Agreement on Investment, Draft

UNIT EIGHT: NEW CONCERNS RELATED TO THE LAW OF INVESTMENT

UNIT OBJECTIVES

After completing this unit, students should be able to:

- ◆ identify the new concerns related to the law of investment;
- ◆ analyze the principles with regard to environment;

INTRODUCTION

In this unit we will discuss the new concerns of law of investment. First, we will discuss issues related to environment. Investment is essential for the development of economy, human rights should not be violated under the disguise of investment, however. Hence, we will discuss issues of human rights under the second topic of this unit. We will wind up our discussion by summarizing essential points. Further, we will have questions that are aimed at helping students to test their progress in learning the material in unit.

8.1. ENVIRONMENTAL CONCERNS

Is there any international agreement and investment instrument that aims to protect the environment?

When we think of international instruments, we are envisaging provisions that impose duties on states with respect to environment. The Treaty Establishing the Latin American Integration Association requires member countries to

*“take into consideration, among other matters, scientific and technological cooperation, tourism promotion and preservation of the environment”.*⁶⁶⁵

It is observable that, according to this treaty, member states are duty bound to Treaty, member states are duty bound to preserve environment.

⁶⁶⁵ Treaty Establishing the Latin American Integration Association, Article 14

Certain preambular language was also proposed by the chair person of the negotiation during the negotiations of the Multilateral Agreement on Investment (MAI).

Recognising that investment, as an engine of economic growth, can play a key role in ensuring that economic growth is sustainable, when accompanied by appropriate environmental and labour policies, ...

*Reaffirming their commitment to the Rio Declaration on Environment and Development, and Agenda 21 and the programme for its further Implementation, including the principles of the polluter pays and the precautionary approach; and resolving to implement this Agreement in a manner consistent with sustainable development, and with environmental protection and conservation; ...*⁶⁶⁶

In short, we can see efforts have been made at the international level to protect environment. The efforts made by the MAI particularly are intended to relate investment to the international Declaration of Environment and Development. Hence, the principles that are enshrined under the Declaration would be applied. For example, the principle of polluter pays, and precautionary approach would be applicable. According to the precautionary approach, prior prevention of damage to environment is implemented while in case of polluter pays principle one who damages the environment must restore it.

However, considerable disagreements among the negotiators have been deserved and it still persists. The basic issue here is the balance between the investment liberalization objectives and the environmental preservations and principles.⁶⁶⁷

Cotonou Agreement (2000) also contains provisions that link economic development and the environment. As per this agreement, FDI must apply and integrate, at every level, the “principles of sustainable management of natural resources and the environment.”⁶⁶⁸

⁶⁶⁶ United Nations, International Investment Agreements: key Issues, volume II, (2004), P.83

⁶⁶⁷ Ibid

⁶⁶⁸ Cotonou Agreement, 2000

The treaty for the Establishment of the Economic Community of Central African states, provides that member states have agreed “to arrange for an appropriate application of science and technology in the development of agriculture ... and preservation of the environment”⁶⁶⁹ Even though the language of this Treaty is stronger, it is limited to the arrangement for appropriate application of science and technology.⁶⁷⁰

The convention on Environmental Impact Assessment⁶⁷¹ also provides, in stronger language as follows:

The parties shall, either individually or jointly, take all appropriate and effective measures to prevent, reduce and control significant adverse transboundary environmental impact from prepared activities.⁶⁷²

Under this provision an activity includes activity that arises from FDI, Thus, even though the convention is not an IIA, it has a significant implication for investment activities.⁶⁷³ Investment activities are required to go through environmental impact assessment in order to control the significant adverse impact upon the environment.

What are the responsibilities of TNCs in protecting environment?

So far, we have considered relevant instruments on the issue of protection of environment in relation to investment. Now, let us discuss the responsibilities of TNCs.

The OECD Guidelines (the original 1976, the reserves 1991 and the 2000 Guidelines) clearly indicate that transboundary corporations have the obligation to protect the environment.⁶⁷⁴

⁶⁶⁹ Art 51(1)(b)

⁶⁷⁰ UN, P.84

⁶⁷¹ The convention is signed by over 25 European Countries, the United States of America, and Canada.

⁶⁷² Art. 2(1)

⁶⁷³ UN, Ibid, P.84

⁶⁷⁴ UN, Ibid

The United Nations has prepared a draft code of conduct on the issue of environment. The code incorporates some responsibilities of Transnational corporations under paragraphs 41-43.

“Transnational Corporations shall/should carry out their activities in accordance with national laws, regulations, administrative practices and policies relating to the preservation of the environment of the countries in which they operate and with due regard to relevant international standards.”

Transnational Corporations are duty bound to protect the environment and, where damages happen, to restore it to the extent appropriate and feasible.

They are required to take steps so as to protect the environment and where damages occur to rehabilitate it. If doing so, they are required to develop and apply adequate technologies for this purpose.

What is more, transnational corporations should respond to requests of governments and “cooperate with international organizations in their efforts to develop and promote national and international standards for the protection of the environment.”⁶⁷⁵

NGO’s also have shown their desire to protect the environment. A document that was drafted by an investor by grouping the principles of the coalition for Environmentally, Responsible Economies (CERES), reaffirms the responsibility of investors to protect the Earth. The document calls upon the commitment to reduce or eliminate damage to the environment. The draft NGO charter on Transnational corporations prepared by :

The people’s Action Network to monitor Japanese TNCs incorporates provisions on the responsibilities of TNCs. As per Art 13 of the draft, TNCs are duty bound to⁶⁷⁶

- Implement an environmental assessment and follow up;
- Adopt pro-environmental management system;
- Freely disclose information on the enterprises environmental policy;
- Compensate for the damage caused and restore the environment to its original state.

⁶⁷⁵ UN, Ibid, P.85

⁶⁷⁶ UN, Ibid, P.85

In general, the above discussed instruments reflect the responsibility of TNCs with respect to environmental protection, TNCs are responsible to develop and maintain best protection environmental conservation, risk and impact assessment, environmental restoration, information dissemination, and cooperate with national authorities. They are required to comply with relevant national or international standards to protect the environment.⁶⁷⁷

Each state has also the responsibility to regulate the environment in light of the international standards. Ethiopian laws are also aimed to protect the environment. A host state wants to ensure that the entry of the foreign investment will not have negative effects upon the environment. In other words, the host state has to make sure that the environment is not affected as a result of the foreign investment. There is a fear that multinational corporations export hazardous technology, the use of which is not permitted in their home states. In addition, the multinational corporations may not take proper environmental measures that they would have been forced to use in their home states. Thus, they cut costs of environmental measures by investing in developing states.⁶⁷⁸ Investment activities undertaken by domestic investors may also pollute the environment.

To curb the effect on environment, a foreign investment feasibility study should be done. The feasibility study that should be made prior to the permission for entry of the foreign investment may require that an assessment be made of the environment impact of the investment. If the effects on the environment are harsh, permission will be denied.⁶⁷⁹ For example, if the investment affects negatively the natural environment, it should be denied. Permission Products of a factory, for instance, may pollute the river water that is used for household and irrigation in the area. Similarly, the gasses emitted from a certain factory may pollute the air in the surrounding area. For instance, in the past, the dirt that emanates from Nifas Silk Cement Factory was polluting the environment, and people living nearby have developed respiratory problems.

Developed states placed greater emphasis on the effect of the activity of a foreign investor on the environment. Hence, if it is shown that the harm to the environment is irreversible or outweighs the

⁶⁷⁷ Ibid, p.86

⁶⁷⁸ M. Sornarajah; **The International Law on Foreign Investment**, 1996,p. 107

⁶⁷⁹ **Ibid**

benefits of the project, an investment project or agreement may be excluded, even after it had commenced.

For example, a dispute arising with regard to sand mining on Fraser Island, close to the Great Barrier Reef, led the Australian government to terminate a concession, which had been given to two American corporations to mine sand on the Island. because it was shown through a study that the environment will be adversely affected by minerals such as zircon and retile in the sand mining. The termination of the contract was not an easy task. The government of the United States of America intervened diplomatically to protest the cancellation of the concession. However, the Australian government maintained a firm stand.⁶⁸⁰

The right of a state to cancel agreements or to reject investment that causes significant environmental harm has a general acceptance. The right emanates from the sovereignty of a state to protect its territory from environmental harm. It also emanates from the fact that in modern international law, a state is a repository of the right to safeguard the environment in the interest of mankind. Thus, the state has a right to protect the environment.⁶⁸¹

Coming to Ethiopia, the Ethiopian “government and citizens have the duty to protect the environment”.⁶⁸² Under our Constitution, protecting the environment is a duty of the government as well as individual citizens. Further, the government should endeavour to ensure that the environment is clean and healthy to live in for citizens.⁶⁸³ Furthermore, all investment projects shall not damage or destroy the environment.⁶⁸⁴

We have seen that a principle of “one-stop-shop service” is incorporated under in to investment law.⁶⁸⁵ This may be a challenge to the EIA since it may lack skilled personnel to study an environmental impact assessment of investment projects. Thus, investment projects that are hazardous to the environment may be granted permission. In short, there seems to be a loophole in this regard.

⁶⁸⁰ **Ibid**, p. 108

⁶⁸¹ **Ibid**

⁶⁸² FDRE Constitution, Article 92(4)

⁶⁸³ **Ibid**, Article 92(1)

⁶⁸⁴ **Ibid**, Art 92(2) Cum. Art. 44

⁶⁸⁵ Proc. No 280/2002 (as amended) Art. 26

Under Article 44 of the Constitution, to have clean and healthy environment is a right of all peoples. The Ethiopian government has to select a technology that is suitable and non-obsolence.⁶⁸⁶

It is worth noting that the use of the right should be on objective grounds. Thus, the state's right to exclude investment that could cause harm to its environment is justifiable if the objective factors evidence that.⁶⁸⁷

Ethiopian Investment Law gives due concern to the protection of the environment. For example, according to Art. 9(1) (A) of Regulations No 120/1985, an investment permit may be revoked where the investor on agriculture violates the rules to protect the environment.

Nowadays, it is a requirement that investment projects should go through environmental impact assessment to make sure that they do not adversely affect the environment.

What do we mean by environmental impact assessment? Environmental impact assessment is a consideration of the effect of projects on the environment. In Ethiopia, the Environmental Impact Assessment Proclamation No 299/2002 and the environmental Regulations as well as directives govern the investment environment nexus. The Ethiopian Environmental Protection Authority (EEPA) is the federal organ responsible for the implementation of environmental law. Where investment projects have potential environmental negative impacts, investors are required to submit Environmental Impact Assessments (EIA) to the authority. Directives issued by EEPA identify investment projects that regulate EIA.⁶⁸⁸

What do we mean by EIA? Environmental impact assessment is defined as “the methodology of identifying and evaluating in advance any effect (positive or negative) which results from the implementation of a proposed project or public instrument”.⁶⁸⁹ Impact, here, means any change to the environment or its component.⁶⁹⁰ The main purpose of EIP is to protect the environment from harm caused due to the implementation of development projects.

⁶⁸⁶ Regulations No. 121/1993 Art 7(2)

⁶⁸⁷ Sornarajah; **Ibid**, pp.108-109

⁶⁸⁸ **An Investment Guide to Ethiopia**, 2004, P.61.

⁶⁸⁹ Environmental Impact Assessment Proclamations, Proclamation No 299/2002, **Federal Negarit Gazeta**,

⁶⁹⁰ **Ibid**, Art. 2(4).

A distinguishing feature of EIA is that it is anticipatory.⁶⁹¹ As it is clearly provided in the preamble statement of the proclamation, environmental impact assessment is used to predict and manage the environmental effects of the investment projects prior to their approval. The term “predict” suggests that there may be some uncertainty or some “guess work” associated with EIA. However, experience has that knowledge of environmental systems are usually sufficient to make reasoned estimates of the likely significant effects of proposals.⁶⁹² Therefore, it is possible to identify the harm that would be caused to environment by implementing a given investment project to stop it.

From the legal point of view, the application of EIA to new investment project proposals can be considered as a good management practice in terms of minimizing environmental risks to the project and the decision making process. Thus, most environmental impact assessments are undertaken as a result of regulatory requirements.⁶⁹³

When should EIA be applied? In the United Kingdom, EIA is triggered by the type of the project proposed. In the first category, projects that will always require an EIA are indicted which include oil refineries, large waste and waste water disposal and treatment facilities, pipelines covering over 40km distance, industries using chemicals, and metal melting.⁶⁹⁴

There are also projects that may require an EIA if they are likely to have significant effects on the environment. Food industry projects, tourism and leisure projects, wind farms etc may require EIA in the UK.⁶⁹⁵

In Ethiopia, projects likely to have negative impacts on the environment require environmental impact assessment while projects not likely to have negative impacts do not⁶⁹⁶ The details of the categories must be indicted in a directive.⁶⁹⁷ For example, large-scale mining projects require environmental impact assessment because they have the potential to affect the environment negatively. This includes large oil

⁶⁹¹ John Brady (editor), **Environmental Management in Organizations**, 2006, P. 187

⁶⁹² **Ibid**

⁶⁹³ **Ibid**, P. 190

⁶⁹⁴ **Ibid**,

⁶⁹⁵ **Ibid** p. 191

⁶⁹⁶ Environmental Impact Assessment Proclamation No 299/2002, Art 5(2)

⁶⁹⁷ **Ibid**, Art 5(1)

and natural gas developments, large ores mining projects, major pipelines, etc.⁶⁹⁸ In general, projects that have adverse affects on the environment must go through EIA.⁶⁹⁹

What are the criteria to EIA? To determine the applicability of EIA, we should take into account the characteristics of the project, the location of the project, and the characteristics of the potential impact.⁷⁰⁰ As per Art 4(1) of Proclamation No. 299/2002,

The impact of a project shall be assessed on the basis of the size, location, nature, cumulative effect with other concurrent impacts or phenomena, transitional effect, duration, reversibility or irreversibility or other related effects of the project.

Our criteria seem to be more stringent than those discussed earlier because it includes duration, and other points in addition to the criteria seen above. But could it be implemented properly? Monitoring at the implementation stage is also an essential part of EIA.⁷⁰¹

Regional Investment organs are concerned about the issue of environment. Ato Gezahegn⁷⁰² explained that the Tigray Investment Commission has made sure that the activity of crusher is far away from residential houses. The Commission also made sure that the sewerage system does not have adverse negative effect on environment. In Oromia Region, the Investment Commission ensured that the septic tank does not pollute the environment, and they required that this be indicated In the project plan. However, he underscored that the officers will be lenient if the investor pays some amount of money in the form of bribe.⁷⁰³

Questions

- 1) Nowadays, the protection of environment of the host state is becoming the concern of the law of investment. Do you believe that it is fair from the economic development point of view? Give your reasons.

⁶⁹⁸ Draft Model for Environmental Assessment, Management and Monitoring of Mining Activities, 2007, 2-3

⁶⁹⁹ **Ibid**, 2-1, schedule 1

⁷⁰⁰ John, **Ibid**, P-191

⁷⁰¹ See Art.12 of the Proclamation No 299/2002

⁷⁰² Discussions made with Ato Gezahegn, an expert in Import and export, and Transport sector, 08/07/08, Addis Ababa. 2:00-4:00PM

⁷⁰³ **Ibid**.

- 2) Should we check the investment project irrespective of the type (local or foreign investment) of the environmental protection issue?
- 3) Assume that it was discovered that foreign investment activities have a damaging effect on environment after they were approved. What are the measure that may be taken to solve such problem?
- 4) Analyze the concept of environmental impact assessment of investment projects.
- 5) We have to select an investment project that will use upto date and suitable technology for our country. Comment.

