Supporting Investment and Trade in Africa

Ethiopia and investment provisions in AfCFTA: issues and challenges

Alemayehu Geda and Guta Legesse, with inputs from Yohannes Ayele and Martha Belete

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Key messages

Commitments to investment in the African Continental Free Trade Area (AfCFTA) can help to attract foreign direct investment (FDI), which has various benefits for the Ethiopian economy. FDI can help catalyse domestic investment, lead to transfer of technology and managerial skills, and create jobs and reduce poverty.

However, there are challenges. One, synchronising national investment laws. Two, the proper implementation of laws. Three, the lack of a stable political and macroeconomic environment. Four, the costs of doing business in Ethiopia. As such, this report suggests possible actions for the Government of Ethiopia and others around AfCFTA and Investment Issues to overcome these challenges.
# Table of contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acknowledgements</td>
<td>3</td>
</tr>
<tr>
<td>List of acronyms</td>
<td>4</td>
</tr>
<tr>
<td>Executive summary</td>
<td>5</td>
</tr>
<tr>
<td>1. Introduction</td>
<td>9</td>
</tr>
<tr>
<td>2. Background on investment and investment policy in Ethiopia</td>
<td>10</td>
</tr>
<tr>
<td>2.1. Recent FDI performance</td>
<td>10</td>
</tr>
<tr>
<td>2.2. National investment policy, laws and FDI promotion</td>
<td>13</td>
</tr>
<tr>
<td>2.3. International investment-related obligations</td>
<td>16</td>
</tr>
<tr>
<td>3. The AfCFTA Investment Protocol: status, issues and expected impacts</td>
<td>19</td>
</tr>
<tr>
<td>3.1. Status and negotiation issues</td>
<td>19</td>
</tr>
<tr>
<td>3.2. Expected impacts for Ethiopia: broad view, industrialisation</td>
<td>24</td>
</tr>
<tr>
<td>4. Interactions between AfCFTA provisions and domestic law</td>
<td>27</td>
</tr>
<tr>
<td>4.1. Points of convergence</td>
<td>27</td>
</tr>
<tr>
<td>4.2. Points of divergence</td>
<td>28</td>
</tr>
<tr>
<td>5. Conclusions: priority actions and support measures</td>
<td>32</td>
</tr>
<tr>
<td>References</td>
<td>35</td>
</tr>
</tbody>
</table>
Acknowledgements

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<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AfCFTA</td>
<td>African Continental Free Trade Area</td>
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<tr>
<td>APHA</td>
<td>Animal and Plant Health Agency</td>
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<td>AU</td>
<td>African Union</td>
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<td>BIT</td>
<td>Bilateral Investment Treaty</td>
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<td>COMESA</td>
<td>Common Market for Eastern and Southern Africa</td>
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<tr>
<td>DEFRA</td>
<td>Department for Environment, Food &amp; Rural Affairs</td>
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<tr>
<td>EIC</td>
<td>Ethiopian Investment Commission</td>
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<td>FCDO</td>
<td>Foreign, Commonwealth and Development Office</td>
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<td>FDI</td>
<td>foreign Direct Investment</td>
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<td>FDRE</td>
<td>Federal Democratic Republic of Ethiopia</td>
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<td>FET</td>
<td>Fair and Equitable Treatment</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GFCF</td>
<td>Gross Fixed Capital Formation</td>
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<td>IGAD</td>
<td>Intergovernmental Authority on Development</td>
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<td>MFN</td>
<td>Most-Favoured Nation</td>
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<td>NBE</td>
<td>National Bank of Ethiopia</td>
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<td>PAIC</td>
<td>Pan-African Investment Code</td>
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<tr>
<td>REC</td>
<td>Regional Economic Community</td>
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<tr>
<td>SEZ</td>
<td>Special Economic Zone</td>
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<tr>
<td>SIVEP</td>
<td>Service d'inspection vétérinaire et phytosanitaire aux frontières</td>
</tr>
<tr>
<td>UAE</td>
<td>United Arab Emirates</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>UNCITRAL</td>
<td>United Nations Commission on International Trade Law</td>
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<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
</tr>
<tr>
<td>UNECA</td>
<td>United Nations Economic Commission for Africa</td>
</tr>
<tr>
<td>US</td>
<td>United States</td>
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<tr>
<td>WTO</td>
<td>World Trade Organization</td>
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Executive summary

Regional integration schemes and agreements such as the African Continental Free Trade Area (AfCFTA) and its Investment Protocol are important not only because they offer market and investment opportunities but also because they can lock in good policies by serving as agencies of restraint that force a country to follow the commitments it has made in such arrangements. AfCFTA and its Investment Protocol should be taken as one such opportunity to strengthen existing institutions or create new institutions and provide further incentives to shape investment policy more generally.

Commitments to investment in AfCFTA can help to attract foreign direct investment (FDI), which has various benefits for the Ethiopian economy. FDI can help catalyse domestic investment, lead to transfer of technology and managerial skills, and create jobs and reduce poverty. The ability to create jobs is a major reason for Ethiopia to design attractive incentive schemes and provisions on investor protection to attract FDI.

Analysis of Ethiopia’s investment policies shows that, despite various incentives offered, as by most countries in the continent, the level of investment attracted is significantly below the level that is needed. Understanding the reason for this requires an in-depth study, and this briefing attempts to introduce some of the major challenges by focusing on Ethiopia’s investment law in relation to the Investment Protocol which Ethiopia is currently negotiating as part of signing the AfCFTA Agreement in general.

Given the importance of FDI for the Ethiopian economy, implementation of the AfCFTA and its Investment Protocol is an opportunity that Ethiopia could leverage to shape its investment law and attract investment. Thus, it could be used to harmonise Ethiopia’s investment policies and laws with the minimum global standard and to sharpen its unique appeal for investors. Moreover, a well-thought-out investment agreement could help African countries avoid a ‘race to the bottom’ in a bid to attract investment. This requires addressing the synergies between the AfCFTA Investment Protocol and the various bilateral investment treaties (BITs) that each country has already entered into. It could also be used to address major challenges related to FDI, such as regarding enforcement of contracts and proper application of the law. Meanwhile, the Ethiopian government is currently using special economic zones (SEZs) both to attract FDI and to realise its industrialisation drive. Ethiopia needs to explore further how to ensure that the Investment Protocol is well aligned with Ethiopia’s SEZ strategy.

The AfCFTA Investment Protocol has the potential to offer a continental-wide framework for an efficient investment information system, which may emerge as a systemic spillover effect of the Investment Protocol at country level. It may also act as an agency of restraint and increase the confidence of investors, who may in turn facilitate further investment to Ethiopia. Realising the benefits of the incoming Investment Protocol and dealing with potential challenges requires addressing the issues that this briefing identifies. This process needs to be guided by Ethiopia’s 10-year development plan. The underlying vision of the country is structural transformation (industrialisation) and job creation through supporting strategic sectors, especially those with strong backward and forward linkages and job creation.

We identify a range of challenges and discuss the policy implications. A table at the end of this section summarises the main points.

The first challenge relates to synchronising national investment laws with the various BITs, the World Trade Organization provision (when Ethiopia accedes) and the AfCFTA Investment
Protocol. Ethiopia has signed 35 BITs, and 22 of them are in force while 12 recently signed treaties are not in force. Negotiation of the Investment Protocol offers Ethiopia the opportunity to address this challenge.

The Investment Protocol needs to ensure that market actors do not abuse market power, restrict market entry and focus on rent extraction with little value added. Thus, the protection of investors needs to be balanced with regulating the activities of investors and investment facilitation, which are becoming increasingly important features of modern agreements. Meanwhile, modern investment agreements increasingly leave out dispute settlement, which has become a controversial matter, leaving this to BITs or national laws. Ethiopia should be prepared to exploit the AfCFTA’s potential to address anticompetitive practices by negotiation alignment with its competition law. The synchronisation can also be extended to incorporate dispute settlement issues. Other areas of disparities that require further consideration for harmonisation include ownership rights of immovable property; minimum capital required from foreign investors; capital share restrictions; employment of expatriate staff; and foreign exchange use and transfer of funds. It is imperative that the government of Ethiopia work on these areas ahead of time so the country can benefit from the AfCFTA Investment Protocol.