8.2. HUMAN RIGHTS

The issue of the protection of human rights in investment activities could be seen from the international and national perspective

At the International Level

In the history of investment, one of the problems of transnational corporations is that they violate human rights. To curb this problem, TNCs are duty bound to observe human rights. There is a wide debate on the applicability of human rights obligation on TNCs. However, some important provisions are incorporated in international instruments. For example, the 1998 draft NGO Charter on Transitional Corporations prepared by the People's Action Network to Monitor Japan's Transnational Corporations Abroad in paragraph 4 mentions the issue. The Amnesty International United Kingdom Business Group's "Human Rights Guidelines for Companies" provides general human rights standards applicable to corporate operations. The United Nations draft code of conduct of TNCs mentions the observance of human rights as one of substantive standards.⁷⁰⁴

⁷⁰⁴ United Nations, *Ibid*, Pp. 143-144

According to Amnesty International Human rights Guidelines for Companies, corporations are duty bound to protect human rights in their operations. The guidelines advocate the following principles as being of importance to corporations:⁷⁰⁵

- *All companies should adopt an explicit policy on human rights which includes public support for the Universal Declaration of Human rights;*
- *All companies should ensure that any security arrangements to protect human rights and are consistent with international standards or law enforcement;*
- *All companies should take reasonable steps to ensure their operations do not have a negative impact on the enjoyment of human rights by the communities in which they operate;*
- *All companies should ensure that their policies and practices prevent discrimination based on ethnic origin, gender, sex, colour, language, national or social origin, economic status, religion, political or other conscientiously held beliefs. All companies should ensure that their policies and practices prohibit the use of chattel slaves, forced labour, bonded child labourers or coerced prison labour;*
- *All companies should ensure that their policies and practices provide for safe and healthy working conditions and products.*

In general, we can conclude that the issue of observance of human rights by trans national corporations in their operations is getting acceptance at the international level. This also has an influence on nations since states are the members to international community.

In Ethiopia

Investment is essential for the development of an economy. Development becomes a right of people in general. A right to development is provided under the provisions of Art. 43 of the Constitution. Hence, the people of Ethiopia, and nations and nationalities have the right to sustainable development.⁷⁰⁶ What is most important is that international agreements to which Ethiopia is a party must promote our right to

⁷⁰⁵ **Ibid**, p. 145

⁷⁰⁶ FRDE Const. Art. 43 (1)

sustainable development.⁷⁰⁷ Therefore, our government is duty bound to ensure that foreign investment agreements promote the right of development of our people. It is also important to note that this right to development is economic right.

Trans-national corporations may also have negative impact upon the human right in general, and workers' right in particular. Negative social and political impacts have been observed mainly in mineral-rich poor countries with weak institutions. If there are poor governance frameworks, and weak institutional capacities of host states to formulate and implement laws and regulations, there is no doubt that problems of social and political may be seen.⁷⁰⁸ Health and safety in the extractive industries have consistently passed on challenge, particularly in artisanal mining in developing countries.⁷⁰⁹

We have seen earlier that investors may violate the rights of individuals, For example, the investor may disregard the rules of healthy working environment. What is essential is that investors may make the investment beneficial to few individuals only. That means, the investment could make few rich, and most of the people poor. This violates the right of our people to development enshrined under the Constitution Art. 43. Therefore, our Government i.e. the Ethiopian Investment Agency should make sure that investment does not violate this right of people.

Questions

- 1) Analyze the nexus of investment with the right of development of the people.
- 2) Evaluate how investment law protects human rights of the employees.
- 3) Discuss which governmental body is responsible to ensure that investment activities do not violate human rights.

8.3 DISPLACEMENT OF PEOPLE

⁷⁰⁷ **Ibid**, Article 43(2)

⁷⁰⁸ **Ethiopian Investment Guide**, 2007, p.26

⁷⁰⁹ **Ibid**

Implementation of investment projects may require displacement of people because it may be necessary to expropriate the land that is under the holding of people.

The displacement of people from their localities may adversely affect their life. In such a case, displacement should not be made so as to protect the life of the people. On the other hand, it is important to use a certain locality for more benefit than that of individual, and it may be crucial to expropriate the locality. Thus, it is essential to make a balance between the rights of individuals and the people.

As enshrined in the FDRE Constitution, "... the government may expropriate private property for public purposes subject to payment in advance of compensation commensurate to the value of the property".⁷¹⁰ Expropriation may be made only for public purpose. "Public Purpose" means the use of the property as such by the decision of appropriate government authority in conformity with the law in order to insure the interest of the people.⁷¹¹

Expropriation may be made for sustainable socio-economic development of the Ethiopian people. Second, compensation must be paid to the owner before the expropriation is implemented. The value of the property must be determined.

If there were some properties situated on the land expropriated, the land holder is entitled to compensation for a) the property situated on the land and (b) permanent improvements s/he has made on such Republic of Ethiopia, Federal Negarit Gazeta, Art. 40(8) land.⁷¹² The amount of the property situated on the land must be determined "on the basis of replacement cost of the property".⁷¹³ In case of expropriation of urban dwelling, the value should not be less than the current value of constructing a single room low cost house.⁷¹⁴

⁷¹⁰ Proclamation No 1/1995, Proclamation of the Constitution of the Federal Democratic Republic of Ethiopia, **Federal Negarit Gazeta**, Addis Ababa,

⁷¹¹ See proclamation No.455/2005 Art 2(5)

⁷¹² Proclamation No 455/2005 A Proclamation to provide for the Expropriation of landholdings for public purposes and payment of compensation, **Federal Negarit Gazeta**, Art. 7(1).

⁷¹³ Ibid, Art. 7(2).

⁷¹⁴ Ibid, Art. 7(3)

Coming to the value of improvements made on the land, the compensation must be equal to “the value of capital and labour expended on the land”.⁷¹⁵ This provision does not take into account the market value of the property. This may be not good for the right holder. In any case, the case of removal, transpiration and erection of the property must be added to the compensation.⁷¹⁶

According to the FDRE Constitution,

*All persons who have been displaced or whose livelihoods have been adversely affected as a result of State programmes have the right to commensurate monetary or alternative means of compensation, including relocation with adequate State assistance*⁷¹⁷

As we can observe from the above constitutional provision, persons who are displaced due to the implementation of investment projects have the right to compensation. Compensation may be monetary, or it may take other forms, i.e. it may be in kind. They are also entitled to relocation with adequate state assistance.

An issue of displacement compensation is treated from the rural and urban land point of view. If a rural landholder is expropriated, his/her land, s/he is entitled to displacement compensation and the value must be equal to ten times the average annual income s/he secured during the last five years.⁷¹⁸ A person may also be given a substitute land which can be easily ploughed.⁷¹⁹ Displacement compensation is effected in addition to compensation for expropriation.

With respect to displacement compensation for an urban land holder whose land holding has been expropriated,⁷²⁰

⁷¹⁵ Ibid, Art.7(4)

⁷¹⁶ Ibid, Art. 7(5)

⁷¹⁷ FDRE Constitution, **Ibid**, Art 44(2)

⁷¹⁸ Proclamation No 455/2005, **Ibid**, Art 8(1)

⁷¹⁹ **Ibid**, Art 8(3)

⁷²⁰ **Ibid**, Art 8(4)

- i) S/he is entitled to urban land for the construction of a dwelling house; and
- ii) S/he is entitled to a displacement compensation equivalent to annual rent of the demolished house.

If a person has leased a land, she will be given a similar plot of land to use for the remaining period.⁷²¹

The amount of compensation is to be determined by a committee,⁷²² and a person who is dissatisfied with it can appeal to the administrative organ.⁷²³ Next, a person may also lodge an appeal to a court whose decision is final on the point if s/he is dissatisfied with the decision of the administrative organ, within 30 days from the date of the decision.⁷²⁴

Consider the following cases on displacement compensation.

Commission File No 404/99

Hidar 5,2001 E.C

Appellant – Yerer Goro St. Gorge Church Office, Representative – Diakon Getahun Berhe

Respondent – Bole Sub City Land Development and Administration Department

Ato Bisrat Tsega, Representative – Ato Bisrat Bezabih

Facts

Yerer Goro St. George Church was established long ago and has a file in the former Woreda 28 Bole Kotebe Farmers, Association, Now Bole Sub-City, Kebele 14/15. Since the Church renders spiritual services night and day, clergies and other members of the church are living in houses built on the land possessed by the church. The church and the houses of the clergymen are waiting for the issuance of title deed. The church argued that the order is illegal and the commission should dismiss the order. However, the respondent ordered the appellant to evacuate the land because the land is needed for investment to be made by an investor.

⁷²¹ **Ibid**, Art 8(6)

⁷²² **Ibid**, Art 10

⁷²³ **Ibid**, Art 11(1)(2)

⁷²⁴ **Ibid**, Art 11(4)

The respondent argued that the appellant did not prove its possessory right on the land with accepted evidence. It also argued that it did not adduce evidence to prove the church hand over the land to lodge a petition as per Art. 11(6) of proc. No 455/2003. The respondent argued that the revisal of the church to evacuate and the claim for compensation is not acceptable in the eyes of law.

A piece of land in Bole Sub-City Keble 14/15 covering an area of 30,000 m² is given to him as per the decision of the Board of Addis Ababa City Government Land Development and Administration, is which intended for real estate investment. He stated that a letter written by the patriarch is about places of ፀበል Church but not possession possessed illegally by those under the disguise of the church.

Reasoning of the Commission

The notices adduced by the appellant are given as per Proc. NO 272/94 Art. 16(2) which show that the notices are given to evacuate (a land possessed illegally (the content of the letters show)

The appellant did not adduce evidence to prove the land is possessed legally by the Clergymen simply arguing that the land is the possession of the church. The decisions of the Board and petitions that are adduced by the appellant could not be evidence for possession of the land or permission to build on the violate. Then the commission ruled that the claims made by the appellant are not acceptable.

As it is observable from the decision, a person who claims for compensation must prove that s/he has a legal right on the land and/or the house built. Immovable property could be proved by title deed, the appellant failed to adduce title deed but and the decision of the commission is correct. The other point to be made clear is that the clergymen tried to show that the houses built by them are part and parcel of the

church. But, that does not seem true. The important offices and parts of the church are properties of the church but the individual houses of the clergies could not be part of the church.

In general, a person is required to show that s/he is a legal owner or possessor of the land and/or building so as to claim compensation.

Read the following cases and answer the questions that follow.

The Addis Ababa City Government Urban Land Clearance Matters Appeals Commission

T/F/No-2798/92

Yekatit 8, 1996 E.C

- 1) W/ro Aster Mulugeta
- 2) W/ro Manyashlash Mulugeta

Respondents:-

- 1) A.A City Government Labour and Development Bureau
- 2) House Lease Administrative Agency
- 3) Lease Office of A.A. government
- 4) Najat International P/L/C

Facts of the Case

The appellants lodged a petition written on August 4, 1992 EC. To the court stating that House No 1815 in Woreda 5 Kebele 19 was a share from inheritance. The appellants have a title deed No 5/16353 issued by the Association of Urban dwellers. The Minister (office) cannot handover the house to the appellants by saying that they should wait until the leasers of the house get another house for their trading activity. The action is lodged because the first respondent did not hand over the house to the appellants or failed to preserve the right of the owners for pre-emption or to give compensation; the second respondent failed to do what is expected of him when houses that were leased were transferred to a third party; the third respondent rejected the claim of the appellants' the four respondent stored construction on the land after (Confiscated) those who leased the house to them, or if that is not possible to preserve their right to invest on the area or effect payment of compensation.

The first respondent argued that the Ministry has written a letter dated Megibit 24, 1983 EC. No K.B./K.S/K19/612/83 the title deed be given back so as not to be used by the appellants and the title deed shows the house belongs not only to the appellants but also to the heirs.

The second respondent also argued that the house is not the property of the appellants and the amount of compensation is not based on the market value of the house, i.e. is very high.

The third respondent argued that they did not give the house to the fourth respondent, and they have no power to give back houses that are nationalized.

The fourth respondent on its part argued that it paid Birr 210,000.00 for good will to Ato Abebe W/Selllassie who leased the house from lease of house Agency and started construction on the area. The house is demolished and no house could be given to the appellants.

Reasoning of the Appeals Commission

The commission reasoned that a title deed No 5/26353 proved that House No 1815, found in Keftegna 5, Kebele 19 is the property of W/ro Aster Mulugeta and W/ro Mangahlashal Mulugeta, who are the heirs of Ato Mulugeta Emru.

The reason the Ministry of Urban Development wrote a letter to give back the title deed was that the appellants were not give back an income and to make clear how it should be made where the house (residence) is used for trade against the rules.

The commission requested the Land Administration Authority to give an opinion on the issue but failed.

The title did not return to the government organ and it has a power to prove the ownership right over the house than the letter. The reasons to write the letter, i.e. to check it against rules and failure to return the income could not render the right of the appellants over the house .

Decision of the Commission

The Commission held that the 1st and 3rd respondent should pay (comparable) compensation to the appellants.

Questions

- 1) Do you agree with the decision of the Commission? Reason out.
- 2) What do you understand by comparable compensation? What criteria should be taken into account to determine the exact amount of compensation? State your reasons.

Date: Tikimt 6, 1996 E.C

Claimant – Ato Ahmed Aein – Attorney Ato Getachew Molla

Respondents

- 1) Lease Office – Attorney Ato Getachew G/Sellasié
- 2) Kurtu International

Facts of the case

The claimant stated that he inherited House No 536 in Woreda 1 Kebele 06 from his father Seid Ahmed Zein as selected as per Pro. No 47/67. The Office of Woreda 1 Kebele 6 Administration requested him to submit a title deed so as to effect compensation payment since it sold the house in lease to Kurtu

International. The claimant claimed that he has pre-emption right to invest on the area arguing that the office should give him a pre-emption right.

The first respondent argued that the claimant did not submit his investment project and in the absence of that he could not claim the right to invest.

The second respondent stated that the area was given to Ato Nega Tesera and its area is 1000 m² and it was given to him since Ato Nega failed to invest as per their agreement. At that time the claimant did not claim. In addition, the area is more than 20% of his possession.

Reasoning of the commission

The court examined that and the claimant was requested by Labour and Urban Development Bureau and Woreda 1, kebele 06 administrative office to come up with evidence showing his possessory right so as to effect payment of compensation and to give land.

Since the issue whether or not he is entitled for land and compensation was not decided by relevant bodies, the court did not examine it.

Regarding pre-emption right to invest the court examines Art. 1398 and Art. 1462(2) of the Civil Code.

Art 1398 states that

If a land gains more value in money that is taken as public service if the money is used for the public court reasoned. The court also examines Art 2(7) of proc. 272/19...

The court reasoned that this is similar to what is provided under Art. 1462(2) of the Civil Code. Thus, the court concluded that no land is give to be to one whose property is expropriated for the public purpose.

Decision of the Court- the court decided and confirmed that the claimant has no pre-right

Questions

- 1) What do you understand by public purpose?
- 2) Do you believe that the decision of the commission is correct? Give you Reason

Commission File No – 326/99

Tikmit 22, 2000 E.C

Appellant – Ato Fantaye Kebede – Attorney Ato Tewodros Mihret

Respondents:

- 1) Lideta Kifle Ketema Land Development Administraiton Department- Attorney – Azeb G/wold
- 2) Lideta Kifle Ketema, Kebele 01/18 Office

Facts

The appellant stated that the House No 731 found in Ledeta kifle Ketema, Kebele 01/18, the amount of compensation for the house due to the fact that the area was needed for investment was very less (Birr 100,727.00) did not take into account the price for the area an which the house was built (70.52 m²), the materials the stones & chipwood the house was built, with an which the three meter high fence built in stones, & bloaoket, the service house (16.065 M²), the compound buil with concrete nein for cement. The land is 266.6 7M² which does not include lease of the house for a year according to Procl. No 455/2003.

The second respondent argued that the issue of compensation could not be raised against it. The first respondent argued that the rate of compensation was made taking in to account the price of building materials in 1988 E.C and was fair.

Reasoning of the Commission

The commission can not observe the area since it was demolished. The commission accepted the evidence that shows the value of the house rather than that of the first respondent by arguing that it is fair (just)

The first respondent failed to show why the service was not taken into account in preparing the compensation. The commission proved that a service covering 9.40 m² was built as per the certificate.