The second challenge relates to the proper implementation of laws. The Ethiopian investment law is well targeted to indigenous ownership, job creation and related safeguard measures that are consistent with the national interest. However, there is a need for proper implementation and enforcement of the investment and other laws. For instance, strict supervision and review of FDI applications is needed to restrict fraudulent investments as the country has incurred significant loss in government revenues and experienced abuse of the law (such as importing second-hand machines, excessive loan-taking without delivering outputs, relocating early, etc.) by some foreign investors in recent years.

However, achieving this in an efficient, timely, cost-effective and transparent manner is difficult, which hinders foreign investment in Ethiopia. More concretely, these challenges of proper implementation of laws are found to be pervasive in relation to access to land for investment contracts enforcement, lack of internal coordination between regional states and the federal state in deciding on investment-related issues, especially on land. These challenges partly arise from capacity problems in implementation agencies, especially in regional government. For instance, the new 2020 Investment Proclamation set up an investment council composed of investment organs from regions and officials from the federal government to coordinate and streamline investment activities. Unless these investment implementation challenges are addressed upfront, any further improvement in the investment law through the AfCFTA Agreement to attract and benefit from foreign investment may yield few benefits. In this regard, speedy establishment of the proposed investment council; quick resolution of land disputes jointly through the Ethiopian Investment Commission (EIC) and regional authorities until the council begins functioning; and efficient communication with existing foreign investors who have such problems are some of the policy actions that authorities could take as a positive signal in attracting investment.

The capacity challenges noted above are related to the institutional dimension of implementation, and it is worth looking deeper at the responsibilities assigned to the EIC as an implementation agency and its ability to handle these. The list of responsibilities given to the EIC is extensive, ranging from policy formulation to implementation and monitoring (Proclamation No. 1180/2020) – and yet it appears that the EIC does not have sufficient capacity to undertake them all in an efficient and cost-effective manner. The Investment Protocol may not be effective in facilitating investment to Ethiopia if such institutional challenges are not addressed. The short-term policy directions to address this challenge include (1) streamlining and simplifying the activity of the EIC and coordinating its work with regional bureaus of investment; (2) establishing clear responsibilities for the implementing organs of the institution and making them accountable when they fail to perform their duties in a time-bound context; and (3) making the implementation steps and responsibilities
transparent through an open information technology system that can be monitored both by investors and by responsible higher authorities. In the medium to long-run, engaging in significant capacity-building at the EIC continuously and implementing appropriate staff retention schemes to avoid high staff turnover will be important.

**The third challenge is the lack of a stable political and macroeconomic environment.** Macroeconomic stability refers to stable and low inflation and balance of payments and sustainable economic growth. With an investment to gross domestic product (GDP) ratio of 35% against a domestic savings to GDP ratio of about 15-22% over the past five years (and a large trade deficit), FDI has been crucial for Ethiopia since 2013, not only to bridge a significant resource gap but also to help cover about one-fifth of the country’s annual shortage of foreign exchange each year. Thus, attracting FDI is crucial for Ethiopia to address its chronic balance of payments deficit problem, which is related to challenges of growth in the export and import-substituting sectors. Notwithstanding the government’s efforts to attract FDI, for this purpose among others, its foreign exchange problems and frequent regulations to ration foreign exchange through a policy of foreign currency surrender (the latest surrender rate being about 70%) could be a major hurdle to attracting FDI. In relation to this, first, a 70% surrender rate is quite high for the investor, and this could cripple any incentive to invest more in the future. Second, the NBE’s frequent and unpredictable adjustments to the surrender rate aggravate the problem. They may also lead to illicit activities (such as over- and under-invoicing of imports and exports, respectively) for those already engaged in Ethiopia. Furthermore, periodic violent conflict that at times leads to destruction of property (in short, political instability) are major challenges to investment in Ethiopia.

**The fourth challenge relates to costs of doing business in Ethiopia.** Ethiopia is a land locked country with underdeveloped infrastructure and associated high land transportation costs, bureaucratic delays in general and delays at customs in particular and corruption (in short, the high cost of doing business); Ethiopia remains below regional and world averages in the World Bank’s Doing Business rankings, at 146 (of 190 countries) in 2016, deteriorating to 189 in 2020, which is very low compared with its regional peers, such as Uganda with a rank of 116, Kenya at 56 and Rwanda at 38 in the same year, 2020. Thus, a special focus on investment facilitation and enhanced incentives, including better access to foreign exchange for investors engaged in exporting and import-substituting activities, would be a short-term policy direction worth looking into to alleviate the chronic foreign exchange problem and attract foreign investment at the same time. For instance, to attract foreign investment, the government is developing several industrial parks in important economic corridors with fully developed infrastructures such as electricity, water, roads, etc.

Finally, in many African countries, an emerging trend relates to the significant engagement of firms from emerging economies such as China, India and Turkey, among others, both in traditional FDI sectors and also in major investments of host countries financed by credit (or vendor financing) from governments of these emerging economies. This is a new grey area of ‘foreign’ investment that is worth the attention of policy-makers because of its sheer magnitude and fast growth. Vendor financing-based investment from China’s EXIM bank in Ethiopia, for instance, is much more important than Chinese FDI in Ethiopia. The trend is similar in many African countries. This area is worth deeper study in the future, especially regarding its implication for standard FDI in host countries.

To conclude, the table below summarises the policy implications of this report, both for the Government of Ethiopia and for support agencies. These efforts need to be followed by an in-depth study and strategy – which are beyond the scope of this study.
### Summary of possible actions for the Government of Ethiopia and others around AfCFTA and Investment Issues

<table>
<thead>
<tr>
<th>Investment (Protocol) issue highlighted in the brief</th>
<th>Link to AfCFTA</th>
<th>Possible action/options for government in relation to investment (short run)</th>
<th>Further complementary actions/support needed (medium run)</th>
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</thead>
<tbody>
<tr>
<td><strong>Aligning existing laws and AfCFTA Investment Protocol</strong></td>
<td>Provisions on investment protection in AfCFTA</td>
<td>Examine the Pan-African Investment Code (PAIC) and emerging AfCFTA investment issues and align them with Ethiopian law and negotiations in the Investment Protocol accordingly.</td>
<td>Deeper studies and/or capacity-building on strategy and scenarios for negotiation.</td>
</tr>
<tr>
<td><strong>Implementation of laws, especially by regional governments, that includes disputes with land access and use issues</strong></td>
<td>Investment facilitation in AfCFTA Investment Protocol</td>
<td>(1) Speedy setup of the new investment council stated in the new Investment Proclamation; (2) quick resolution of disputes on land issues by a joint EIC and regional authorities committee until the council begins functioning; and (3) effective and efficient communication with foreign investors that have such problems.</td>
<td>(1) Capacity-building on investment facilitation; (2) A study to identify major challenges (as a priority); (3) establishing an accountable and transparent system both in the EIC and in regional investment authorities.</td>
</tr>
<tr>
<td><strong>Stable political and macroeconomic environment</strong></td>
<td>AfCFTA to lead to better public–private dialogue that can help address these issues</td>
<td>Inclusive politics and peaceful resolution of conflicts</td>
<td>Capacity-building in macroeconomic management.</td>
</tr>
<tr>
<td><strong>Foreign exchange shortage and rationing</strong></td>
<td>Not explicitly related to AfCFTA (a national problem)</td>
<td>A special focus on investment facilitation and enhanced incentives, including extended access to foreign exchange, for investors engaged in exporting and import-substituting industries</td>
<td>Attracting investment from the Africa region, including limited offering of equities in profitable public firms.</td>
</tr>
<tr>
<td><strong>The use of industrial parks (SEZs)</strong></td>
<td>Possible issues around harmonisation of investment protocol and SEZ policies</td>
<td>Developing a negotiation position about their further use in the context of the Investment Protocol will help Ethiopia prepare ahead of time.</td>
<td></td>
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<tr>
<td><strong>Implications of investment financing from emerging economies for FDI</strong></td>
<td>Upcoming negotiations on the Investment Protocol of the AfCFTA</td>
<td>Deliberating on this issue during the negotiations on the Investment Protocol</td>
<td>A deeper study on implications for attracting FDI and how to handle both types of investment in the future.</td>
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1. Introduction

Just before the emergence of COVID-19 as a global pandemic in early 2020, the Ethiopian government had embarked on a far-reaching economic reform and liberalisation programme – termed ‘Homegrown Economic Reform’ – running from 2018 to 2021. Given the long history of a fairly controlled economy, this reform was believed to be crucial for the growth of foreign direct investment (FDI) in Ethiopia. The key feature was to increase the government’s efficiency and to liberalise the economy, including privatising key public enterprises, opening the Ethiopian economy to foreign firms and speeding up the drive to access World Trade Organization (WTO) membership. This reform was also supported by major Western donors and international financial institutions with a promise of significant external finance. Then the COVID-19 pandemic hit the economy in 2020, and the north of the country slid into severe conflict in 2021, with detrimental effects both to the reform and to the prospects of securing the promised external finance and attracting new FDI.

Before the onset of COVID-19, the economy was expected to grow at 9%, in line with trend of high growth of 10.4% per annum for more than a decade (Alemayehu and Addis, 2015). However, according to official data, growth declined to 6% in 2019/20 owing to the effects of COVID-19 (NBE, 2020).

However, even before it was hit by the economic effects of COVID-19 and the conflict in the north, the Ethiopian macroeconomy had been generally characterised by significant imbalances, partly because of structural factors and partly because of macroeconomic mismanagement, including corruption. More specifically, there was a significant gap between gross domestic savings and investment, a high trade deficit, a large balance of payments deficit, rising indebtedness and increasing inflation. As a result, by 2019/20, inflation was very high (20%), public debt as a percentage of gross domestic product (GDP) stood at 55.6% and the export–import gap remained significant because imports were (and still are) about five times exports. This annual external gap was generally bridged by, among other things, significant flows of FDI, which helped partly address the country’s foreign exchange problem (Alemayehu, 2008; Alemayehu and Addis, 2015). It is partly for this reason that the government is giving its unreserved support to attracting FDI.

It is in such a macroeconomic context that Ethiopia ratified the Africa Continental Free Trade Area (AfCFTA) Agreement, whose second phase will focus on, among other things, negotiation of the Investment Protocol. This briefing aims to review investment policy in Ethiopia and implementation of this in the context of the AfCFTA. It also aims to show how national policies could be used to shape negotiations around the AfCFTA Investment Protocol and related international agreements to which Ethiopia has committed to create a conducive environment to attract more FDI and realise the country’s industrialisation strategy.

The rest of the briefing is organised as follows. Section 2 presents background information on Ethiopia’s FDI performance, investment policy and alignment with international obligations. Section 3 focuses on the AfCFTA Agreement, including the Investment Protocol, and Ethiopia’s negotiation status and expected impacts. Section 4 looks at the interaction between the AfCFTA Agreement and its incoming Investment Protocol and domestic investment law. Section 5 concludes by pointing out outstanding challenges and their implications for policy actions to enhance Ethiopian investment policy.
2. Background on investment and investment policy in Ethiopia

2.1. Recent FDI performance

The Ethiopian growth pattern in the past decade is similar to the general excellent growth pattern of the African continent. The economy grew at an average annual rate of 9% between 2000 and 2012. Computing from 2003, the average annual growth rate was around 11% for nine consecutive years. The growth continued in the next decade (2011/12–2018/19), with a similar average annual growth rate of 9.2%. Growth in investment was crucial for this performance. For instance, as Figure 1 shows, in the six years before COVID-19, the share of investment in GDP averaged 38%, while domestic savings as a share of GDP represented just 21.5%. During this period, FDI as a share of GDP averaged about 4.2% (accounting for about 11% of total gross investment). The role of China in both investment and financing of investment (especially in public infrastructure investment) is significant – thus China is the leading FDI source country for Ethiopia.

**Figure 1: Pattern of investment, FDI, savings and growth, 2013/14–2019/20 (%)**

Note: Investment share and gross domestic savings on left axis; GDP growth and FDI share in GDP on right axis. Source: Authors’ computation based on NBE and UNCTAD data

Overall, FDI inflows to the country were very low before 2013, mainly because of weak private investment policies in the 1990s and early 2000s and the protracted civil war before the 1990s

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1 Alemayehu and Addis (2015) are critical of both the official growth rate and the saving rate. Examining if from different perspective including a growth model-based growth accounting exercise, they estimate the growth during this special decade to be about 6%, not 9 or 11 % noted; they also inferred the saving rate to be about 10% of GDP. This still was an excellent growth performance which is about the continent’s average which about 5% during the same time.
The stock of FDI, which was only around $1 billion in 2000, had increased to $4.3 billion in 2010. After 2010, it increased consistently, reaching $15 billion in 2016 and $22.25 billion in 2018, according to Ethiopian Investment Commission (EIC) data. This had further increased to $27.5 billion in 2020 – thus FDI has grown more than fivefold in the past 10 years.

Despite this recent significant increase, the share of Ethiopian FDI stock in the total stock of FDI in Africa is negligible. It was about 0.7% before 2010 and had increased to 2.8% by 2020 ($27.4 billion). Although this latter figure is significant in the East Africa region, being about a third of the region’s FDI stock, it is very small when compared with the African total stock of FDI in 2020, which was close to $1 trillion. In addition, the annual flow of FDI as a percentage of gross fixed capital formation (GFCF) was around 0.7% in 1990. This figure had reached a little over 6% in 2013, albeit with ups and downs over the years, and had not fundamentally changed in 2020, at about 7.1% of GFCF. There is a need to examine the factors behind this general poor performance in Ethiopia and what needs to be done to improve the situation.

Table 1: Recent pattern of FDI, world and Ethiopia

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<td></td>
<td>FDI stock ($ billion)</td>
<td>Share (in world/Africa, %)</td>
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<tr>
<td>World</td>
<td>7,377</td>
<td>19,899</td>
<td>41,354</td>
<td>100.0</td>
<td>100.0</td>
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<td>Developed economies</td>
<td>5,779</td>
<td>13,137</td>
<td>28,680</td>
<td>78.3</td>
<td>66.0</td>
<td>69.4</td>
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<td>Developing economies</td>
<td>1,545</td>
<td>6,066</td>
<td>11,803</td>
<td>20.9</td>
<td>30.5</td>
<td>28.5</td>
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<td>Africa</td>
<td>153.06</td>
<td>619.12</td>
<td>978.8</td>
<td>2.1</td>
<td>3.1</td>
<td>2.4</td>
</tr>
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<td>East Africa (share in Africa)</td>
<td>7,202</td>
<td>36,826</td>
<td>92.73</td>
<td>4.7</td>
<td>5.9</td>
<td>9.5</td>
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<tr>
<td>Ethiopia (share in Africa)</td>
<td>0.941</td>
<td>4,206</td>
<td>27,351</td>
<td>0.6</td>
<td>0.7</td>
<td>2.8</td>
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<td></td>
<td>FDI flows ($ billion)</td>
<td>Annual growth (%)</td>
<td>Proj.</td>
<td></td>
<td></td>
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<td>World</td>
<td>2,065.2</td>
<td>1,436.7</td>
<td>1,530.2</td>
<td>998.89</td>
<td>-20.2</td>
<td>-12.8</td>
<td>6.5</td>
<td>-34.7</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Developed economies</td>
<td>1,344.5</td>
<td>707.65</td>
<td>749</td>
<td>312.17</td>
<td>-33.5</td>
<td>-20.9</td>
<td>5.8</td>
<td>-58.3</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td>Developing economies</td>
<td>653.89</td>
<td>692.48</td>
<td>723.39</td>
<td>662.56</td>
<td>7.4</td>
<td>-1.4</td>
<td>4.5</td>
<td>-8.4</td>
<td>7</td>
<td></td>
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<tr>
<td>East Africa</td>
<td>8.3</td>
<td>8.78</td>
<td>8.05</td>
<td>7.726</td>
<td>6.46</td>
<td>5.8</td>
<td>-8.3</td>
<td>-4.0</td>
<td>-16.4</td>
<td></td>
</tr>
<tr>
<td>Ethiopia</td>
<td>4.14</td>
<td>4.017</td>
<td>3.31</td>
<td>2.549</td>
<td>2.395</td>
<td>-3.0</td>
<td>-17.6</td>
<td>-23.0</td>
<td>-6.0</td>
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Note: * The projections for the world, developed and developing economies and Africa range from 10% to 15%, 15% to 20%, 5% to 10% and 0% to 10%, respectively.