Held

- The price be made again taking the list that shows more details
- The price of a service be made and added to the price of compensation,
- The one year lease price be given according to Proc. No 455/97

In general, the commission decided that the compensation be made as per the revised manual

Questions

- 1) Should the claimant pay the one year lease of the House? state your reason out
- 2) Do you believe that the service should be paid?
- 3) Do you agree with the argument that more detailed specification be made? Why or why not?

SUMMARY

We have discussed that investment should not adversely affect the environment. A state has the right to ensure that foreign investment does not affect the environment. This right emanates not any from the right of sovereignty of a state to protect its territory from environmental harm but also from the fact that a state is repository of the right to safeguard the environment in the interest of human being, under international law. This right is incorporated under Art. 44 of the FDRE Constitution. The government is obligated to promote this right as per the provisions of Art. 92 of the Constitution. As per the Ethiopian investment law, the government is should make sure that an investment project to be undertaken by domestic or foreign investor should not adversely affect the environment.

Further, we have discussed that human rights are the other concerns of the law of investment. We have seen that the Ethiopian people in general have the right to economic development. Thus, the investment should promote a sustainable economic development of all the people of Ethiopia.

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Agency 3) Lease Office of A.A. government 4) Najat International P/L/C, T/F/No-2798/92, Yekatit 8, 1996 E.C

- Claimant – Ato Ahmed Aein – Attorney Ato Getachew Molla, **Respondents** 1) Lease Office – Attorney Ato Getachew G/Sellasia 2) Kurtu International, Tikimt 6, 1996 E.C
- Appellant – Ato Fantaye Kebede – Attorney Ato Tewardros Mihret , Respondents: 1) Lideta Kifle Ketema Land Development Administration Department- Attorney – Azeb G/wold and 2) Lideta Kifle Ketema Kebele 01/18 Office, Commission File No – 326/99, Tikmit 22, 2000 E.C

UNIT NINE: INVESTMENT DISPUTE SETTLEMENT

UNIT OBJECTIVES

After completing this unit, students should be able to:

- ◆ analyze the nature of dispute settlement;
- ◆ distinguish between different types of dispute settlement mechanisms;
- ◆ appreciate the role of diplomacy role in solving investment disputes;
- ◆ analyze the nature of arbitration as a dispute resolution mechanism; and
- ◆ apply the rules of investment dispute settlement.

INTRODUCTION

So far, we have dealt with essential points about investment in general, We have discussed new concerns related to the law of investment which are environmental concerns and human rights. these points and other issues may give rise to dispute. Hence, it is imperative to learn about investment dispute settlement which this unit is devoted to.

First, we will discuss dispute settlement in Ethiopia. Under this topic, we will be considering general comments about the issue. Then, we will discuss alternative dispute resolution mechanisms under the second topic of this unit.

The third topic is devoted to a discussion of investment dispute settlement. A dispute that arises from investment activities may be settled by courts of law or outside courts. The main investment dispute settlement mechanisms out of court are diplomatic channels and arbitration. Thus, we will be discussing these mechanisms. We will have questions after each topic and revision questions for the unit. We will also summarize the important points discussed under the unit.

9.1. DISPUTE SETTLEMENT: GENERAL REMARKS

What do we mean by settlement? Do you remember what you have learnt about dispute in your Civil Procedure Law course?

First and for most, there must be a dispute that needs settlement. There is no dispute until a defendant denies the claim or raises some points to defend. Thus, there is a dispute only where one party asserts a claim and another party denies on whatever grounds.⁷²⁵ Dispute settlement is a mechanism for resolving a dispute. Disputes may be that can only be settled in the courts of law. There are also other disputes that should be resolved out of court by alternative dispute resolution mechanisms. Other disputes may be only suitable for mediation, conciliation or good offices if at all they could be settled.⁷²⁶

What sort of disputes, can only be resolved in a court of law? Issues involving public law (such as crimes), administrative disputes and matters between individuals and the government are disputes that are only resolved by courts.⁷²⁷

Commercial disputes may be resolved out of court i.e. through alternative dispute resolution (ADR). Commercial persons, including investors chose arbitration because it appeared to be a good way of resolving disputes in the past. at present, arbitrators are selected based on usage and only because other methods seem even worse. As Nariman⁷²⁸ explains, arbitration, conciliation and mediation are in realty different forms of dispute resolution mechanisms out side courts.⁷²⁹

What are the advantages of resolving disputes in court and outside courts? The following are the advantages of resolving disputes in courts:⁷³⁰

- i) in general, the judges will be highly qualified with experience to solve disputes;
- ii) the court uses established rules of procedures that are used to investigate facts;

⁷²⁵ P. C. Rao and William Sheffield; **Alternative Dispute Resolution: What it is and how it works**, 2005, p. 59-60

⁷²⁶ **Ibid**, pp. 60-61

⁷²⁷ **Ibid**, p. 61

⁷²⁸ **Ibid**

⁷²⁹ **Ibid**, p. 45

⁷³⁰ **Ibid**, p. 61

- iii) the principles applied by courts are reliable and reasonable;
- iv) courts have dignity, authority and attract public confidence;
- v) court proceedings can sometimes spar settlement negotiation.
- vi) legal aid may be available,

On the other hand, arbitration offers the following advantages⁷³¹

Arbitration helps the parties to keep their secrets;

The parties can come up with their own rules or procedures;

It may help to minimize hostility;

It may be less costly;

The parties may select the place and time;

The parties may elect an expert in the field of the dispute.

In general, courts of law are not necessarily the most effective. The court system involves primarily an antagonistic process. If a dispute is brought before the court, the court should determine a winner and a loser of the case. As a result, the court system raises the tension between the parties rather than trying to reach an amicable compromise.⁷³² Thus, parties would resort to a mechanism of dispute settlement whereby both of them would be winners.

ALTERNATIVE DISPUTE RESOLUTION MECHANISM

What is ADR? Black's Law Dictionary⁷³³ defines ADR as a procedure for settling a dispute by means other than litigation, such as arbitration or mediation.

⁷³¹ **Ibid**

⁷³² Landlord Zone; 2003

⁷³³ Bryan, A, Garner, **Black's Law Dictionary**, 2004, p. 86

Even though the Dictionary does not enumerate many of the mechanisms of ADR, it makes it clear that alternative dispute resolution (ADR) is a mechanism employed to settle disputes other than courts of law which are established by the government of a given state.⁷³⁴

According to Stephen J. Ware,⁷³⁵

ADR can be defined as encompassing all legally permitted processes of dispute resolution other than litigation ADR is defined as everything but litigation because litigation, as a matter of law, is the default process of dispute resolution.

According to this definition, ADR is a dispute resolution mechanism to the exclusion of litigation. Thus, courts and arbitration proceedings are excluded because they involve litigation. However, one can inquire as an alternative to litigation?

under normal circumstances, disputes are settled by courts of law. The court system must be organized to provide simple, accessible, cheap, and local, public justice.⁷³⁶ However, the court system may lack such qualities, and people may tend to resort to solve their problem out of court.

According to P.C Rao,⁷³⁷ ADR offers an alternative option to litigation and by no means substitutes the traditional way of resolving disputes by means of litigation. Therefore, ADR is used as an alternative mode of resolving disputes by means of arbitration, mediation, conciliation and negotiation. ADR offers procedural flexibility, saves time and money, and avoids the stress of a conventional court trial.⁷³⁸

⁷³⁴ Aschalew Ashagre, 2006, p.

⁷³⁵ Bryan, **Ibid**,

⁷³⁶ Willian Twinint, " Alternative to what? Theories of Litigation Procedure and Dispute Settlement in Anglo-American Jurisprudence: Some Neglected classics," **The Modern Law Review**, Vol. 56, May 1993, P.383.

⁷³⁷ P.C Rao and William Sheffield (editors), **Alternative Dispute Resolution: What it is and how it works**, 2005, p.25

⁷³⁸ **Ibid**, P.30

A) ARBITRATION

I. DEFINITION AND NATURE OF ARBITRATION

The term “arbitration” is defined in different ways based on different purposes. In short, we do not have a generally accepted definition of the term “arbitration”.

Blacks’ Law Dictionary defines the term as “A method of dispute resolution involving one or more neutral third parties who are usually agreed to by disputing parties and whose decision is binding”.⁷³⁹ This definition reveals that arbitration is a method employed to resolve a dispute by private judges for the settlement of a case. The decision made by the private judges regarding the dispute between the parties is binding.

Lord Hainlsham, on his part, defines arbitration as

*The process by which a dispute or difference between two or more parties as to their mutual legal rights and liabilities is referred to and determined judicially and with binding effect by the application of law by one or more persons (the arbitral tribunal) instead of by a court of law.*⁷⁴⁰

In light of this definition for an arbitration to exist, there must be a dispute or difference. In the absence of a dispute, no arbitration will be there. In short, arbitration is concerned with the determination of disputes between the parties. The difference of depute should relate to a civil matter capable of being decided. It does not relate to a criminal matter.⁷⁴¹

Arbitration is regulated by law. In principle, arbitration is based on the agreement of the parties to arbitrate.⁷⁴² Such type of arbitration is voluntary arbitration since it arises from the free will of the disputing parties. A law may also make arbitration mandatory. This type of arbitration is known as compulsory arbitration.⁷⁴³

⁷³⁹ Bryan A Garner, **Ibid**, p.112

⁷⁴⁰ Lord Haislham of St. Marylebone (Editor-in-chief). **Holsby’s Laws of England**. (vol.2) 1991 Pp 332-333.

⁷⁴¹ **Ibid**; Pp 333

⁷⁴² Pieter Sanders, **ARBITRATION**, 1996, P.5.

⁷⁴³ Jacqueline M. Nalan-Haley, **Alternative Dispute Resolution in a Nutshell**, St Paul, Minnesota, West Publishing Co, 1992. Pp 124-125

In case of Compulsory arbitration, the dispute is referred to arbitrators against the will of the parties Although. Compulsory arbitration, negates the generally accepted attributes of arbitration, it is deemed to be appropriate and worth retaining in specific types of disputes such as family and labour relations, where maintaining continuity of relationship is important, not only for the parties alone, but also for the society at large.⁷⁴⁴

We have seen that, as a matter of principle, arbitration requires the consent of the parties. Thus, the likelihood of being aggrieved by a decision is greatly reduced although this may not be the case for compulsory arbitrators. Secondly, parties are free to choose the arbitrators. This gives them the opportunity to appoint arbitrators. who are competent, and knowledgeable in the area of the dispute or well acquainted with the circumstances surrounding the dispute.⁷⁴⁵ The parties have also the opportunity to appoint individuals in whom they have confidence in the handling of the issue. Thus, the parties are more likely to accept the decision of the arbitrators without reservations. The relationship of the parties can be maintained and antagonism will be avoided since they will be satisfied with the outcome of the arbitration proceeding.⁷⁴⁶ In case of compulsory arbitration, the relationship between the parties can be maintained because the arbitrator may be expert in the area of dispute or aware of circumstances surrounding the case, and thus resolve the dispute which satisfy the parties.⁷⁴⁷

Arbitration, under Ethiopian law, is in general voluntary. This is revealed from Article 3325(1) of the Civil Code which provides that the arbitral submission is the contract where by the parties to a dispute entrust its solutions to a third party, the arbitrator, who undertakes to settle the dispute in accordance with the principles of law.

The first element in arbitration in light of the above mentioned provision is that arbitration is a contract. Thus, the general principles of contract are applicable. According to the general principles of contract incorporated under book IV, Title XII of the Civil Code, capacity, consent, object and form, if any, must

⁷⁴⁴ Rene David, **Arbitration in International Trade**, Kluwer Law and Taxation Publishers, Netherlands, 1998, Pp 8-9

⁷⁴⁵ **Ibid**; P.10

⁷⁴⁶ **Ibid**

⁷⁴⁷ **Ibid**

be fulfilled to have a valid contract.⁷⁴⁸ Since consent is one of the important elements of a contract, arbitration under the Ethiopian law is voluntary and must be based on the agreement of the parties. However, it is worth noting that special laws may order for compulsory arbitration without the consent of disputing parties.

The object of arbitration is to settle a dispute. Thus, the existence of dispute is an important element of arbitration under our law.⁷⁴⁹ The agreement to arbitrate may refer to an existing or future dispute. What is important is the existence of dispute that necessitates arbitration. This second element of arbitration is incorporated under Article 3325 (1) of our Civil Code.

The freedom of the parties to choose arbitrators is the third element of arbitration. The parties are free to choose whomever they deem appropriate to serve as an arbitrator.⁷⁵⁰ In principle, parties are free to choose their own 'judges'. However, the court may elect arbitrators where parties fail to exercise their freedom.

The fourth element of arbitration is an award. An award is a final judgment or decision given by arbitrators.⁷⁵¹ Arbitrators are required to conduct a hearing analogous to court proceeding in order to arrive at a decision which resolves the dispute at hand.⁷⁵² Parties are at liberty as to the arbitral proceedings. However, if they failed to regulate the proceedings, mostly by reference to rules of arbitration, the law comes to interfere. It is worth to note that arbitration is a judicial process, by which arbitrators, as private judges, render a binding decision that is enforceable like a judgment of a court.⁷⁵³ However, the court must confirm the award where the party seeks for execution.⁷⁵⁴ The award rendered by arbitrators on the basis of the agreement of the parties. becomes final and binding with limited recourses.⁷⁵⁵

II) ARBITRATION VERSUS COURTS OF LAW

⁷⁴⁸ Civil Code of the Empire of Ethiopia of 1960, Article 1678.

⁷⁴⁹ **Ibid**, Article 2328

⁷⁵⁰ **Ibid**; Arts 3331-3335

⁷⁵¹ Brayan, **Ibid**, p.147

⁷⁵² Civil Procedure Code of the Empire of Ethiopia of 1965, **Negarit Gazetta**, Extraordinary Issue No 3 of 1965, Article 317(1)

⁷⁵³ Peter, **Ibid**, p.5

⁷⁵⁴ Civ. Pro. C. **Ibid**, Art, 319 (2)

⁷⁵⁵ Harry T. Edwards, "Alternative Dispute resolution; Panacea or Anathema", **Harvard Law Review**, Vol.99 (1986)

There are two basic contradictory thoughts about arbitration in relation to courts. The first thought considers arbitration as the most useful and the most advantageous method for the common good. During the French Revolution the constituent assembly solemnly proclaimed that arbitration was the most reasonable way of terminating disputes between citizens. What is more, it is considered as a birth right (*droit naturel*) of person, and no encroachment by legislator was proclaimed. This was confirmed by the 1791 French Constitution. Currently, the Constitution of El Salvador under Article 174 and Venezuela under Article 190 incorporate this principle of the right of parties to resort to arbitration. Other countries also impliedly guaranteed this right by affirming the principle of freedom of contract in their constitutions.⁷⁵⁶

On the other hand, there is a school of thought which considers that the courts established by the state have an inherent right to settle disputes of legal nature. In accordance with this view, courts can in no case be deprived of their power of jurisdiction. Thus, it is not allowed to establish extraordinary or specialized courts. The Indian Constitution of 1948 is a typical example. Pursuant to this view, arbitration is forbidden.⁷⁵⁷

It is true that the sovereign is endowed with the power to administer justice. However, this does not mean that the sovereign should administer justice only through courts all the time. In the words of Rene David;

*The prerogative of justice is satisfied as long as the sovereign retains the ability to control how justice is administered by other bodies within his borders. It is not opposed to arbitration therefore, but requires that arbitration, in its various forms, be subject to some control and be thus, to some extent, integrated into the judicial organization of the state...*⁷⁵⁸

⁷⁵⁶ Rene, **Ibid**, Pp. 55-56

⁷⁵⁷ **Ibid**, P.56

⁷⁵⁸ **Ibid**, p.57

Arbitration is an alternative to recourse to the courts. Arbitration has a binding effect on parties and is enforceable if certain essential requirements are met.⁷⁵⁹

Coming to Ethiopia, “everyone has the right to bring a justice able matter to, and to obtain decision or judgment by, a court of law or any other competent body with judicial power”.⁷⁶⁰ It is clear from this provision that arbitral tribunal is recognized under the Ethiopian, law at least impliedly.

B) Conciliation

Conciliation is a mechanism of ADR by which we can solve disputes between parties. Conciliation and mediation are used interchangeably. In both conciliation and mediation the dispute will be settled by mutual agreement of the parties. However, the positive role of the neutral third party is more emphasized in case of mediation than that of conciliation in some jurisdictions. The role of the third party will depend on the nature of the dispute, the degree of the willingness of the parties and the skill of the individual neutrals. Therefore, the role of the third party may not help us to distinguish between conciliation and mediation.⁷⁶¹

What is conciliation? Conciliation is defined as “a non-binding procedure in which an impartial third party, the conciliator, assists the parties to a dispute in reaching a mutually agreed settlement of the dispute.”⁷⁶²

According to this definition, conciliation is nonbinding, i.e. either of the parties could reject the result. However, conciliation helps the party to agree on the solutions to solve their dispute. Therefore, their mutual consent is essential and would be the basis for enforcement of the solutions.

⁷⁵⁹ Robert Prtchard (editor), **Economic Development, Foreign Investment and the Law: Issue of Private sector Involvement Foreign Investment and the Rule of Law in a New Era**, Kluwer law, London, International Bar Association, 1996, Pp 207-10

⁷⁶⁰ Proclamation of the Constitution of the Federal Democratic Republic of Ethiopia, Proc, No 1/1995, **Negarit Gazeta**, 1st year, no 1, Article 37(1).

⁷⁶¹ P.C Rao & William Sheffield, **Ibid**, P. 84

⁷⁶² **Ibid**, P.88

A third party neutral searches ways in which the dispute could be solved amicably and helps the parties in dispute to solve their dispute. It is a relatively unstructured method of dispute settlement mechanism. The role of the third party neutral is to facilitate communications between the parties.⁷⁶³

Under the Ethiopian legal system, conciliation is recognized to solve family disputes, labour disputes. For example, as per Art. 82(2) of the Revised Family Code, the disputing spouses can settle their dispute by conciliation. It is also provided under Article 119 of the Revised Family Code that parties can use conciliation to settle disputes.

Conciliation offers the following advantages.⁷⁶⁴

- A) it offers a more flexible alternative to any type of disputes, small or large;
- B) the parties can withdraw from conciliation at any time and stage;
- C) it offers the opportunity to keep the secrets of the parties.
- D) it facilitates the maintenance of continued relationship between the parties. This feature of conciliation is significant to investors and their employees etc to continue the work.

C) Mediation is the ADR mechanism in which a neutral third party advocates for settlement, and seeks each party to move enough to settle the dispute. Thus, it is referred to as assisted negotiation.⁷⁶⁵ The main difference is that mediation involves a third party whose role is to help the parties reach a mutually agreeable solution to the problem of conflict or disagreement. Mediation is a voluntary process.⁷⁶⁶

Mediation is the process by which a third party neutral, referred as mediator, plays a more active role by giving independent compromise formulas after hearing both the case of the disputants their case and stating their terms of compromise. In mediation, a chosen facilitator helps parties to come to terms acceptable to both although the proposal normally comes from the parties themselves.⁷⁶⁷ In general, mediation is a facilitated negotiation. with the help of negotiator (expert), a mediator.

D) Negotiation is a means of settling disputes usually using verbal communication. According to Fisher and Ury, the following are the four principles of negotiation.⁷⁶⁸

⁷⁶³ Bryan, **Ibid**, P. 307

⁷⁶⁴ P.C.Rao and William, **Ibid**, P.91

⁷⁶⁵ **Ibid**, P. 211

⁷⁶⁶ UNHCR- Community Course Booklet, in ...

⁷⁶⁷ Tilahun Teshome, ...

⁷⁶⁸ Mudhava Menon, **Ibid**,

- A) **Separate the people from the problem.** The relationship (the people) is separate from any substantive problem (conflict). We may reduce the possibility of miscommunication and emotions negatively affecting the negotiation by distinguishing the relationship from the problem.
- B) **Focus on interests not positions**-interests are underlying needs, desires, concerns wants, values, or fears. Interests motivate people, however, often individuals will state a position.
- C) **Invent options for mutual gain**-negotiation requires creativity and the commitment to brainstorm options that will be acceptable to both parties. In brain storming, negotiations need to separate stage of evaluating options from the state of generating options.
- D) **Insist on trusing objective or mutually acceptable criteria**-It is essential to identify several relevant standards of criteria by which parties can evaluate the fairness or acceptability of a negotiated agreement. Negotiations can brain storm criteria or standards in the same way as they brain storm options.

In short, negotiation is a mechanism by which the parties to the dispute solve their dispute without the intervention of any third person.⁷⁶⁹

But ADR, in the narrow sense, does not have binding effect upon the parties to dispute. In ADR, the victim may simply reject the outcome. The structures of ADR are more or less formalized and sophisticated.⁷⁷⁰

ADR in general may direct the discussions toward accommodation rather than discord. The result depends on its acceptability to all parties concerned, and therefore, it is essential to negotiate the dispute.

ADR includes the concept “alternative”. However, it is worth noting that it is the substitute for a traditional forum clause. ADR is less formalistic than court proceedings, and parties may choose to solve their dispute through ADR, but that does not mean that they waive their right to go to court and have justice.⁷⁷¹ ADR does not provide a mechanism to obtain a binding result, if it did, it could not be considered as ADR but arbitration.⁷⁷²

To ensure neutrality, the majority of the arbitrators should not be solely appointed by one party to the dispute.⁷⁷³

Questions

⁷⁶⁹ Garner, **Ibid**, P. 1065.

⁷⁷⁰ Robert, 1996, **Ibid**, 210

⁷⁷¹ **Ibid**,

⁷⁷² **Ibid**.

⁷⁷³ **Ibid**. 243-44

- 1) What do we mean by alternative dispute settlement mechanism?
- 2) Discuss how investment dispute may be settled through conciliation.
- 3) Analyze mediation as a mechanism to settle instalment dispute under the Ethiopian legal system.
- 4) Explain how negotiation and compromise are used to settle investment dispute.

9.2) SETTLEMENT OF INTERNATIONAL INVESTMENT DISPUTE

In every foreign direct investment, we find a relationship among a host state, a foreign investor and the home country of the investor, which is known as trilateral relationship. As was discussed before elsewhere in the material, each state has a sovereign power to admit foreigners within its territory and regulate their activities, as well as to protect its nationals abroad from acts contrary to international law. Hence, disputes might arise between states or between states and investors within the context of the investment activities of transnational corporations.⁷⁷⁴

Investment dispute may either be state-to-state or investor-state investment disputes. State-to-state (or “inter-state”) investment dispute may arise directly between the signatories of IIAs, or to issues that first arise between investors and their host states, but then becomes inter-state disputes.⁷⁷⁵

Governments may take measures affecting the establishment, and operations of investment might create disputes, and such disputes are categorized under state-to state disputes.⁷⁷⁶

Dispute Settlement Arrangements (DSAs) are made in IIAs or at national laws. At the international level, two states may arrange dispute settlement mechanisms. There is lack of compulsory dispute settlement force within the international system at large. Thus, the parties involved must ensure that they can settle the disputes amicably and peacefully.⁷⁷⁷

⁷⁷⁴ UN, Volume III, 2004, p.316

⁷⁷⁵ Ibid

⁷⁷⁶ Ibid, Pp. 316-17

⁷⁷⁷ Ibid, p.317

What are the objectives and purposes of DSAs? The first purpose is to ensure the availability of pre-determined set of procedures that will help parties to decide upon the disputes that will be final and authoritative decision could be made if dispute arises. Second, the purpose is not only to settle disagreements concerning the interpretation, implementation or application of the provisions of IIA, but also to avoid of conflict. So as to avoid conflict, governments are required to notify and discuss on the issues. In addition, it is an obligation of the parties to discuss before they resort to employ dispute settlement mechanisms, with the intention of avoiding conflicts. In short, the purposes and objectives behind the arrangement of DSAs include a contribution to “the avoidance, management and settlement of state-to-state disputes”.⁷⁷⁸

Disputes settlement mechanisms and their procedures

DSAs mainly provide for dispute settlement mechanisms through bilateral means. There could also be third-party mechanisms to settle inter-state investment disputes.

Those two mechanisms include the following:⁷⁷⁹

- Conciliations and negotiations;
- Ad hoc inter-state arbitration;
- Permanent arbitral or judicial arrangements for dispute settlement; and
- Political or administrative intuitions’ decisions are binding.

A) Consultations and Negotiations

Consultations and/or negotiations are typically the first type of investment dispute mechanisms that utilize a bilateral decision making process. Diplomatic channels, negotiations and consultations are the three formulations which essentially involve a negotiations process. Settlement of disputes through diplomatic negotiations and/or consultations has been historically the most common means to dispute settlement between states. Negotiations could resolve the disputes or in more complicated cases, assist to narrow

⁷⁷⁸ Ibid, p.318

⁷⁷⁹ Ibid, p.320

down the issues to more manageable proportions, or they prepare them for resolution by a third party process.⁷⁸⁰

Consultations facilitate the parties to exchange information and learning for the purpose of avoiding the emergence of a dispute. Since consultations have regulatory functions, and could promote meaningful cooperation between the contracting parties.⁷⁸¹

Negotiations and consultations are normally concluded on an ad hoc basis. They are flexible, and time framed to begin and end.

The following are examples:

Disputes between contracting parties concerning the interpretation or application of this agreement should, if possible, be settled through the diplomatic channel.⁷⁸² Disputes or differences between the counteracting parties concerning interpretation or application of this agreement shall be settled through negotiations⁷⁸³

B) Ad Hoc Arbitration

Parties may fail to reach a mutually acceptable solution to their disputes through negotiations. In such a case, most IIAs and bilateral investment treats provide for recourse to ad hoc arbitration. Then, an ad hoc arbitration may be established by the will and participation of the parties.⁷⁸⁴

⁷⁸⁰ Ibid, p. 320

⁷⁸¹ Ibid

⁷⁸² The UK model BIT, Article 9(1)

⁷⁸³ The Asian African Legal Consultative Committee (ALCC model (A) BITs, articles 11(1)

⁷⁸⁴ UN, Ibid, p.327

Each party selects one arbitrator within a prescribed time period. In most cases, parties select their own national, and this could ensure that there will be a member who has knowledge of special circumstances prevalent in his/her country.⁷⁸⁵

The parties are also required to select a third person who is non-national of both countries. If they could not appoint, one either of them may request the president of the International Court of Justice to appoint an arbitrator. Then, the parties will agree upon the working procedures. Some DSAs provide for the time limit within which the arbitration is to be completed. For example, arbitration must be made and completed within six months of the date of selection of the third arbitrator.⁷⁸⁶

C) Permanent arbitral and judicial institutions

There are permanent arbitral and judicial institutions to state disputes, for example, the permanent court of Arbitration at the Hague and the International Court of Arbitration of the ICC and ICSID.⁷⁸⁷

D) Permanent political intuition for dispute settlement

DASs might provide resort to a political organ for settlement of investment disputes. For example, the ASEAN dispute settlement mechanism of the governments of Burundi Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand, provides that the panel procedures established by the Senior Economic Officials Meeting (SEOM) to assist the body in ruling on the dispute.⁷⁸⁸

INVESTOR-STATE DISPUTE

⁷⁸⁵ Ibid, p.328

⁷⁸⁶ UN, Ibid, Pp.330-31

⁷⁸⁷ Article X(3) of the United States model BIT

⁷⁸⁸ United Nation, **Ibid**, p.331

A dispute may arise between a private investor and the state. Under customary international law, such a dispute may be resolved in the tribunals and/or courts of the country concerned. The court system may not be effective and the investor's may recourse to diplomat or enterprise.⁷⁸⁹

A dispute may arise over the interpretation of their respective rights and obligations under the applicable investment law. A dispute may also arise as to the treatment according to certain standards or failure to provide protection required by treaty or customary law. In principle the dispute between a state and an investor is settled by mutual and amicable means.⁷⁹⁰

9.3) INVESTMENT DISPUTE SETTLEMENT UNDER THE ETHIOPIAN LAW

The Ethiopian investment laws regulate the settlement of state-state and state –investor disputes, which we will discuss in the next section of the material.

9.3.1) DISPUTES BETWEEN ETHIOPIAN GOVERNMENT AND CONTRACTING PARTY

Bilateral investment treaties Ethiopia has concluded with other countries stipulate different mechanisms of investment disputes between Ethiopian Government and other contracting party. They are diplomatic channels, joint commission; and ad hoc arbitration.

A) DIPLOMATIC CHANNELS

In the present time, disputes are governed by the provisions of bilateral investment treaties. A number of treaties provide that contracting parties will undertake consultations on matters relating to the investment treaty. Thus, parties may opt for any formal proceedings to settle their disputes amicably. Some

⁷⁸⁹ **Ibid**, Pp. 347-48

⁷⁹⁰ **Ibid**, p. 349

provisions of bilateral investment treaties explicitly provide a forum for the resolution of disputes.⁷⁹¹ For example, the bilateral investment treaty concluded by Ethiopia and the Government of the People's Republic of China provides that the representatives of the parties shall hold meetings in Addis Ababa and Beijing to

- ii) implement the agreement;
- iii) exchange information on law and investment opportunities;
- iv) resolve investment disputes;
- v) exchange ideas to promote investment;

and other relevant issues(Art. 12).

In general, there is an opportunity for contracting parties to resolve their disputes before it is submitted to third parties. Most investment treaties provide that the disputes shall be settled through negotiation between the governments of the contracting parties. In other words, disputes shall be resolved through diplomatic channels.⁷⁹²

The investment agreements to which Ethiopia is a party incorporate such a mechanism. For example the agreement we cited above provides under Article 8(1) that investment disputes “shall, as far as possible, be settled by consultation through diplomatic channel.”

Thus, it is a requirement that a dispute be brought between the ambassador of one of the contracting parties and the relevant ministry of the other party. The matter could be settled by the experts of both countries where the need arises, i.e. where the matter includes technical issues.⁷⁹³

Any dispute that might arise between the contracting parties i.e. **state-state** dispute with regard to the interpretation and application of the agreement must be settled by consultation through diplomatic channel. Thus, diplomacy has a great role in solving investment dispute.

⁷⁹¹ Dolzer, Rudolf and Stevens, Margaret, **Bilateral Investment Treaties**, The International Centre for Settlement of Investment Dispute, Martinus Nijhoff Pub., the Hague, 1995: p. 121

⁷⁹² **Ibid**, p. 123

⁷⁹³ **Ibid**

B) JOINT COMMISSION

If the dispute cannot be settled through diplomatic channel,⁷⁹⁴ it must be given to a joint commission constituted by representatives of both parties. The joint commission is empowered to convene without undue delay at the request of the first party to take action.⁷⁹⁵

C) AD HOC ARBITRAL TRIBUNAL

D)

If the dispute cannot be settled within a specified period of time, it must be submitted to an *ad hoc* arbitral tribunal. The tribunal shall be composed of three arbitrators, two selected by the respective contracting parties, one selected by the two arbitrators. The third arbitrator must be selected from a third state, which has a diplomatic relation with them and will act as a chairperson of the arbitral tribunal.

If the arbitral tribunal has not been constituted within four months from the date of receipt of the written notice for arbitration, the President of the International Court of Justice (ICJ) is invited to appoint the arbitrator(s). The President of the ICJ should not be a national of the contracting parties. If the President is a national to either of the contracting party or is otherwise prevented from discharging the said function, the next most senior member⁷⁹⁶ of the ICJ must be invited to appoint an arbitrator.

Once established, the arbitral tribunal has given the power to determine its own procedure. Further, the decision of the arbitral tribunal must be rendered on the basis of the terms of the agreement and the principles of international law recognized by both contracting parties.⁷⁹⁷ This provision gives the parties the opportunity to be guided by the principles of the international law so long as they recognize (accept)

⁷⁹⁴ Under the Bilateral Agreement between Ethiopia and China it must be submitted to the arbitral tribunal if the dispute is not settled within 6 months while it must be submitted to a joint commission under the agreement between Ethiopia and Belgian-Luxemburg Economic Union if it cannot be settled through diplomatic channel.