Source: Authors’ computation based on UNCTAD (2021a)

Although data comparable to the United Nations Conference on Trade and Development (UNCTAD) data in Table 1 are not available by source country, available data from the EIC can help us infer the major FDI source countries for Ethiopia and the nature of that FDI. The EIC 2015 data show China as the major source country for FDI to Ethiopia, followed by Saudi Arabia and Turkey. Other significant source countries include India, the Netherlands and the UK. Using data for 1992–2017, the share of FDI stock from China in the total stock of FDI in Ethiopia was 12%. This is followed by Saudi Arabia and Turkey, at 5% each, and India and China/Ethiopia joint ventures, at 4% each. The other 15 source countries, including the UK and the US in the West and Sudan and Egypt in Africa, had a share of less than 1% each in the total stock of FDI in Ethiopia (EIC, 2015; Addis, 2022).

The stock of FDI data used for this, which is about $10.45 billion according to the US Department of State in 2018 (as well as in Addis, 2022), both of which are based on EIC data, is significantly lower than the stock of FDI in Ethiopia, of $22.5 billion in 2018 and $27.35 billion in 2020, seen in the UNCTAD data in Table 1.
In terms of the nature of FDI coming to Ethiopia, unlike in many countries in Africa, where FDI is invariably destined for the natural resource intensive sector (Alemayehu, 2019), FDI in Ethiopia goes primarily to manufacturing. The manufacturing sector took about 70% of FDI stock between 1992 and 2017 (45% and still the leader when measured by the number of projects too). This is followed by FDI in construction contracting, including water well drilling (11.1% of the stock of FDI), agriculture (8.6%) and real estate, machinery and equipment rental (6.4%) (EIC, 2019; Addis, 2022).

Notwithstanding their relatively small size, recent FDI flows are impressive. This can be seen in both Table 1 and Figure 2. Figure 2 shows that FDI inflows were negligible before 2013. The average annual inflow of FDI to Ethiopia was just about $11 million in the 1970s, decelerated to an average annual figure of $0.4 million in the 1980s and picked up a little to $70 million in the 1990s. Leaving aside the year 2011 when it reached $626 million, it remained at about $300 million until 2012. In 2013, it jumped for the first time to the $1 billion mark, about 3% of GDP.

FDI inflows were low before 2013 despite the liberalisation of various economic sectors to foreign investors in the early 1990s. Various factors, such as the protracted civil war in the country since the 1970s, war with neighbouring Eritrea (1998–2000) and the 2005 failed election and the violence that accompanied it may have affected foreign investors’ confidence; the global financial and economic crisis as well as the ineffectiveness of the country’s investment policy (see below) could also explain this poor performance.

**Figure 2: FDI flows to Ethiopia, 1970–2020 ($ million and % of GDP)**

Source: Authors’ computation based on UNCTAD data

FDI thus began to grow dramatically after 2013, when it more than quadrupled compared with 2012. It continued to grow at an average annual rate of 46% until 2016. At its peak in 2016, it reached $4.14 billion, which was also its highest share in GDP (nearly 6%). It declined a little in 2017 and significantly after that, until the outbreak of the COVID-19 pandemic in 2020, when
its share in GDP went down to 2.6%. The decline before the outbreak of the pandemic was related to the civil unrest that engulfed the country during this period, which eventually led to the overthrow of the regime that was in power from 1991 to 2018 and the coming of a new prime minister who initiated the policy reform and liberalisation policy alluded to above.

Although the level of FDI in 2020, at $2.4 billion, was very low compared with the levels registered in 2016–2019, the decline in 2020, at 6%, was not significant compared with the decline registered a year before the pandemic year in 2019 – although the government’s 2019/20 fiscal year data reported a decline of 19.8%, which is significant (NBE, 2020). Looking at the 6% decline using the calendar year shows good performance from Ethiopia given the pandemic’s effect in the East Africa region, which saw a 16.4% decline in FDI flows, and on the continent, where FDI declined by 15.6%. Similarly, it compares well with other regions, such as Latin America and the Caribbean, where FDI contracted by 45% in 2020, ‘transition economies’, where it declined by 58% and the developed economies, where it declined by 58.3% (Table 1; UNCTAD, 2021a). Although the Ethiopian economy also suffered as a result of the pandemic, especially in hospitality, aviation and other services, official data show 6.1% economic growth. The manufacturing, agriculture and hospitality industries drew the highest shares of investment in 2020. The government initiated a programme to facilitate FDI in manufacturing, and several Chinese firms have already started production (UNCTAD, 2021a); this undoubtedly contributed greatly to ameliorating the impact of the pandemic.

Recent data suggest better prospects for FDI. Preliminary information from the EIC shows that Ethiopia attracted $3.9 billion in FDI in the fiscal year 2020/21, an increase of about $1 billion compared with the previous fiscal year. However, this is mainly attributed to the sale of the first private telecom licence, at $850 million, to Kenya’s Safaricom and its consortium of investors. In addition, according to the EIC, about 19 foreign businesses invested in the newly inaugurated Yirgalem Integrated Agro-Industrial Park in the year, partly as a result of the government’s concerted efforts to attract such investment.

In sum, the situation for the Ethiopian economy in general and its external sector in particular is challenging because of the economic effects of the conflict-war and the reconstruction needed. The external sector is also very vulnerable to shocks such as those related to COVID-19, terms of trade and the level of capital inflows (including aid, borrowing and remittances). And yet it is the external sector (external finance and trade) that has a significant impact on the national economy, as Ethiopia is overly dependent on imports, largely financed by such capital inflows, which include FDI, for its day-to-day survival. Thus, creating a conducive policy for attracting FDI is important not only to spur growth but also to partly address external sector challenges in general and the shortage of foreign exchange in particular in the coming years.

In this respect, implementation of the AfCFTA, with measures lowering barriers to intraregional trade, as well as progress on an agreement on the Investment Protocol that reflects the national interests of Ethiopia and helps the country address its law and policy implementation challenges by serving as an agency of restraint could support FDI flows, which have significant scope to expand (UNCTAD, 2021a).

2.2. National investment policy, laws and FDI promotion

Ethiopia aspires to achieve middle-income status by 2025. As indicated in the country’s current 10-year plan (2021–2030), the government aims to reduce poverty from 20% of the population to 7%. To achieve this, the previous government enacted an investment policy aimed at expanding foreign and domestic investment (1991–2018). The current government, which came to power in 2018, has strengthened this through a 2020 Investment Proclamation (Negarit Gazeta, Proclamation No. 1180/2020). According to this, the EIC is the main institution responsible for providing information to foreign investors; approving and issuing investment permits; monitoring the implementation of approved projects; approving and issuing work permits to foreign workers for approved projects; facilitating the acquisition of land by foreign investors; and advising the government on investment matters (FDRE, 2020a;
EIC, 2021). Some interviewees suggested that the new investment laws, when implemented well, provide sufficient protection and incentives to attract and retain FDI.

Proclamation No. 1180/2020 has nine parts while its Regulation No. 474/2020 has eight parts. Part 1 of the Proclamation covers terminologies and scope of application. Part 2 presents the objectives of investment. Part 3 covers areas of investment, forms of enterprise and capital requirements for investment. Part 4 presents provisions on investment permits. Under Part 5, registration of technology transfer and collaboration agreements with domestic investors is discussed. Part 6 covers investment incentives, guarantees and protection, and facilitation. Part 7 looks at grievance procedures and investment dispute settlement. Part 8 presents on investment administration organs. Part 9 covers miscellaneous provisions. In light of this new Proclamation, key issues in relation to the incoming AfCFTA Investment Protocol worth looking into include the following.

**Economic sectors open to FDI**

The new Investment Proclamation and Regulation invite foreign investors to engage in all sectors of the economy, with some exceptions, noted below. The Regulation enacts and envisages four investment modalities: joint ventures with government; domestic investment; joint investment between domestic and foreign investors; and foreign investment. Since domestic investors include the Ethiopian government, we could say that there are in fact five modalities. Areas reserved for joint investment with the government include electrical energy; air transport services; bus rapid transit; postal services; and the manufacturing of weapons. Areas reserved for joint investment by domestic and foreign investors include freight forwarding and shipping agency services; domestic air transport; cross-country public transport with seating capacity of 45 passengers; urban mass transport; advertisement and promotion; audio-visual; and accounting and auditing services.

A number of investment areas are exclusively reserved for Ethiopian citizens, including the financial sector; transmission of electric energy; primary and middle-level health services; wholesale trade (excluding wholesale of petroleum, petroleum products, wholesale of own products produced in Ethiopia and electronic commerce) and retail trade (excluding retail, as provided under appropriate law, of own manufactured products produced in Ethiopia and electronic commerce); import and export trade of minerals and raw materials; construction and drilling service below grade I; and non-star-designated hotels, lodges, resorts, restaurants and bars. Transport-related investments, such as tour operations, travel agencies and lease equipment, are reserved for domestic investment, as are investments in grinding mills; bakeries; indigenous clothes-making; media services; customs clearance; brick manufacturing; quarrying; lotteries; laundry services; security and private employment agency services; legal consultancy; and brokerage. All other areas of investment not listed in the new Proclamation (and in the Regulation) are open to foreign investment.

The new Regulation follows a negative list approach, whereby it presents an exhaustive list of investment areas in which foreign investors may not take part. All investment areas not included on the list are open to foreign investment. It also advises FDI engagement on an advanced level for some restricted areas, such as hotels, construction and transport.

**Ownership limitations and requirements**

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3 According to Proclamation No. 1180/2020, ‘domestic investor’ could mean an Ethiopian national; an enterprise incorporated in Ethiopia and wholly owned by an Ethiopian national; the Ethiopian government; a public enterprise; a cooperative society established as per the relevant law; a foreign national or foreign enterprise treated as a domestic investor as per the relevant law or international treaty ratified by Ethiopia; or an enterprise incorporated in Ethiopia jointly by any of the aforementioned investors. ‘Foreign investor’, on the other hand, could mean a foreign national; an enterprise in which a foreign national has an ownership stake; an enterprise incorporated outside of Ethiopia by any investor; an enterprise established jointly by any of these investors; or an Ethiopian permanently residing abroad and preferring treatment as a foreign investor.
A foreign investor jointly investing with a domestic investor in the service sector is not allowed to hold more than 49% of the capital. The presence of such an ownership percentage cap for joint investments by foreign and domestic investors in the services sector in Ethiopia means that policy-makers need to indicate these in the schedule of commitments.

Further, there is a minimum capital requirement from foreign investors in to obtain a licence, and this depends on the form of ownership and the type of sector.

The Investment Proclamation also requires the foreign investor to deposit the minimum amount of entry capital in cash, depending on the type of sector and whether the investment is owned fully by a foreign investor or jointly with domestic investor(s). All fully foreign-owned investments, except those in consultancy and publishing activities, are required to deposit a minimum entry investment capital of $200,000 per project. If the investment is undertaken in partnership with domestic investor(s), the capital required will be reduced to $150,000 per project. The minimum capital required for a foreign investor to engage in the areas of architectural, engineering and related technical consultancy services or in publishing activities is $100,000 if the investment is fully foreign-owned and $50,000 if it is jointly owned with a domestic investor.

On the other hand, a foreign investor reinvesting profit or dividends from existing enterprises in areas allowed for foreign investment and buying the entirety of an existing enterprise owned by a foreign investor or the shares therein is free of such entry capital requirements.

**Monitoring and reporting requirements**

An investment licensee should report to and cooperate with the licensing authority periodically — every three months once the licence is granted. The licensee should submit a quarterly progress report on the implementation of the investment project to the appropriate investment organ. Failure to regularly report performance will lead to suspension of the investment permit, with correction to be carried out within one year of the suspension; failure to do so will lead to revocation of the permit.

Similarly, an investment permit is renewable every year until a business licence is issued. An investment permit shall be revoked if an investor fails to commence implementation of the project within two years of being issued the permit or has delayed completion of the project by two years from the time that is agreed with the appropriate investment organ. The appropriate investment organ may renew the investment permit when there is a sufficient reason for the delay in the commencement or completion of the project.

**FDI promotion: investment opportunities, incentives and protection**

The government provides several fiscal incentives to attract FDI. These include duty-free imports of machinery and equipment, exemptions from income tax, loss carryforward, foreign exchange surrender, access to cheaper loans, income tax deductions, etc. In addition, investing in relatively less developed regions, such as Gambela, Benishangul-Gumuz, Guji, Somali and Afar regional states, has additional advantages in terms of tax privileges: an income tax deduction of 30% for three consecutive years once the exemption period is completed.

Investors engaged in manufacturing activities will be exempted from income tax for three years in the food industry; for three to five years in textiles, depending on the degree of processing, and vegetables and certified seeds; for five years in the sugar sector, machinery and equipment, pulp and paper production, basic chemicals, basic iron and steel, pharmaceuticals and finished leather products; three to four years in plastic and other non-metallic mineral processing, computers, and electronic and electrical-related; eight years in forestry; and one year in luxury-type manufacturing activities such as chocolate and candy, alcoholic beverage and soft drink production (the exception being wine and beer, which have three and two year
exemptions, respectively). In addition, if the investor is engaged in the export sector or supplies 60% of its products to a firm engaged in the export sector, it will obtain an additional two years of income tax privileges.

The Ethiopian investment policy also allows for the development of industrial zones by the federal government or, and when deemed necessary, by joint investment of the government and the private sector as well as independently by the private sector, as amended in a 2014 regulation on industrial parks. Such zones are also exempted from income tax for 10 years if located around Addis Ababa and for up to 15 years for those located in the regions.

With respect to diversification and value chain development, Ethiopia has a policy for the development of strategic sectors, such as textiles and garments, meat, leather and leather products, and agro-industry, mainly through FDI (KIP, 2017). These government priority areas qualify for government support, especially when investors are engaged in exporting their products. Generally, investors engaged in these government priority areas have duty-free import privileges on the capital and construction materials necessary for their project. If the investment outlay is over $200,000 and creates permanent jobs for over 50 persons, the project is entitled to duty-free imports of capital goods up to five years after acquiring the licence.

Regarding foreign currency, any investor can operate a foreign currency account in a bank in Ethiopia for the purpose of their investment; the amount of foreign exchange to be submitted to the National Bank of Ethiopia (NBE) depends on the existing directives of the Bank. Recently, given the shortage of foreign currency in the country, the amount of foreign currency to be surrendered to the NBE from export earnings generated has reached a very high level of 70%; 20% of the earnings go to the account of the investor while the remaining 10% belongs to the client’s bank.4

Two problems with foreign currency surrender are observed here. First, 70% surrender is high for the investor, and this will cripple the incentive to invest more in the future and also make imports of intermediate inputs to maintain business operations very difficult. Second, the NBE adjusts the surrender rate quite frequently and it is not predictable. In little over a year, the NBE has changed the surrender rate five times, reducing the privilege of the investor by more than a half from 45% to 20%. This erodes investors’ confidence and risks sabotaging the Regulation through illicit activities (such as over- and under-invoicing of imports and exports, respectively) or totally discouraging risk-averse FDI engagement.