⁷⁹⁵ Bilateral Investment agreement between Ethiopia and Belgian-Luxemburg Economic Union, October 2006, Article 12(2)

⁷⁹⁶ According to the Bilateral investment agreement between Ethiopia and Belgian-Luxemburg Economic Union, Article 12(3) the Vice- President of the ICJ will appoint the third arbitrator.

⁷⁹⁷ Bilateral agreement between Ethiopia and China, Art-8(5)

the principles. It equally offers the opportunity not to depend on international law principles because the dispute may be resolved without resort to international law. The states may also differ in recognising international principles to be applied. In such a case, the international law would not be applied. Thus, the agreement may not help to develop international principles on the area.

As to the manner of decision, the arbitrators should decide by a majority of votes. The decision may not include the reasons for the award, and the tribunal must explain the reasons of its award only when either of the parties request.⁷⁹⁸ This by itself may be an obstacle in the development of international law. The award must be final and binding.

We have seen that each contracting party has the right to appoint an arbitrator. Accordingly, each party must cover the cost of the arbitrator and the proceedings. Both should also cover the cost of the chairperson of the tribunal.⁷⁹⁹

9.3.2) INVESTOR-ETHIOPIAN STATE DISPUTE

There are various methods envisaged under bilateral investment agreements to settle disputes between investor and contracting party.

A) NEGOTIATION

Negotiation is the one of the mechanisms to settle disputes between an investor and a contracting party. Thus, one of the parties may notify the matter to take an action. The parties are encouraged to settle their differences through negotiation, if necessary, by seeking expert advice from a third party.⁸⁰⁰

⁷⁹⁸ Bilateral agreement between Ethiopia and China, Art-8(6)

⁷⁹⁹ Bilateral agreement between Ethiopia and China, Art-8(7)

⁸⁰⁰ Bilateral Investment agreement between Ethiopia and Belgian-Luxemburg Economic Union, October 2006, Article 11(1)

B) COURTS

Where the dispute cannot be settled through negotiation, it must be submitted to the competent jurisdiction of the State (court).⁸⁰¹

C) ARBITRATION

It is also allowed for the parties to the dispute to submit their disputes to an international arbitration even without exhausting the administrative or judicial remedies in the State. In such a case the dispute must be submitted to one of the following organisations:

- An ad hoc arbitral tribunal set up according to the arbitration rules laid down by the United Nations Commission on International Trade Law (U.N.C.I.T.R.A.L.O.)
 - The International Centre for the Settlement of Investment Disputes (I.C.S.I.D.)
 - The Arbitral Court of International Chamber of Commerce in Paris;
 - The Arbitration Institute for the Chamber of Commerce in Stockholm.
- The award of the tribunal is final, binding and is required to be executed by the parties.

The International Centre for Settlement of Investment Disputes (ICSID)

⁸⁰¹ **Ibid**, Article 11(2)

The International Centre for Settlement of Investment Disputes (ICSID) was created by the World Bank in 1966. However, it is an autonomous international organization. It facilitates the arbitration of disputes between member countries and foreign investors who are nationals of other member states.⁸⁰²

The purpose of the convention is to promote an atmosphere of mutual confidence between states and foreign investors. It has the aim of stimulating a large flow of international capital into countries which ratify it to safeguard and promote the interests of investors who, unlike states, have no recourse to the International Court of Justice.⁸⁰³

International Centre for Settlement of Investment Disputes (ICSID) Convention came into force in 1966.⁸⁰⁴ The Convention provided a complete, self-contained system for the settlement of disputes between foreign investors and their host states by arbitration.

The Convention opens the opportunity for contracting parties of bilateral investment treaties (BITs) to incorporate arbitration to solve investment disputes pursuant to the ICSID clauses. Accordingly, it was in 1968 that the Netherlands-Indonesia treaty included an ICSID clause for the first time.⁸⁰⁵

Jurisdiction

The jurisdiction of the Centre, as defined by Art 25(1) of the ICSID Convention, extends to:

*any legal dispute arising directly out of an investment, between a Contracting State (or by any constituent subdivision or agency of the Contracting State designated to the Centre by that State) and a national of another contracting State, which the parties to the dispute consent in writing to submit to the Centre.*⁸⁰⁶

⁸⁰² Bonner and Waits; 2007, p.12

⁸⁰³ Hailsham; 1991: 422

⁸⁰⁴ Dalzer and Stevens; **Ibid**, p. 120

⁸⁰⁵ **Ibid**, p. 130

⁸⁰⁶ **Ibid**, Pp. 130-31

Pursuant to Article 25(1) of the ICSID Convention, the following four requirements must be met to have jurisdiction.⁸⁰⁷

- There must be a legal dispute;
- It must arise directly out of an investment;
- The parties must have agreed to submit their dispute to ICSID;
- The dispute must be between a contracting state or its subdivisions and a foreign investor from another contracting state.

Thus, whenever there is a legal dispute about legal rights, the first requirement is fulfilled. The consent of the two parties is the “cornerstone” of ICSID’s jurisdiction. Hence, all parties concerned must agree to submit their dispute to the ICSID if it arises.⁸⁰⁸ The mere ratification of the ICSID Convention is not in itself consent to arbitration by a state. The preamble of the Convention makes it clear that ratification of the convention makes the state party to it, but does not give the ICSID a jurisdiction to resolve the dispute.⁸⁰⁹ Thus, the state must give its consent clearly.

The consent may be given in an arbitration agreement concluded between the state and the investor before or after the dispute has arisen.⁸¹⁰ The Convention is flexible since it allows the parties to declare their consent not in a single instrument. Accordingly, the consent of the host state might be set forth in appropriate provisions of its investment promotion legislation.⁸¹¹ Once the party declares the consent, it may not be revoked unilaterally; the party is abided by the consent.⁸¹²

The Award-The Arbitral Tribunal should make an award after examining the issues (disputes) submitted to it. The award must be made in writing and state the reasons on which it is based.⁸¹³ According to

⁸⁰⁷ Julian, Mistelis and Kroll; 2003: 776

⁸⁰⁸ Dolzer and Sterns, **Ibid**, p. 131

⁸⁰⁹ Julian, Mistelis, and Kroll; **Ibid**, p. 777

⁸¹⁰ **Ibid**

⁸¹¹ Dolzer and Stevens; **Ibid**, p. 131

⁸¹² **Ibid**

⁸¹³ Art. 48(3) of the Convention

Article 48(1) of the Convention, the award must be decided by majority vote, and be signed by members of the tribunal who voted for it.⁸¹⁴

The Centre must not publish the award without the consent of the parties.⁸¹⁵ The Secretary General must dispatch certified copies of the award to the parties. The date the copy is dispatched is considered as the date of the award.⁸¹⁶ The award should be registered and it has the same force and effect as a judgment of the Court (High Court). Therefore, it will be executed like any other judgment made by the court.⁸¹⁷

QUESTIONS

- 1) What do you understand by ICSID?
- 2) What are the requirements that must be fulfilled by the ICSID to arbitrate
- 3) Discuss how contracting parties may settle investment dispute through diplomatic channels.
- 4) To solve investment disputes by diplomatic channels, experts play great role.
Comment.
- 5) Analyze arbitration as an investment dispute mechanism.
- 6) Compare and contrast settling investment disputes in courts of law and through arbitration.

SUMMARY

We have learnt that a dispute may be settled by courts of law or outside courts. We have seen that judges are highly qualified in solving disputes, courts use formally established procedures, and the principles

⁸¹⁴ Art. 48(2) of the Convention

⁸¹⁵ **Ibid**, Art. 48(5)

⁸¹⁶ **Ibid**, Art 49(1)

⁸¹⁷ Hailsham; 1991: 430

applied are reliable and reasonable. On the other hand, we have identified that courts may develop hostility which may destroy the chance of disputants to work together after the dispute is settled. And this does not favour investment Hence parties resort to settle their disputes out of court.

We have seen that the Ethiopian legal system allows the parties to solve their dispute in courts of law as well as out of court.

We have considered that ADR is a procedure for settling a dispute by means other than litigation.

When we say alternative, we mean alternative to courts.

So, we have seen that arbitration, conciliation, mediation and negotiation and compromise are mechanisms of alternative dispute settlement.

Further, we have discussed that an investment dispute may be settled by utilizing diplomatic channels. Thus, governments can settle their investment disputes through negotiation. Arbitration is the other means to solve investment disputes.

We have seen that arbitration offers flexibility for investors; it offers advantage to preserve privacy among others. We have seen that arbitrators must give their award in writing which is executable.

Review Questions

- 1) Arbitration is one form of out of court dispute resolution method. According to Article 318(2) of the Civil Procedure Code the decision made by arbitrators should comply with the legal provisions on judgment. Do you believe that it is still an alternative to court proceeding? State you reason out.
- 2) Compare and contrast conciliation and mediation from the investment dispute settlement point of view.
- 3) Gerbru and Hiruth have a partnership in business. Gebru is working as a manager to their partnership. However, Hiruth is not comfortable with the performance of Gebru and the finding of auditors shows that the partnership has lost Birr 130,000.00. As a result, she claimed 130.000.000 Birr from him. Then, each of them elected one arbitrator, Hellen and Zinabu. The

two arbitrators on their part elected the third person. Abebe, as an umpire of the tribunal. Hellen, the arbitrator elected by Gebru is his girlfriend. Hellen has refused to hear the evidence produced by Hiruth. She also mistreats Hiruth during the process while other two arbitrators remain neutral. Finally, Hiruth becomes the loser of the claim.

Can Hiruth lodge an appeal to court? Why or why not?

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True/False

1. If an investment project uses technology that negatively affects the environment, the hos state may oblige the investor to take proper environmental measures.
2. Cancelling an investment contract if the investment pollutes the environment is always an easy task.
3. The Investment Law as it stands now enabl the Ethiopian Investment Commission to study impact assessment of a given investment project.

4. The Ethiopian Government need not bother about whether or not an investment violates the people's right to development.
5. One of the requirements to be fulfilled to settle a dispute is that it needs settlement.
6. Investors opt to settle their disputes out of court since the court system involves an antagonistic process.
7. The most important investment dispute settlement, according of the convention, is agreements.
8. Arbitration is more informal but it does not offer an opportunity to keep the dispute not to be public.
9. ICSID has a jurisdiction to settle disputes that arise from commercial activities other than investment.
10. ICSID will have a jurisdiction to settle investment disputes if parties give their consent for arbitration.
11. An award rendered by the ICSID could be published without the consent of the parties.
12. The International Centre for Settlement of Investment Disputes (ICSID) is an organization dependent upon the World Bank.
13. Investment incentives are aimed at attracting foreign investment to Ethiopia.
14. In principle nationalization and expropriation of investment are the same.
15. The concept of a joint venture under the Ethiopian Commercial Code and the Investment Law is similar.
16. Ethiopia, being member to the common market for Eastern and Southern Africa, offers a good opportunity to invest in Ethiopia.
17. The Ethiopian Investment Commission is empowered to issue directives to promote investment in Ethiopia.
18. Regional investment organs have the power to license investors who want to invest in the Regions according to relevant laws.
19. Investment is regulated under the Ethiopian law with a view to making sure that it promotes the development of the country.
20. Our law provides that the investor must submit the description of an intended investment project.

21. Bilateral investment treaties are one form of regulating investment transaction.
22. If the rules that are incorporated in bilateral investment treaties are continuously used by other bilateral treaties, they could be an international law in the area.
23. In the history of investment, the effort to govern it by an multinational instrument has not been successful.
24. Trade related investment measures represent one of the efforts to govern investment at the international level.

Choose

1. Which of the following should be fulfilled, in order for the ICSID to have a jurisdiction to settle a dispute?
 - A. There must be a dispute.
 - B) The dispute should arise from trade.
 - C) The parties must agree to submit their dispute to ICSID.
 - D) A and B Are correct.
 - E) A and C are correct.
2. A consent to submit an investment dispute to the ICSID may be given _____
 - A) After the dispute has arisen.
 - B) Before the dispute has arisen.
 - C) Both
 - D) None
3. The remedy that could be taken where the investment project is found to be hazardous to the environment is
 - A) Granting permission
 - B) Rejecting permission
 - C) Both
 - D) None
4. The method by which we can check whether or not a given investment project has the negative impact on environment is

- A) Making an impact assessment
 - B) Testing the project for six months
 - C) Recruiting a supervisor after granting an investment permission
 - D) None
5. The Right to development, incorporated under our Constitution is the right of
- A) an individual
 - B) people
 - C) a certain group
 - D) All
6. Which of the following **IS NOT** an incentive under the Ethiopian Investment Law?
- A) Exemption from income tax
 - B) Exemption from payment of customs duty
 - C) Exemption from all types of tax for 15 years.
 - D) A and B
- 7) Which of the following is a guarantee to foreign investors?
- A) To transfer profits to their country
 - B) To invest in any region
 - C) To collect value added tax
 - D) To live in their home country
8. Which of the following **IS NOT** a form of investment in Ethiopia?
- A) Sole proprietorship
 - B) Share Company
 - C) Private Limited Partnership
 - D) Limited Company
9. Which of the following is an opportunity to invest in Ethiopia?
- A) Availability of market
 - B) Availability of raw materials
 - C) Cheap labour
 - D) All

Review Questions I

D) Choice

- 1) Which of the following is not an element of the definition of investment?
A) Expenditure of capital B) Degradation
C) Enterprise D) Investor
- 2) Which of the following is a pre-requisite for investment?
A) Saving B) Consumption C) No commitment D) all
- 3) An economic theory based on the premise that free market will yield maximum productivity is known as
A) the middle path B) the dependency theory
C) the liberal consensus D) the classical theory
- 4) The first attempt to create rules to govern the conduct of foreign investment has been made by _____
A) the United States of America B) the European Union
C) the ILO D) the United Nations
- 5) Arbitral awards are _____ sources of international law on foreign investment.
A) subsidiary B) primary C) elementary d) original
- 6) Which of the following is not a feature of bilateral investment treaties?
A) equitable treatment B) discrimination
C) compensation D) National treatment
- 7) Rights of states to regulate the flow of foreign investment emanates from
A) political right B) social condition C) sovereignty D) none
- 8) Which of the following are areas open to joint investment?
A) banking B) insurance C) electric power D) Telecommunication services
- 9) The Investment Commission has the power to
A) Initiate policies B) issue proclamation C) A and B D) none
- 10) Which of the following is not a favorable situation to invest in Ethiopia?
A) liberal economic policy B) poverty
C) raw materials D) market
- 11) Joint venture may take the form of
A) corporate joint venture B) partnership joint venture
C) Private joint venture D) A and C E) A and B
- 12) Which one of the following is a financial incentive.
A) subsidized credits B) income tax deduction
C) granting monopoly right D) A and B

- 13) A guaranty to investors may be
 A) guarantee against loss B) guarantee against expropriation
 C) guarantee against poverty D) all
- 14) A dispute that arises from investment may be resolved by
 A) elders B) fighters C) arbitration D) none
- 15) To protect the environment, states may
 A) promote polluting activities B) encourage absolute machines
 C) Chan agreements D) all

II) True/False

- 1) Disputes arising from foreign investment can be resolved by the International Centre for Settlement of Investment Disputes.
- 2) In arbitration, the dispute will be resolved without a trial of the case.
- 3) As a rule, arbitration of investment dispute is voluntary.
- 4) The prevailing Ethiopian Government is duty bound to make sure that investment does not make few individuals rich while the people at large remain poor.
- 5) Now a days, states do not bother about whether or not the investment projects harm the environment
- 6) Our government can not expropriate even though it is intended to be made for the public interest.
- 7) Nationalization of investment which has ideological over tone is an act of bringing the investment under ownership.
- 8) The Ethiopian investment law allows investors to impart capital goods and construction materials that are necessary for their investments to Ethiopia
- 9) The concept of joint venture is employed to have similar (same) meaning under Ethiopian laws.
- 10) Company, as a form of investment in Ethiopia, offers no opportunity to raise capital.
- 11) Investors have an opportunity to invest in mining gold in Ethiopia.
- 12) In Ethiopia, a regional investment organ has a duty to report to the federal governments an investment is granted by it.
- 13) Governmental regulations of investment are aimed at discrimination. and consumer protection.
- 14) Bilateral investment treatise accord fair and equitable treatment to investors.
- 15) General principles of law are strong norms used as a source of international law on foreign investment.

- 16) The existence of non-democratic government may be a threat to foreign direct investment because the investment, contracts might be changed if such government is replaced by a democratic one.
- 17) According to the classical theory foreign direct investment is beneficial to both the capital sending and host states economy.
- 18) It is legal to for a foreign investor invest on grinding mills in Ethiopia.
- 19) Investment is of long-term in nature and thus time is an essential element of investment.
- 20) Developing countries have very strict laws to protect their environment. Which, in turn, repel, foreign direct investment.

III) Matching

A

B

- | | |
|---|--|
| _____ 1) 1966 | A) ICSID convention came into force |
| _____ 2) <i>Opinio juris</i> | B) the World Bank Guidelines on foreign investment |
| _____ 3) Portfolio investment | C) foreign investors are allowed to invest in mining |
| _____ 4) The 1956 income tax decree of Ethiopia | D) Custom as a source of international law on foreign investment |
| _____ 5) 1992 | E) Investment implementing organ in Ethiopia |
| _____ 6) Sweden | F) Out of court investment dispute settlement mechanism |
| _____ 7) The Ethiopian civil Aviation Agency | G) Movement of money for the purpose of buying shares in a foreign country |
| _____ 8) COMESA | H) Ethiopian investment year |
| _____ 9) Incentives | D) Ethiopian Investment year |

_____ 10) Arbitration

J) Intended to promote positive economic
benefits

K) A market for investors in Ethiopia

L) The first proper law to regulate
investment in Ethiopia

Review Questions I

Answer key

I) Choice

- | | | |
|------|-------|-------|
| 1) B | 6) B | 11) E |
| 2) A | 7) D | 12) A |
| 3) C | 8) D | 13) B |
| 4) D | 9) A | 14) C |
| 5) A | 10) B | 15) C |

II) True/False

- | | | | |
|----------|-----------|-----------|-----------|
| 1) True | 6) False | 11) True | 16) True |
| 2) False | 7) True | 12) True | 17) False |
| 3) True | 8) True | 13) False | 18) False |
| 4) True | 9) False | 14) True | 19) True |
| 5) False | 10) False | 15) False | 20) False |

III) Matching

- | | | |
|------|------|-------|
| 1) A | 4) L | 7) E |
| 2) D | 5) B | 8) K |
| 3) G | 6) I | 9) J |
| | | 10) F |

Review Questions II

I. Choice

- 1) Which of the following is NOT an element of the definition of investment under the Ethiopian law?
 - A) Expenditure of capital
 - B) Investor
 - C) Non-expansion
 - D) Enterprise
- 2) Investing in the form of shares is considered to be

A) Expensive	B) Expansion
B) Safe	D) All
- 3) A theory that treats foreign direct investment as wholly beneficial to the host economy is _____ theory.

A) Dependency	C) Liberal
B) Middle path	D) Classical
- 4) A theory that argues that foreign direct investment is not wholly beneficial to the capital sending country is _____ theory.
- 5) The international instrument that reasserted the right of all states to regulate, supervise, and expropriate and nationalize foreign investment was.
 - A) Charter of the United Nations
 - B) Charter of economic rights and duties of states
 - C) African charter
 - D) European commission
- 6) In respect of the development of international law of foreign direct investment, the effort made by developing countries in the 1970's resulted in

- A) Drafting a code of conduct for multinational corporation
 - B) Drafting a code of conduct for host states
 - C) Having a convention on foreign direct investment
 - D) Concluding a bilateral investment treaty
- 7) Ethiopia has concluded a number of bilateral investment treaties. The main purpose of these bilateral treaties is .
- A) To create favourable conditions for foreign investors in Ethiopia
 - B) To create favourable conditions for investment
 - C) To create disfavourable conditions for investment
 - D) To discourage investment in foreign countries
- 8) In respect of expropriation of investment, bilateral investment treaties provide that
- A) Expropriation is made exceptionally for the public interest
 - B) Where expropriations made, it must be made without discrimination
 - C) Compensation should be effected without unreasonable delay.
 - D) A and C E) All
- 9) Regulation of investment may be _____ regulation.
- A) Market C) Cooperative
 - B) Individual D) Monopolistic
- 10) Which of the following sector is open to the state to invest on ?
- A) Telecommunication services C) Manufacturing of Neurons
 - B) Electric power D) None
- 11) Which of the following investment organ has the power to issue directives?
- A) The Investment Commission C) The Investment Board
 - B) The Ethiopian Electric Agency D) The Ethiopian Civil Aviation Agency
- 12) Which of the following parts of our country do NOT offer opportunity for oil and natural gas?
- A) The Ogaden C) The Blue Nile Reftvalley
 - B) the Tekeze Riftvally D) The Southern Riftvelly
- 13) There are investment options in Ethiopia. Identify one which is NOT an investment option.
- A) Sole proprietorship C) one person company
 - B) Joint investment D) The Southern Riftvalley
- 14) The Ethiopian government may undertake investment through
- A) Joint venture C) Cooperative society
 - B) Private limited company D) Public enterprise

- 15) Developing countries adopt _____ incentives to attract foreign direct investment.
- A) Financial
 - B) Fiscal
 - C) Non financial
 - D) All
- 16) Which of the following is a guarantee to investors under the Ethiopian law?
- A) Guarantee against expropriation
 - B) Guarantee to work
 - C) Guarantee for profit
 - D) Guarantee for market
- 17) How are environmental concerns in investment justice?
- A) The host state can exclude an investment project where it causes irreversible damage on environment.
 - B) The capital sending country can pollute the environment
 - C) The UN can stop the project
 - D) The host state can bring the case to the AU.
- 18) Ethiopia have the right to economic development. This means that
- A) investment should promote unsustainable economic development of the people
 - B) Investment should be profitable only for the investor
 - C) Investor could dismiss employees as s/he wishes
 - D) Investment should promote sustainable development of the people.
- 19) A dispute that arises from investment activities could be settled
- A) by court of law
 - B) Out of court
 - C) Both A and B
 - D) None
- 20) According to the convention for the International Center for Settlement of Investment Dispute (ICSID), an investment dispute may be settled out of court
- A) through diplomatic channel
 - B) By judges appointed by government
 - C) By the general secretary of UN
 - D) All

II) True/False

- 1) For the International Centre for Settlement of Investment Dispute to have a jurisdiction contracting states are not required to give their consent.

- 2) Arbitration is a mechanism to settle investment dispute out of court which offers an advantage to minimize hostility.
- 3) The Ethiopian government is obliged to promote the right of sustainable development of all the people through investment.
- 4) A state has no right to cancel investment agreements that cause significant harm to the environment after it began.
- 5) Investors need investment guarantees against nationalization and expropriation should be clearly stated under national laws.
- 6) The prevailing standard of compensation where investment is expropriated stipulates that compensation should be partial.
- 7) Exemption from payment of customs duty is one of the incentives granted to investors under the Ethiopian law.
- 8) A foreigner may have an option to invest through a branch where the foreign type of business organization is not a recognized form by the host state law.
- 9) Joint venture recognized under our investment law as a joint investment with a government is a partnership without having legal personality.
- 10) Infrastructure is one of the sectors in which investors may make their investment in Ethiopia.
- 11) The Ethiopian Investment Commission serves as a two- stop shop since some of the necessary matters are completed there.
- 12) Ethiopia has liberalized its economic policy and foreigners can invest in the financial sector.
- 13) An investor can not carry at investment in Ethiopia unless s/he/it is granted a business license.
- 14) The current trend is for liberal consensus in regulating investment.
- 15) The basic rationale for regulating investment is to widen the role of multinational corporations in the political sphere in addition to the economic one.
- 16) Bilateral investment treaties accord fair and equitable treatment to investors.
- 17) According to trade- related investment measures, an investor is free to see its product in the host state.
- 18) Decisions made by an International Court of Justice are regarded as subsidiary sources of international law on investment.
- 19) Socialism con not be regarded as a risk to foreign direct investment at all
- 20) Investment law is a branch of law that combines law of contract and property law.

IV) Matching

A**B**

- | | |
|--------------------------------|--|
| _____ 1) Reward | A) Changes in industry |
| _____ 2) Nationalism | B) World Bank guidelines on foreign investment |
| _____ 3) 1992 | C) Out of court investment despite settlement mechanism |
| _____ 4) Local content | D) Prospective profits |
| _____ 5) 1959 | E) Profit from investment |
| _____ 6) Arbitration | F) Forms of TRMS |
| _____ 7) Broadcasting services | G) Religious fundamentalism |
| _____ 8) Raw materials | H) The first bilateral investment treaty was conducted |
| _____ 9) <i>Lucrum cessans</i> | I) A sector that is not allowed for foreigners to invest in Ethiopia |
| _____ 10) Courts of law | J) Involves an antagonistic person |
| | K) Favourable situation to invest in Ethiopia |

V) Fill in the blank space

- 1) In case of expropriation of investment, _____ consideration and bargaining are always involved in determining the amount of compensation.
- 2) Our investment law guarantees transfer of _____ and other payment accruing from their employment to the _____ amount of compensation.
- 3) The power to regulate investment flows from _____ of host states.
- 4) A foreign national permanently residing in Ethiopia and having made an investment is known as _____ investor.

Review Questions**Answer key**

- I) Choice (1.5 points each)

- | | | | |
|------|------|-------|-------|
| 1) C | 6) A | 11) C | 16) A |
| 2) B | 7) B | 12) B | 17) A |
| 3) D | 8) E | 13) C | 18) D |
| 4) C | 9) A | 14) D | 20) A |

II) True/False (1.5 points each)

- | | | | |
|----------|----------|-----------|-----------|
| 1) False | 6) False | 11) False | 16) True |
| 2) True | 7) True | 12) False | 17) False |
| 3) True | 8) False | 13) True | 18) True |
| 4) False | 9) False | 14) True | 19) False |
| 5) True | 10) True | 15) False | 20) True |

III) Matching (0.5 point each)

- | | | |
|------|------|-------|
| 1) E | 5) H | 8) K |
| 2) G | 6) C | 9) D |
| 3) B | 7) I | 10) J |

IV) Fill in the blank space (1 point each)

- 1) Political
- 2) Salaries, expatriates
- 3) Sovereignty
- 4) Domestic

GLOSSARY

- **Investment** – Commitment of funds to accrue profit.
- **Investor** – One who invests outside his/her/its home state
- **Domestic investor** – An investor who made an investment in his/her own country.
- **Foreign investor** – An investor who is a foreign citizen and invests outside his/her country.
- **Direct foreign investment** – is an investment made to acquire a lasting interest in an enterprise functioning in an economy other than that of an investor, with a power to control it, with the purpose to accrue profit.
- **Profit** – gain from an investment in the form of capital appreciation of yield
- **Law of investment** – a branch of law consisting of set of rules that regulate investment.
- **Portfolio investment** – A foreign investment made by purchasing shares and other types of securities without having the power to control the investment.

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PROCLAMATION No. 280/2002(as amended)

RE-ENACTMENT OF THE INVESTMENT PROCLAMATION

WHEREAS, the encouragement and promotion of investment has become necessary so as to accelerate the economic development of the country and to improve the living standard of its people;

WHEREAS, in addition to that of domestic investors, it is deemed essential to widen the scope of participation of foreign investors and to facilitate conditions thereof with a view to enhancing the country's investment activities;

WHEREAS, the system of administration of investment needs to be transparent and efficient;

WHEREAS, to these ends, it has become necessary to revise the existing law on investment;

NOW, THEREFORE, IN ACCORDANCE WITH Article 55(1) of the Constitution of the Federal Democratic Republic of Ethiopia, it is hereby proclaimed as follows:

PART ONE

General

1. Short Title

This Proclamation may be cited as the "Investment Proclamation No. 280/2002."

2. Definitions

In this proclamation, unless the context requires otherwise:

- 2.1.** "Investment" means expenditure of capital by an investor to establish a new enterprise or to expand or upgrade one that already exists;
- 2.2.** "Enterprise" means an undertaking established for purposes of gaining profit;
- 2.3.** "Capital" means local or foreign currency, negotiable instruments, machinery or equipment, buildings, initial working capital, property rights, patent rights, or other business assets;
- 2.4.** "Investor" means a domestic or foreign investor having invested in Ethiopia;

- 2.5.** “Domestic Investor” means an Ethiopian or a foreign national permanently residing in Ethiopia having made an investment, and includes the government, public enterprises as well as a foreign national, Ethiopian by birth and desiring to be considered as a domestic investor;
- 2.6.** “Foreign Investor” means a foreign or an enterprise owned by foreign nationals, having invested foreign capital in Ethiopia, and includes an Ethiopian permanently residing abroad and preferring treatment as a foreign investor;
- 2.7.** “Foreign Capital” means capital obtained from foreign sources, and includes the re-invested profits and dividends of a foreign investor;
- 2.8.** “Expansion/up grading” means increasing in value, by more than 25%, the full production or service capacity of an existing enterprise, be it in variety, volume, or both;
- 2.9.** “Appropriate Investment Organ” means the Ethiopian Investment Agency, (hereinafter referred to as the “Agency”), established under this Proclamation or the executive organ of a Region empowered to issue investment permits;
- 2.10.** “Public Enterprise” means an undertaking, wholly owned by the Federal or regional government established to carry out manufacturing, distribution, service rendering or other economic and related activities for gain;
- 2.11.** “Government” means the Federal Government or a Regional Government;
- 2.12.** “Region” means any of those specified under Article 47(1) of the Constitution of the Federal Democratic Republic of Ethiopia and for the purpose of this Proclamation includes the Addis Ababa City Administration and the Dire Dawa Administrative Council;
- 2.13.** The phrase “export-oriented no-equity based foreign enterprise collaboration” means a 100% export-oriented contractual arrangement between a domestic investor and foreign enterprise in which the foreign enterprise provides, among others, all or some of the following:
- Guaranteed external market access;
 - Export product and production know-how;
 - Export marketing know-how;
 - Export business management know-how;
 - Raw materials and intermediate inputs needed for export production.
- 2.14.** “Transfer of technology” means the transfer of systematic knowledge for the manufacture of a product, for the application or improvement of a process or for the rendering of a service,

including management and marketing technologies, but shall not extend to transactions involving the mere sale or lease of goods.”

3. Scope of Application

The provisions of this Proclamation shall not be applicable to investments in the prospecting, exploration and development of minerals and petroleum resources.

PART TWO

Investment Objectives, Areas and Incentives

4. Investment Objectives of the Federal Democratic Republic of Ethiopia

The objectives of the investment policy of the Federal Democratic Republic of Ethiopia are designed to improve the living standards of the peoples of Ethiopia through the realization of sustainable economic and social development, the particulars of which are the following:

- 1) to accelerate the country’s economic development;
- 2) to exploit and develop the immense natural resources of the country;
- 3) to develop the domestic market through the growth of production, productivity, and services;
- 4) to increase foreign exchange earnings by encouraging expansion in volume and variety of the country’s export products and services and the improvement of their quality as well as to save foreign exchange through production of import substituting products;
- 5) to encourage balanced development and integrated economic activity among the regions and to strengthen the intersectoral linkages of the economy;
- 6) to enhance the role of the private sector in the acceleration of the development of the country’s economy;
- 7) to render foreign investment play its proper role in the country’s economic development;
- 8) to create wide employment opportunities for Ethiopians and to foster the transfer of technical know-how, of managerial skills, and of technology required for the progress of the country.