In addition to these opportunities and incentives, the Investment Proclamation promulgates that investment is protected and may not be expropriated or nationalised except for in the public interest and then only with adequate compensation corresponding to the prevailing market value that shall be paid in advance. Investors shall have the right, in respect of their approved investment, to make the following remittances out of Ethiopia: (1) profits and dividends accruing from the investment; (2) principal and interest payments on external loans; (3) payments related to a technology transfer agreement and related such obligation, (4) proceeds from the transfer of shares or of partial ownership of the enterprise to a domestic investor; (6) proceeds from the sale or liquidation of the enterprise; and (7) compensation paid to an investor as well as salaries paid to expatriate staff of the investors.

2.3. International investment-related obligations

Bilateral investment treaties (BITs) grant investors from a contracting state certain guarantees, including ‘fair and equitable treatment’, protection from expropriation and the free transfer of funds. The first BIT was signed in 1959, and it is one of the most important instruments for the international protection of foreign investment (UNCTAD, 2000).

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Ethiopia has close to 60 years of experience in promoting international investment. The first BIT was signed with Germany in 1964, and this remained the only treaty for three decades; it was revised in 2004. The country has signed 34 BITs so far; 22 of them are in force and one (with India) was terminated in 2017 while 12 signed treaties are not in force. South Africa has also terminated its BITs with Ethiopia. Many of these BITs were signed during the 1990s and early 2000s, earning them the name ‘first-generation BITs’. The more recently concluded BITs, with UAE, Morocco, Brazil and Qatar, are the second-generation BITs, as they contain some fundamental differences from the previously concluded ones. Ethiopia has signed BITs with its major trading partners, including China, Germany, Turkey, Egypt, UAE, UK, Italy, the Netherlands, France, Malaysia, Switzerland, etc. Of the nine BITs signed with African countries, only five are in force – those with Sudan, Tunisia, Egypt, Libya and Algeria.

There are some peculiar features of the second-generation Ethiopian BITs: they contain provisions that aim to balance the interests of investors and the state’s regulatory power by imposing obligations on investors: BITs with Brazil, Morocco and Qatar exclude portfolio investment from BIT protection; the BIT with UAE excludes fair and equitable treatment; and the BITs with Morocco and Qatar contain a provision on fair administrative treatment and illustrate the content of such treatment. The BIT with Brazil limits application of the most-favoured nation (MFN) provision to procedural matters. The BIT with Brazil excludes indirect expropriation from the BIT provisions, while the remaining text narrows down the meaning of indirect expropriation. The BITs have also taken a different approach to dispute settlement. The BIT with Brazil provides only for state-to-state dispute settlement, while the others require exhaustion of local remedies before presenting disputes to arbitration.

Among Regional Economic Communities (RECs), Ethiopia is a member of the Common Market for Eastern and Southern Africa (COMESA), which was established in 2000. Among other issues it encourages and facilitates private investment flows into COMESA, and envisages developing a common investment area through a more liberal and transparent investment environment. However, Ethiopia is not yet a member of the COMESA Free Trade Area. Ethiopia is also a member of the Intergovernmental Authority on Development (IGAD), which is relatively more active on regional security issues than trade and investment.

On the multilateral front, the original Working Party to negotiate Ethiopia’s accession to the WTO was established in 2003. The process has taken many years, with several years of discontinuity, and the country relaunched the Working Party after prolonged periods of inactivity in 2020. Currently, accession to WTO is still a work in progress.

All these agreements (including BITs, WTO accession, the AfCFTA Agreement, etc.) and the incoming Investment Protocol in the context of the AfCFTA need to be guided by national competition policy, which to some degree addresses FDI through the two important clauses of the WTO – MFN and national treatment – which can be taken as an overarching framework for liberalisation. These clauses, however, need to be framed with the interests of the country at heart, to lead to win-win solutions for both the country and its foreign investors. In order to support the competitiveness of the economy and to guide the process properly, Ethiopia introduced its first trade-related law in 2003: the Trade Practice Proclamation (No. 329/2003) aimed to promote competition in the domestic market. This was later replaced by the Trade Practice and Consumer Protection Proclamation (No. 685/2010) in 2010. Currently, the Trade Competition and Consumer Protection Proclamation (No. 813/2013) is the binding law with regard to competition regulation in trade in Ethiopia. The administration of the proclamation comes under the Ministry of Trade and Regional Integration while Ministry of Justice is entrusted with the adjudicative power over cases in relation to the trade practice and consumer protection proclamation.

5 https://investmentpolicy.unctad.org/international-investment-agreements/countries/67/ethiopia
6 Sudan, Tunisia, Egypt, Libya, Algeria, Nigeria, South Africa, Morocco and Equatorial Guinea.
7 https://www.wto.org/english/news_e/news20_e/acc_01sep20_e.htm
However, a fundamental issue involved in using Ethiopian investment law to shape the AfCFTA Investment Protocol that requires the attention of negotiators relates to how to treat Ethiopia’s existing BITs vis-à-vis the Investment Protocol. Since, for historical reasons, most BITs are generally informed by the laws and interests of the capital-exporting countries, which are invariably developed countries, the BITs signed with these countries by African states could undermine the incoming protocol if the capital-exporting countries have more power in their implementation in each African country. It is worth examining this issue in terms of harmonising the BITs that each country has signed so as to strengthen the AfCFTA Investment Protocol. Meanwhile, the negotiations on the Investment Protocol also need to avoid a ‘race to the bottom’ among African countries in their bid to attract investment.
3. The AfCFTA Investment Protocol: status, issues and expected impacts

3.1. Status and negotiation issues

The AfCFTA Agreement and the Investment Protocol

The AfCFTA is one of the most ambitious regional integration projects in Africa to date, in terms of both the number of participating countries and the areas/subject matters covered. It aspires to have all African countries as participants and, so far, 54 of the 55 African Union (AU) member states are signatories, of which 42 have ratified it. The AfCFTA aims to eventually create a single continental market for goods and services and the free movement of persons. As indicated under Article 3 of the Agreement, the AfCFTA plans to address challenges of overlapping membership and enhance intra-Africa trade through trade liberalisation and facilitation efforts. The Agreement covers various subject matters/areas in relation to economic integration. The negotiations on different protocols covering these areas are to be conducted in different phases. In the first phase are included the Protocols on Trade in Goods, Trade in Services and Dispute Settlement. These protocols were presented to the AU member states together with the Agreement establishing the AfCFTA, forming part of the AfCFTA Agreement, but negotiation on specific commitments on both trade in goods and services and other matters like rules of origin are still ongoing.

Phase II negotiations, according to Article 7 of the AFCFTA Agreement, will cover intellectual property, investment and competition policy. In addition to this, different provisions scattered across the AfCFTA Agreement and the protocols indicate that investment is centre stage in the AfCFTA. For example, Article 3 of the AfCFTA Agreement, providing the general objectives of the AfCFTA, includes ‘contribute to the movement of capital and natural persons and facilitate investments building on the initiatives and developments in the State Parties and RECs’ as one of this. This provision does two things: it provides facilitation of investment as one objective of the AfCFTA while at the same time indicating that the future protocol on investment might be focused on facilitating investment among state parties, thereby limiting the scope of the protocol. Another point we can garner from this provision is the expectation that negotiations on investment will build on the initiatives and developments undertaken by the state parties and RECs. This requires an assessment of how cross-border intra-African foreign investment is governed/treated.

The regulation of cross-border intra-Africa foreign investment is mainly left to the BITs signed among the African states and to national legislations. As seen in UNCTAD (2021b), 141 of the 733 BITs, excluding other investment agreements, signed by countries in Africa have been intra-African investment agreements. The BITs have responded mainly to two motivations: ‘the formal endorsement of like-minded states sharing a common objective of regulating investment through domestic and international law-making, and the recognition of investment regulation as a means to attract greater investment and to deepen regional integration’
(UNECA, 2016). However, the existence of multiple BITs, all of which exhibit differences in different matters, impedes harmonisation of investment regulation on the continent.