5) Areas of Investment Reserved for the Government or Joint Investment with the Government

- 1) The following investment areas are exclusively reserved for the Government:
 - (a) Transmission and supply of electrical energy through the Integrated National Grid system: and
 - (b) Postal services with the exception of courier services.

2) Investors shall be allowed to invest in the following areas only in joint venture with the Government (ሃገራዊ ስምንት ወይንም);

(a) Manufacturing of weapons and ammunition; and

(b) Telecommunication services.

(c) air transport services using aircraft with a seating capacity of more than 20 passengers.

6) Areas of Investment Reserved for Domestic Investors

Areas of investment shall be specified by regulations to be issued by the Council of Ministers.

7) Regarding Investments to be undertaken in Joint Venture with the Government

The Supervising Authority of Public Enterprises shall receive investment proposals submitted by any private investor intending to invest in joint venture with the government; it shall submit same to the Ministry of Trade and Industry for decision and, upon approval, designate a public enterprise to invest as partner in the joint investment.

8) Areas of Investment Open for Foreign Investors

All areas of investment, other than those exclusively reserved, under this Proclamation, for the Government or joint venture with the Government (ሃገራዊ ስምንት ወይንም) or for Ethiopian national or other domestic investors which shall be specified by regulations to be issued by the Council of Ministers, shall be open for foreign investors.

9) Investment Incentives

1) Areas of investment specified by regulations to be issued by the Council of Ministers pursuant to the investment objectives stated under Article 4 of this Proclamation shall be eligible for investment incentives.

2) The regulations to be issued pursuant to Sub Article (1) of this Article shall determine the type and extent of entitlement to incentives.

PART THREE

Forms of Investment and Capital

Requirements for Foreign Investors

10) Forms of Investment

1) Investment may be effected in one of the following forms:

(a) Sole proprietorship

(b) Business organizations incorporated in Ethiopia or abroad;

(c) Public Enterprise established in accordance with the relevant law;

(d) Cooperative Societies formed in accordance with the relevant law.

2) Any business organization specified under Sub Article (1)(b) of this Article shall be registered in accordance with the Commercial Code or any other relevant law.

11) Capital Requirements for foreign Investor

1) Any foreign investor to be allowed to invest pursuant to this Proclamation, shall be required to allocate a minimum capital of 100,000 US dollars for a single investment project.

2) Notwithstanding the provisions of Sub Article (1) of this Article, the minimum capital required of a foreign investor investing jointly with domestic investors shall be 60,000 US dollars.

3) The minimum capital required of a foreign investor investing in areas of engineering, architectural, accounting and audit services, project studies or business and management consultancy services or publishing shall be:

(a) 50,000 US dollars if the investment is made wholly on his own;

(b) 25,000 US dollars if the investment is made jointly with domestic investors.

4) A foreign investor:

(a) re-investing his profits or dividends; or

(b) exporting at least 75% of his out puts

shall not be required to allocate a minimum capital.

5) Any foreign investor having brought investment capital into the country shall have registered same at the National Bank of Ethiopia and obtain a certificate of registration.

PART FOUR

Investment Permit

12) Requirement of Permit

1) The following investors shall be required to obtain investment permits:

(a) foreign investors;

(b) foreign nationals, excluding Ethiopians by birth, taken for domestic investors pursuant to Article 2(5) of this Proclamation;

(c) domestic investors investing in areas eligible for incentives;

(d) domestic and foreign investors making investments in partnerships (up to 49% foreign ownership).

2) Notwithstanding the provision of sub-Article (1) of this Article, a foreign investor intending to buy an existing enterprise in order to operate it as it stands or to buy shares of an existing enterprise shall obtain prior approval from the Ministry of Trade and Industry

3) Upon receipt of an application made in accordance with sub-Article (2) of this Article, the Ministry of Trade and Industry shall after examining the matter in light of the relevant laws within two working days:

(a) register the share transfer or replace the business license upon receipt of the appropriate fee, where the application is found acceptable; or

(b) notify to the investor its decision and the reason thereof in writing, where the application is found unacceptable

- 4) The provisions of this Article shall not affect the right of an investor of Ethiopian national or foreign national, an Ethiopian by birth taken for domestic investor, intending to invest, in conformity with the relevant laws of the country, in areas not eligible for incentives or waiving his right of entitlement in those areas eligible for incentives.

13) Application for Investment Permit by a Domestic Investor

20) An application for investment permit by a domestic investor shall be made in a form designed for such purpose and submitted together with the following documents:

(a) Where the application is signed by an agent, a photocopy of his power of attorney;

(b) Where the investment is to be made by an individual person, a photocopy of his identify card, or a photocopy of the certificate evidencing his domestic investor status and his recent two passport size photographs;

(c) Where the investment is to be made by a business organization, photocopies of its memorandum of association and Articles of association; or where the business organization, photocopies of its memorandum of association and Articles of association; or where the business organization is to be newly established, in addition, it shall submit photocopies of the shareholders' identity cards or photocopies of certificates evidencing there domestic investor status;

(d) Where the investment is to be made by a public enterprise, a photocopy of the regulation under which it is established or a photocopy of its memorandum of association and Articles of association; and

(e) Where the investment is to be made by cooperative society, a photocopy of its Articles of association.

14) Application for investment permit by a foreign Investor

Application for Investment Permit by a foreign investor shall be made in a form designed for such purpose and submitted to the Agency together with the following documents in two copies:

(a) where the application is signed by an agent, a photocopy of his power of attorney;

- (b) where the investment is to be made by an individual person, a photocopy of the pages of a valid passport showing his identity and his recent two passport size photographs;
- (c) where the investment is to be made by a business organization incorporated in Ethiopia, photocopies of its memorandum of association and Articles of association; or where it is to be newly established, in addition, it shall submit photocopies of the pages of a valid passport of each shareholder showing his identity;
- (d) where the investment is to be made by a branch of a foreign business organization in Ethiopia, photocopies of its memorandum of association and Articles of association or a similar document of the parent company; and
- (e) where it is a joint investment by domestic and foreign investors, in addition to the documents provided under (c) above, photocopies of identity cards or photocopies of certificated evidencing the domestic investor status of the domestic investors, as the case may be.

15) Application for Investment Permit for Expansion or Upgrading

- 1) An application for investment permit to expand or upgrade an existing enterprise shall be made in a form designed for such purpose and submitted together with the following documents:
 - a) where the application is signed by an agent, a photocopy of his power of attorney;
 - b) where the investment is made by a business organization, photocopies of its memorandum of association and Articles of association; and
 - c) Photocopy of a valid business license of the existing enterprise.
- 2) The application form and documents stipulated under Sub-Article (1) of this Article shall be made:

in two copies, where they are to be submitted to the Agency; or

in one copy, where they are to be submitted to Regional Investment Organs.

16) Issuance of Investment Permit

- 1) Upon receipt of an application made in accordance with Articles 13, 14 or 15 this Proclamation, the appropriate investment organ shall, after examining the intended investment activity in light of the Proclamation, Regulations and directives issued thereunder within five working days:

(a) issue the investment permit upon receipt of the appropriate fee, where the application is found acceptable; or

(b) notify to the investor its decision and the reason thereof in writing, where the application is found unacceptable.

2) The appropriate investment organ shall, after issuing the investment permit, notify the concerned government institutions that the latter could conduct the necessary follow up.

3) An investment permit shall contain the following:

(a) the name, nationality and address of the investor;

(b) the investment activity; and

(c) the region in which the investment is to be made.

4) a holder of an investment permit shall not be required to obtain a business license until completion of project implementation and the commencement of production or of rendering of service.

5) an investment permit may not be transferred to another person without the prior authorization of the appropriate investment organ.

6) where an investment permit is transferred to another person or where any change occurs in its content, it shall be submitted to the appropriate investment organ and amended accordingly.

17) Renewal of Investment Permit

1) An investment permit shall be renewed annually until the investor commences the marketing of his output or services; provided, however, the investor shall submit progress reports on the implementation of the project, to the appropriate investment organ, at the end of every six months.

2) An application for renewal of an investment permit shall be submitted at least a month before the end of a period of one year for which the permit remains valid.

3) The appropriate investment organ shall renew the investment permit, where satisfied, as to the existence of sufficient cause for the delay in the commencement or completion of implementation of the project.

18) Suspension or Revocation of Investment Permit

1) Where an investor violates the provisions of this Proclamation or regulations or directives issued to implement this Proclamation, the appropriate investment organ may suspend the investment permit until the investor takes due corrective measures.

2) the appropriate investment organ may revoke an investment permit where it is ascertained that:

(a) the investor obtained the permit fraudulently or by submitting false information or statements;

- (b) the investor has transferred the permit to another person without the authorization of the appropriate investment organ,
 - (c) incentives granted are misused or illegally transferred to another person;
 - (d) the investor has failed, without good cause, to 17 of this Proclamation.
 - (e) If the investor is found engaged in a commercial activity without obtaining a business license”.
- 3) The appropriate investment organ shall, prior to suspending or revoking a permit, notify the investor in writing as to the causes for taking such action and allow him a period of one month to present his views thereon.
 - 4) The appropriate investment organ shall suspend or revoke the permit where the investor fails to respond within the time limit prescribed in sub-Article (3) of this Article or presents unacceptable justification.
 - 5) Upon suspension of an investment permit, the investor shall immediately lose entitlement to all benefits.
 - 6) Upon revocation of an investment permit, the investor shall return within 6 months all the benefits he was granted.
 - 7) An investment permit may not be suspended or revoked by any organ other than the appropriate investment organ having issued same.

19) Right to appeal

An investor who has a grievance against a decision of an appropriate investment organ may, within 30 days from receipt of the decision, appeal to the Federal Investment Board or to the concerned organ of a Regional Government, as may be appropriate.

PART FIVE

Transfer of Technology, Loans, Utilization of foreign currency, and Remittance of Funds

20) Technology Transfer Agreements

- 1) Where an investor concludes a technology transfer agreement related to his investment, he shall submit the same to the Agency for approval and registration.

2) Upon receipt of an application for registration as per Sub-Article (1) of this Article, the Agency shall issue the registration certificate within two working days.

3) A technology transfer agreement which is not registered in accordance with this article shall have no legal effect.

21) Loans and utilization of Foreign Currency

1, An investor who acquires an external loan shall have such loan registered with in the National Bank of Ethiopia in accordance with the directives of the Bank.

2. For transactions related to their investment, foreign investors shall be allowed to open and operate foreign currency accounts in authorized local banks in accordance with directives of the National Bank of Ethiopia.

22) Remittance of Funds

1) Any foreign investor shall have the right, in respect of an approved investment, to make the following remittances out of Ethiopia in convertible foreign currency at the prevailing rate of exchange on the date of remittance:

a) Profits and dividends accruing from investment;

b) Principal and interest payments on external loans;

c) Payments related to a technology transfer agreement registered in accordance with this proclamation;

d) Proceeds from the sale or liquidation of an enterprise;

e) Proceeds from the transfer of shares or of partial ownership of an enterprise to a domestic investor.

2) Expatriates employed in an enterprise may remit, in convertible foreign currency, salaries and other payment accruing from their employment in accordance with the foreign exchange regulations or directives of the country.

PART SIX

Investment Guarantees and Protections

23) Investment Guarantees and Protections

1) No investment may be expropriated or nationalized except when required by the public interest and then, only in compliance with requirements of the law.

2) Adequate compensation, corresponding to the prevailing market value, shall be paid in advance in case of expropriation or nationalization of an investment for public interest.

3) Any foreign investor may remit compensation paid to him, pursuant to this Article, out of Ethiopia in convertible foreign currency.

PART SEVEN

Investment Administration

24) Investment Administration Organs

The administration of investment shall be carried out through the following organs:

- 1) The Ministry of Trade and Industry;
- 2) The Investment Board;
- 3) The Agency
- 4) Regional investment organs to be defined by the laws of the respective region.

25) Jurisdiction

1) The administration of investment in respect of the following shall be under the jurisdiction of the Agency

- (a) investment made by foreign investor;
- (b) investment made by foreign national permanently residing in Ethiopia taken for a domestic investor;
- (c) investment made, in areas eligible for incentives by domestic investor who is required to obtain business license from concerned federal organs;
- (d) joint investment by domestic and foreign investor.

2) Notwithstanding the provision of Sub-Article (1) of this Article, the issuance, renewal and cancellation of investment permits for air transport services and for generation or transmission or supply of electrical energy shall be carried out by the Ethiopian Civil Aviation Authority and the Ethiopian Electricity Authority respectively, representing the Agency.

3) Investments other than those referred to in sub Article (1) of this Article shall fall under the jurisdiction of regional investment organs.

4) The granting of incentives by way of exemptions from import taxes and customs duties shall fall under the exclusive jurisdiction of the Ministry of Revenues.

26) One-Stop Shop Service

1. The Agency or Regional Investment Organs shall provide the following services as required under the relevant laws to investors they have given investment permits. representing the competent Federal or regional executive bodies as appropriate:

- (a) Notarization of memorandum of association and Articles of association;
- (b) effecting commercial registration;
- (c) issuance of work permits to expatriate employees;
- (d) grading of construction contractors; and
- (e) issuance of business licenses.

The Authority shall register and render a one-stop service to export-oriented non-equity based foreign enterprise collaborations.

The Agency and regional investment organs shall carry out their functions under Sub Article (1) of this Article in compliance with the relevant laws thereof.

Upon receipt of an application for a business license in accordance with Sub-Article (1)(e) of this Article, the appropriate investment organ shall, after examining the matter in light of the relevant laws within five working days:

- a) issue the business license upon receipt of the application fee, where the application is found acceptable; or
 - b) notify to the investor its decision and the reason thereof in writing, where the application is found unacceptable.
- 5) Notwithstanding the provision of Article 22 Sub-Article (2) (a) of commercial Registration and Business Licensing Proclamation No. 67/1997, the appropriate investment organ shall issue the business license upon signing, by the investor, of an undertaking to respect the relevant laws and directives of the land.
- 6) Notwithstanding the provision of Sub-Article (1) of this Article, the Agency shall issue business licenses representing only the Ministry of Trade and Industry.
- 7) Notwithstanding the provision of sub-Article (1) of this Article amendments notarization, renewal, replacement or cancellation to be made in relation to documents stated therein shall be effected by the relevant Federal or Regional executive bodies.

8) The appropriate investment organ shall, after rendering the services listed under Sub-Article (1) of this Article, notify the concerned government institutions so that the latter could conduct the necessary follow up.

27) Transmission of Information on Investment

Each regional investment organ shall transmit to the Agency information compiled with respect to the resource potential and investment opportunities of the Region as well as periodic reports on investment activities therein.

PART EIGHT

The Investment Board

28) Members of the Board

- 1) The number of members of the Investment Board shall be determined by Government.
- 2) The Minister of Trade and Industry shall be the Chairperson of the Investment Board.
- 3) The members of the Board shall be drawn from Government and private sector.
- 4) The Director General of the Authority shall be a member of the Board.
- 5) The Board shall have its own secretariat. The powers and duties of the Secretariat shall be determined by the internal rule of procedures of the Board.

29) Powers and Duties of the Board

The board shall:

- 1) supervise and follow up, as the superior authority the implementation of this Proclamation and the activities of the Agency;
- 2) decide on policy issues arising in connection with the implementation of this Proclamation;
- 3) issue directives necessary for the implementation of this Proclamation and regulations issued hereunder;
- 4) submit, as necessary, amendments on investment incentives, to the Council of Ministers for approval;
- 5) decide on appeals submitted to it by investors against decisions of the Agency;
- 6) determine service fees to be charged by the Agency;
- 7) approve the annual work program and budget of the Agency;
- 8) publicly notify investors of directives it issues from time to time;
- 9) whenever it deems necessary, decide on new or additional incentives, other than what is provided for under the Investment Incentives Regulations and submit same to the Council of Ministers for approval.

30) Meetings of the Board

- 1) The Board shall meet regularly once in a month. However, it may hold extra-ordinary meetings at any time when necessary.
- 2) There shall be a quorum where more than half of the members are present at meetings of the Board.
- 3) Decisions of the Board shall be passed by a majority vote, however, the chairperson shall have a casting vote in case of a tie.
- 4) Without prejudice to the provisions of this Article, the Board shall draw up its own rules of procedure.