The RECs have also covered the regulation of intra-Africa cross-border investment to some extent. The eight RECs recognised by the AU as building blocks for the formation of the African Economic Community (AU, 2006) have prepared model investment agreements. These generally take the form of guiding instruments for both individual member states and investors.

Some reports indicate that, in general, investment promotion and protection across the continent is marked by disjointed and in some cases contradictory and overlapping regulations (Mafurutu, 2021). This fragmented landscape of investment instruments creates uncertainty for investors. The Pan-African Investment Code (PAIC), developed by the AU, and expected to inform the Investment Protocol, can contribute to addressing the challenges of this fragmented regulatory regime of intra-Africa cross-border investment. However, this instrument, as indicated in the preambular statement, is only a guiding instrument, to be used voluntarily by member states. Its voluntary nature means the aspired to result of harmonising the fragmented regulatory regime may not necessarily be achieved.

Including investment matters in the AfCFTA through the adoption of the Investment Protocol will, however, result in this harmonisation, as the AfCFTA Agreement made the protocols, when adopted, an integral part. However, this assertion must still be made cautiously, as the content of the Investment Protocol is yet to be concluded, and some provisions in the AfCFTA Agreement may be read to suggest that it will focus more on investment facilitation without providing for strong investment protection. This can be gathered from Article 4 of the AfCFTA Agreement, which provides, in dealing with specific objectives, that the state parties shall cooperate on investment, intellectual property rights and competition policy for the purpose of fulfilling and realising the general objectives of the AfCFTA. This provision suggests that the Investment Protocol will be limited to serve as an instrument of investment cooperation, in which case the provisions contained will be similar to the traditional approaches found in certain REC investment instruments (Erasmus, 2021).

On the other hand, some suggest that the Protocol could provide investors with additional legal protection that is not covered in a country’s investment law to mitigate against investment risk on the continent. Such protections are expected to include several protection standards typically found in new-generation investment treaties on the continent and to reflect the policy position of African states on investment protection as espoused in the 2015 PAIC, which is expected to inform the AfCFTA Investment Protocol (Erasmus, 2021) or could be a source on which negotiators will draw. This is because, as with the PAIC, the AfCFTA Investment Protocol is expected to cover standards of protection that relate to (1) expropriation and compensation, (2) the MFN treatment, (3) the national treatment and (4) free transfer of funds (ibid.). However, as it stands now, according to Feris (2021), it is not clear whether the Protocol will contain provisions such as the Fair and Equitable Treatment (FET) Standard or, at the very least, the Minimum Standard of Protection, found under customary international law, or whether intra-African investors will have recourse through investor–state arbitration or a pan-African investment court, or whether they will be limited to domestic courts. The PAIC appears to suggest that the Protocol will omit the FET standard entirely and that access to investor–state arbitration will be subject to the policy position of a particular host government. It is not clear what role investor–state arbitration will ultimately play under the Protocol either.

From Ethiopia’s national interest perspective (as well as its vision, as expressed in its 10-year plan), its laws regarding foreign investment need to be harmonised with the Investment Protocol that it will enter in the context of the AfCFTA. Ethiopia’s vision is based on industrial policy with the aim of structural transformation (industrialisation) and on spurring productive capacities and development in priority sectors, especially those with strong backward and forward linkages and job creation. The Protocol needs to be aligned with such a vision in such a way that market actors do not abuse market power and restrict market entry and focus on rents rather than local product investment, as noted also in UNCTAD (2021b).
Facilitation of FDI in the context of the AfCFTA needs to pay equal attention both to the regulation of FDI and to maximising each country’s national benefit from such an investment agreement. Although traditionally the aims of investment agreements have been to promote FDI and protect the rights of investors, regulating the activities of investors and investment facilitation are becoming increasingly important in modern agreements. Modern investment agreements are also increasingly leaving out dispute settlement, which has become a controversial matter, generally leaving this to BITs (Erasmus, 2021).

UNCTAD (2021b) argues that investment agreements, both bilateral and regional, play a crucial role in regulating provisions and the obligations of investors to ensure sustainable investment. However, as we have seen, by 2020, only 141 of the 733 bilateral investment treaties, excluding other investment agreements, signed by countries in Africa were intra-African investment agreements. When negotiations on the Investment Protocol commence, as part of AfCFTA Phase II, the sole focus will be on attracting intra-African foreign investment. This could in turn lead to attraction of FDI from the rest of the world, if a conducive investment environment is created in the context of the AfCFTA. This is in line with Ethiopia’s vision, since attracting FDI that contributes to sustainable development and inclusive growth is a central objective of the AfCFTA Investment Protocol. Given that countries in Africa are at different stages of development, and that the Protocol will cover all aspects of international investment policy-making – namely, investment facilitation, promotion and protection – discussions on the Protocol may prove complex (UNCTAD, 2021b). They will become even more complex as the Protocol is also expected to include provisions on investor obligations and the right of host countries in Africa to regulate in the public interest and to ensure that benefits from investment and innovation are realised and intellectual property is agreed upon. Meanwhile, some countries already have comprehensive bilateral agreements with others, and problems may arise regarding overlapping membership in RECs as well as in avoiding competition in the provision of incentives (such as tax incentives) so as to avoid the race to the bottom (Erasmus, 2021; UNCTAD, 2021b).

Status of negotiation and challenging issues

Ethiopia is among the countries that signed the AfCFTA Agreement when it was opened up for this purpose in the Kigali Summit in 2018, and ratified it within one year. The impact of the AfCFTA will depend on the specific market access commitments the country makes. Key informants from the Ministry of Trade and Regional Integration claim that the country is preparing its goods offer. In order to help in this regard, studies have been conducted on selected sectors such as textiles, leather and agro-processing. According to key informants, most of these studies are very general and limited in scope, invariably based on simple revealed comparative static analysis. The government wishes to carry out a deeper and sector-by-sector and product-by-product analysis that covers, for instance, the whole production process, starting from, say, hides and skin and ending with the final product, such as jackets, wallets, shoes, etc., for the leather industry. This has not yet been done. As a result, it is not easy for the government to know which of these production processes and specific products are vulnerable (in terms of both their competitive position vis-à-vis their African peers as well as implications for government revenue loss). Similar analysis is needed across at least the major sectors, such as the textiles sector. However, capacity and resources to do this are limited, according to our key informants in the government.

Similar concerns were expressed with regard to services sector liberalisation in the context of the AfCFTA. It is the view of key informants that preparing the services schedule will be complicated, given the protectionist approach of the country resulting from its fear of capital flight. Services negotiations within the AfCFTA framework focus on five priority sectors – business services, finance, communication, tourism and transport – but deeper studies that will inform the government in preparing the services offer are lacking, as a result of capacity and resource constraints. Thus, the general policy direction is to protect some of the sectors
considered strategic by the government, based on a national interest perspective – that is, the government is generally pursuing a defensive posture.

Notwithstanding such challenges, the government has identified a significant number of goods for liberalisation (to the tune of 6,000 goods). It is expected to liberalise 90% of tariff lines in 10 years for these identified products. A total of 7% are on the sensitive list, expected to start liberalising after the end of a five-year grace period. In total, 97% of tariff lines will be liberalised over 13 years. The remaining 3% of the tariff line products are on the exclusion list and not expected to be liberalised at all (this includes 190 products for Ethiopia).

The Ethiopian government has already finished classifying the goods into immediate full liberalisation, sensitive and exclusive, motivated primarily by three factors: avoiding trade diversion, ensuring government tariff revenue and maximising export potential. As Ethiopia does not have much trade with African countries, except Djibouti, Somalia and Sudan, which is limited to a couple of products (e.g. chat and fuel), there is a risk of trade diversion in relation to imports from Ethiopia. That is, there would be a shift from current partners of Ethiopia in terms of import supply towards African countries. This might entail some undesirable effects, such as revenue losses for the government. To avoid or minimise the possible negative effects of trade diversion, therefore, the government is on course to identify the list of products other African countries are currently exporting to the rest of the world and then to study the implications of this for the country if diverted to Ethiopia (that could relate to revenue loss, export potential, food security and other considerations). Whenever the effect is strong, the government puts the product in the sensitive and exclusive products category.