PART NINE

The Investment Agency

31) Re-establishment

- 1) The Investment Agency* is hereby re-established as an autonomous public institution having legal personality;
- 2) The Agency shall be accountable to the Investment Board.

32) Powers and Duties of the Agency

The Agency shall:

- 1) serve as a nucleus for matters of investment and promote, coordinate and enhance activities thereon;
- 2) initiate and submit to the Board policy and implementation measures needed to create a conducive investment climate for both domestic and foreign investors and follow up the implementation of same upon approval;
- 3) collect, compile, analyze and disseminate information on the resource potential of the country and on the investment opportunities it offers, promote concrete investment projects, provide, upon request, match making service of possible joint investment partners;
- 4) Organize, with a view to helping promote investment, such activities as exhibitions, training and seminar locally or abroad as may be appropriate, give advisory support to investors;
- 5) realize liaison and coordination between investors, public offices, regional Governments and other relevant organs, with a view to enhancing investment;
- 6) Prepare and distribute pamphlets, brochures, films and other materials that help enhance investment;

* The Ethiopian Investment Agency shall be accountable to the Ministry of trade and Industry (Art. 33/5 of Proc. No. 471/2005 Definition of Powers & Duties of the Executive Organs of the FDRE Proclamation)

- 7) issue investment permits in accordance with Article 25 of this Proclamation;
- 8) Monitor the implementation of investment projects for which it has issued permits and ensure that the terms of the investment permits are complied with;
- 9) approve and register technology transfer agreements related to investments;
- 10) negotiate bilateral investment promotion and protection treaties for conclusion between Ethiopia and other countries and sign same upon approval by the Council of Ministers;
- 11) give advice and technical support to regional investment organs with a view to building up their capacity; and
- 12) perform such other functions as may help to promote and enhance investment.

33) Organization of the Agency

The Agency shall have:

- (a) Director General to be appointed by the Government; and
- (b) the necessary staff.

34) Powers and Duties of the Director General

- 1) The Director General shall be the Chief Executive officer of the Agency and, as such shall, subject to the general directives of the Board, direct and administer the activities of the Agency.
- 2) Without limiting the generality of Sub Article (1) of Sub article (1) of this Article, the Director General shall:
 - (a) exercise the duties of the Agency specified in Article 33 of this Proclamation;
 - (b) employ and administer the personnel of the Agency in accordance with the Federal Civil Service Law;
 - (c) prepare and submit to the Board the work program and budget of the Agency and implement same upon approval;
 - (d) effect expenditure in accordance with the budget approved for the Agency;
 - (e) represent the Agency in all its dealings with third parties; and
 - (f) prepare and submit to the Board reports on the performance and financial opinions of the Agency.
- 3) The Director General may, to the extent necessary for the efficient performance of the functions of the Authority, delegate part of his powers and duties to other officials as well as employees of the Agency.

35) Source of Fund

The sources of the fund of the Agency shall be:

- (a) budgetary allocations made by the Federal Government;
- (b) income, assistance and grants obtained from any other sources.

36) Books of Accounts

- 1) The Agency shall keep complete and accurate books of accounts
- 2) The accounts and financial documents of the Agency shall be audited annually by the Auditor General or by auditors designated by him.

PART TEN

Miscellaneous Provisions

37) Allocation of Land

- 1) Where a regional Government receives an application for the allocation of land for an approved investment, it shall, on the basis of the Federal and its own laws, deliver within 60 days, the required land to the investor.
- 2) The region shall allocate land for investment activities and transmit information on such allocations to the appropriate investment organ.
- 3) Each Region shall, in the allocation of land, give priority to approved investments.
- 4) The appropriate investment organ shall, in cooperation with the concerned regional executive organs, facilitate and follow up the allocation of land for approved investments.

38) Employment of Expatriates

- 1) Any investor may employ duly qualified expatriate experts required for the operation of his business.
- 2) An investor who employs expatriates pursuant to Sub Article (1) of this Article, shall be responsible for replacing, within a limited period, such expatriate personnel by Ethiopians by arranging the necessary training thereof.
- 3) Notwithstanding the provisions of Sub-Articles (1) and (2) of this Article, a foreign investor upon obtaining the prior consent of the Agency shall, without any restriction, have the right to recruit expatriate employees on top management positions of an enterprise of which he is the sole or major owner or shareholder

39) Foreign Nationals Taken for Domestic Investors

- 1) Rights and privileges as well as restrictions solely relating to foreign investors shall not be applicable to a foreign national who invests in Ethiopia being taken for a domestic investor.

- 2) A foreign national, excluding an Ethiopian by birth, taken for a domestic investor shall declare same by filling in a form designed for such purpose by the Agency, and submit it together with his application for investment permit.

40) Ownership of Immovable Property

- 1) Notwithstanding the provisions of Articles 390-393 of the Civil Code, a foreign national taken for a domestic investor or a foreign investor shall have the right to own a dwelling house and other immovable property requisite for his investment.
- 2) The provisions of Sub-Article (1) of this Article shall include those who have invested prior to the issuance of this Proclamation.

41) Power delegated to the Ethiopian civil Aviation Authority and the Ethiopian Electricity Authority.

- The Ethiopian civil Aviation Authority and the Ethiopian Electricity Authority shall:
- (a) carry out functions delegated to them under Article 25 Sub-Article (2) in compliance with this Proclamation and Regulations and directives issued there under.
 - (b) forward to the Agency photocopies of the investment permits they issued and the relevant documents.

42) Duty to Provide Information

Any executive organ of the Federal or a Regional Government shall have the duty to provide information relating to investment whenever so requested by appropriate investment organ.

43) Repealed Laws

- 1) The Investment Proclamation No. 37/1996 (as amended) is hereby repealed.
- 2) No law, regulation, directive or practice inconsistent with this Proclamation shall have effect with respect to matters provided for in this Proclamation.

44) Transitory Provisions

- 1) Notwithstanding the provisions of Article 43, incentives provided for in the Investment Proclamation NO. 37/1996 (as amended) and in regulations and directives issued thereunder shall remain applicable in respect of investment approved prior to the issuance of this Proclamation.
- 2) Where an investor, eligible for incentives under Investment Proclamation No. 37/1996 (as amended), opts instead to be a beneficiary of incentives provided for in this Proclamation and

in regulations to be issued hereunder, he may notify the appropriate investment organ and be entitled thereby.

45. Effective Date

This Proclamation shall come into force as of the 2nd day of July, 2002.

Done at Addis Ababa, this 2nd day of July, 2002

GIRMA WOLDE GIORGIS

PRESIDENT OF THE FEDERAL

DEMOCRATIC REPUBLIC OF ETHIOPIA

Annex II

COUNCIL OF MINISTERS REGULATIONS NO. 84/2003(as amended by Regulations No. 146/2008) COUNCIL OF MINISTERS REGULATIONS ON INVESTMENT INCENTIVES AND INVESTMENT AREAS RESERVED FOR DOMESTIC INVESTORS

These Regulations are issued by the Council of Ministers pursuant to Article 5 of the Definition of powers and Duties of the Executive Organs of the Federal Democratic Republic of Ethiopia Proclamation No. 4/1995 (as amended) and Articles 6 and 9 of the Re-enactment of Investment Proclamation No. 280/2002.

PART ONE

General

1. Short Title

These Regulations may be cited as the “Investment Incentives and Investment Areas Reserved for Domestic Investors Council of Ministers Regulations NO. 84/2003.

2. Definitions

Unless the context requires otherwise, in these Regulations:

2.1. “Commission” means the Ethiopia Investment Commission ;

- 2.2. “Board” means the Federal Investment Board;
- 2.3. “Capital goods” means machinery, equipment and accessories, needed to produce goods or render services;
- 2.4. “Customs Duty” includes taxes levied on imported goods;
- 2.5. “Income Tax” means tax levied on profits from business and categorized as the revenue of the Federal Government, Regional Governments or as their joint revenue;
- 2.6. “Proclamation” means Investment Proclamation No. 280/2002;

The definitions provided for under Article 2 of the Proclamation shall apply these Regulations.

3. Investment areas reserved for Domestic Investors

Areas of investment listed in the schedule attached to these Regulations are exclusively reserved for domestic investors.

PART TWO

Exemption from Income Tax

4. Investment Activities Eligible for Income Tax Exemption

1) Were an investor **engaged in manufacturing**, agro-industrial activities or **investment areas of information and communication technology development** or the production of agricultural products to be determined by directives to be issued by the Board:

(a) exports 50% (fifty per cent) of his products **or services**; or

(b) supplies 75% (seventy five per cent) of his product **or services** to an exporter as a production **or service** input;

shall be eligible for income tax exemption for 5 years.

2) Notwithstanding the provisions of Sub Articles (1) of this Article the Board may, under special circumstances, grant income tax exemption for a period not longer than 7 years. However, the granting of income tax exemption for a period longer than 7 years requires the decision of the Council of Ministers.

3) An investor engaged in activities mentioned under Sub-Article (1) of this Article who exports less than 50% (fifty per cent) of his products **or services**, or supplies his products only to the domestic market shall be eligible for income tax exemption for 2 years.

4) Notwithstanding the provision of sub article (3) of this Article, Board may, under special circumstances, grant income tax exemption for a period not longer than 5 years.

5) Notwithstanding the provision of Sub Article (3) of this Article, directives issued by the Board may prohibit exemption from income tax with respect to an investor who supplies his products **or services** only to the domestic market.

6) Notwithstanding the provision of Sub Articles (1) and (3) of this Article, an investor who exports and hides and skins after processing up to crust level may not be entitled to incentives provided therewith.

7) Notwithstanding the foregoing provisions of this Article, where the investment is in relatively under developed Regions such as Gambella, Benshangul and Gumuz. South Omo, in Afar Zones to be determined by the Board, Somali and other Regions determined by the Board, the investor shall be eligible for income tax exemption for an additional year period.

8) The income tax exemption provided under the provisions of Article 4 of these Regulations shall be effective when the investor provides the information for the relevant revenue collecting institution and its validity is ascertained for each income tax period.

5) Income Tax Exemption for Expansion or Upgrading of an Existing Enterprise

An investor engaged in activities mentioned under Sub Article (1) of Article 4 **of this Regulation** who exports at least 50% (fifty percent) of his products **or services** and increases, in value, his production **or services** by **over** 25% (twenty five per cent) shall be eligible for income tax exemption for 2 years.

6) Commencement of Period of Exemption from Income Tax

The period of exemption from income tax shall begin from the date of commencement of production or the date of provision of services, as the case may be.

7) Carry Forward of Losses

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.

PART THREE

Exemption from the Payment of Customs Duty

8) General

- 1) An investor shall be allowed to import duty-free capital goods and construction materials necessary for the establishment of a new enterprise or for the expansion or upgrading of an existing enterprise.
- 2) In addition, an investor granted with a customs duty exemption privilege shall be allowed to import duty-free capital goods necessary for his enterprise.
- 3) Notwithstanding the provisions of Sub Articles (1) and (2) of this Article the Board may, by its directives, bar the duty-free importation of capital goods and construction materials where it finds that they are locally produced with competitive price, quality and quantity.
- 4) An investor eligible for duty-free importation of capital goods pursuant to these Regulations shall be given the same privilege for spare parts whose value is not greater than 15% (fifteen percent) of the total value of the capital goods to be imported.

9) Conditions for Importing Vehicles Duty-Free

1) Any investor may import duty free:

- (a) ambulances used for emergency case of employees;**
- (b) buses used for tour operation services.**

2) Without prejudice to the provision of sub-article (1) of this Article, the Board may issue directives on conditions of importing duty free:

- (a) up to three 4-wheel drive vehicles for tour operation services;**
- (b) vehicles for any other investments depending on the type of the project.**

10) Areas of Investment Not Eligible for Customs Duty Exemption

- 1) Notwithstanding the provision of Article 8 of these Regulations, the following areas of investment are not eligible for exemption from the payment of customs duty:
 - (a) hotels (excluding star-designated hotels), Motels, tea rooms, Coffee shops, Bars, night clubs and restaurants which do not have international standards;
 - (b) wholesale, retail and import trade;
 - (c) maintenance services;
 - (d) commercial road transport and car-hire services;

- (e) postal and courier services;
- (f) real estate development;
- (g) business and management consultancy services;
- (h) advertisement services;
- (i) cinematography and similar activities;
- (j) radio and television broadcasting services;
- (k) theatre and cinema hall operations;
- (l) customs clearances services;

- (m) laundry services;
- (n) travel agency trade auxiliary and ticket-selling services;
- (o) lottery and games of a similar nature;

2) Notwithstanding the provision of Sub-Article (1) of this Article, the Board may where it finds appropriate issue directives providing for additional areas of investment, which may not be eligible for exemption from the payment of customs duty.

11) Transfer of Capital Goods Imported Free of Customs Duty

Capital goods imported free of customs duty shall not be transferred to third parties not entitled to similar duty free privileges, unless prior payment of the customs duty is effected thereon.

PART FOUR Miscellaneous Provisions

12) Penalty

Any investor who acts contrary to Article 11 of these Regulations shall be punishable in accordance with Article 73 of the Re-establishment and Modernization of Customs Authority Proclamation No. 60/1997.

13) Repealed and Non-effective Regulations and Directives

1) Investment Incentives Council of Ministers Regulations No 7/1996 (as amended) and Investment Areas Reserved for Domestic Investors Council of Ministers Regulations No. 35/1998 are hereby repealed.

2) Any Regulations or directives inconsistent with these Regulations shall not have effect with respect to matters provided for in these Regulations.

14. Transitory Provision

1) Notwithstanding the provision of Article 13 of these Regulations, incentives granted pursuant to the Investment Incentives Council of Ministers Regulations No. 7/1996 (as amended) and the

directives issued there under, shall continue to take effect.

2) Where an investor granted with incentives under Regulations No. 1996 (as amended) opts instead to be a beneficiary of incentives provided for in these Regulations, he may notify the appropriate investment organ and be entitled thereby.

15) Effective Date

These Regulations shall come into force on the date of their publication in the Federal Negarit Gazeta.
Done at Addis Ababa, this 7th day of February, 2003

**MELES ZENAWI
PRIME MINISTER OF THE FEDERAL
DEMOCRATIC REPUBLIC OF ETHIOPIA**

SCHEDULE

Areas of Investment Reserved for Domestic Investors

1. The following areas are exclusively reserved for domestic investors:

- 1) retail trade and brokerage;
- 2) Wholesale trade (excluding supply of petroleum and its by-products as well as wholesale by foreign investors of their products locally produced);
- 3) import trade (excluding LPG, bitumen and upon approval from the Council of Ministers, material inputs for export products);
- 4) export trade of raw coffee, chat, oilseeds, pulses, hides and skins bought from the market and live sheep, goats and cattle not raised or fattened by the investor;
- 5) construction companies excluding those designated as grade 1;
- 6) tanning of hides and skins up to crust level;
- 7) hotels (excluding star-designated hotels), motels, pensions, tea rooms, coffee shops, bars, night clubs and specialized restaurants,
- 8) travel agency, trade auxiliary and ticket selling services;
- 9) car-hire and taxi-cabs transport services;
- 10) commercial road transport and inland water transport services;
- 11) bakery products and pastries for the domestic market;
- 12) grinding mills;

- 13) barber shops, beauty saloons, and provision of smith, workshops and tailoring services except by garment factories;
- 14) building maintenance and repair and maintenance of vehicles;
- 15) saw milling and timber making;
- 16) customs clearance services;
- 17) museums, heaters and cinema hall operations;
- 18) Printing industries.

2. Without prejudice to the provisions of sub-Article (1) of this schedule, the following areas of investment are exclusively reserved for Ethiopian nationals:

- 1) banking, insurance and micro credit and saving services;
- 2) forwarding and shipping agency services;
- 3) broadcasting services; and
- 4) air transport services using aircraft with a seating capacity of up to 20 passengers.