Ethiopian businesses are largely supportive of Ethiopia joining the WTO and the AfCFTA because they believe this will provide security and stability for them, as the government cannot frequently change rules and regulations once it has joined these institutions. However, participation of the private sector in analysis and negotiations for these processes has been limited in general. This is partly related to the weak capacity of the private sector to engage in a substantive manner. Private sector actors are not active in the process as are their peers in other African countries, such as South Africa. As a result, responsibility lies on the government alone. It is highly likely that these challenges will continue during negotiation and implementation of the AfCFTA Investment Protocol.

Regarding the AfCFTA Investment Protocol, key informants indicated that the government had participated in two of the preliminary meetings held by March 2022. These meetings focused generally on the modalities for the discussion of the coming Investment Protocol. As such, the government has not yet made any specific decisions on the details of obligations to bring up in negotiations on the Investment Protocol. We were informed that, at the AfCFTA Secretariat level, a zero draft of the Protocol has already been produced and the negotiators have until September 2022 to finalise this. However, the contents of this draft are currently confidential.

Ethiopia’s general stand is likely to be to negotiate for the non-binding nature of some provisions on issues where it wants protection from its national interest perspective. The country wants this to be more of a cooperation agreement, as a binding agreement could mean losing policy space to attract investment. The government also expects the Protocol to provide preferential treatment for African investors compared with non-African investors. Although the Protocol could be binding merely through ratification of the AfCFTA Agreement, the government envisions it as giving significant leeway for member countries to (1) protect their strategic sectors, (2) offer more policy space, especially in industrial parks, where there are already sunk costs and (3) handle investor–state dispute resolution. Creating an alternative platform for dispute resolution could also be important as an option for countries.

Two challenges emerged in our discussions with experts in the government. The first relates to both the trade protocols and that on investment. Some African countries are highly liberalised and would like to see more liberalisation. This is especially true for small countries such as Mauritius, which have already liberalised most of their tariffs and want more liberalised
trade and investment protocols. However, while Ethiopia has a liberal stand on some sectors, such as manufacturing, this is not the case for other sectors. This stand is largely shared by Nigeria – a country with a large population size, like Ethiopia, that also wants to protect its domestic market. This difference between small and big countries could extend to other dimensions, such as the rule of origin requirement, where small countries are likely to ask for a smaller level of value addition, unlike what Ethiopia wants. Such differences in the level of liberalisation may also come up in investment negotiations.

The second challenge is related to the treatment of African investors and investors from the rest of the world and the issue of various BITs that African countries have signed with non-African countries. The Investment Protocol, as an agreement among African countries, needs to provide special privileges to African investors. One issue in this regard will relate to how to identify whether an investor is African or non-African. The Protocol has to clearly provide parameters in this regard.

Finally, lack of in-depth and detailed study on the implications of both the AfCFTA goods and services protocols and the Investment Protocol for various sectors and sub-sectors, as well as for the Ethiopian development strategy, is another challenge facing the government. Key informants identified the need for up-to-date studies on the implications of the BITs for the Investment Protocol and on the national dispute settlement mechanism and how this relates to similar provisions that may come out in the context of the Protocol negotiations.

**Challenges for foreign investors in Ethiopia**

In addition to challenges at the government level, and notwithstanding the significant improvements in Ethiopian investment law over time, investors currently engaged in the country also confront various challenges that the AfCFTA Investment Protocol could offer an opportunity to address. In our interview with key informants engaged in Ethiopia as foreign investors, four major issues emerged as challenges to foreign investment in the country:

1. Lack of contract enforcement by state
2. Problems arise related to land for investment, often involving power struggles between regional states and the federal state.
3. Capacity shortages exist in implementation agencies, especially in the regions.
4. There is insufficient protection and guarantee against the loss of investment.

The first problem is widespread, related to (and a manifestation of) the weak institutional context of the country, with authorities often not accountable for their arbitrary actions that breach investment agreements. This makes the authorities unpredictable, which in turn erodes investor confidence.

Second, investors generally obtain investment permission at the federal level, whereas land provision is in the hand of the regions, over which the federal state has no power. This has been a major problem for foreign investors in the past. Article 44 of the new Investment Proclamation (2020) has addressed this through provision for the establishment of a Federal Government and Regional State Administrations Investment Council. This will be responsible for handling such challenges in a simplified and synchronised manner, overseeing investment services or establishing a system to do this (regarding both pre- and post-investment services) and addressing disputes. Although it remains to be seen whether this can be easily implemented in practice, this is an encouraging step in the right direction.

Third, implementation of this particular issue, as well as of the new investment law in general in the context of the upcoming AfCFTA Investment Protocol negotiations, requires capacity-building that includes regional investment bureaus.

Finally, investors pointed to concerns related to the security of their investment and guarantees against loss in the case of damage. In recent years, the country has witnessed political unrest that evolved into a full-blown war, leading to the destruction of and damage to
 investor property. The BITs as well as the domestic investment legal framework guarantee security for all investors but the state security forces were not able to avert the damage to these investments. Moreover, financial constraints meant that the government was not able to compensate all of the investors whose investments were destroyed, despite the promises contained in the national and international legal documents. In some cases, the fact that the respective international agreement had not entered into force meant that investors were left without any restitution from either the host or the home state.

In addition to the above challenges, which are common to all types of foreign investor, equity investment firms in particular face other challenges (also relevant for other investors):

1. Lack of legal recognition of shareholder (foreign investors and domestic owners) internal agreements as binding documents in the Ethiopian legal system. This is partly addressed by the new Commercial Code but it is still behind the international standard. Therefore, there is still difficulty of enforcing contracts/agreement
2. Lack of distinction between management control and shareholder control as in the practice of international corporate governance: in the Ethiopian system, the one who controls the shareholding controls the management by default;
3. The difficulty of investing in foreign loans, which would allow portfolio diversification through blending equity and lending for foreign investors, owing to the NBE’s regulation on the foreign interest rate cap, which is less than the London Inter-Bank Offered Rate plus 5%;
4. Lack of an institutional framework and awareness on the negative list of investment, which opens up space for discretionary decisions at the level of implementation authorities;
5. Computation of capital gains for tax purposes that varies significantly from international practice and does not take inflation challenges into account; and
6. Lack of a clear understanding among authentication offices of their actual responsibility and hence a tendency to go unnecessarily to details of the legal aspect of the document instead of sticking to their role as a ‘notary service’.

3.2. Expected impacts for Ethiopia: broad view, industrialisation

The role of both physical and human capital investment in driving growth is well understood in the economic literature. The importance of investment is clear, and hence the need for an attractive investment policy to bring about growth and shape the nature of that growth is crucial. Notwithstanding the central role of domestic investment in this regard, FDI, if well facilitated and regulated, is vital for Ethiopia for a number of reasons.

First, there is a significant gap between investment and domestic savings, owing to low levels of domestic resource mobilisation and the country’s aspiration for a higher level of growth. This resource gap was about 15% of GDP in 2015/16–2019/20 and is not likely to decline soon. Attracting FDI is crucial to bridge this gap. Second, and related to this, is the external gap (the import–export gap, or foreign exchange gap), which is at about the same level as a share of GDP. This has persisted for more than a decade and is also not likely to narrow in the near future. As a result, shortage of foreign currency has become an enduring feature of the macroeconomy. FDI will be helpful in addressing such a shortage.

Third, FDI is helpful to broaden the financial base of growth financing from the external sector, which is heavily dependent on remittances, official transfers and loans. Apart from direct equity participation, foreign companies add to capital formation through foreign investors’ ability and opportunities to raise finance from international financial markets and financial institutions.

Fourth, as the endogenous growth theory and the practice of late industrialising countries (such as Japan, Korea and Taiwan) show, FDI offers host country firms the opportunity for the transfer of technology and managerial skills. The same experience, however, shows that benefiting from these opportunities is conditional on the host government and the private
sector’s ability to properly manage and engage with foreign investors, to include setting up appropriate laws and implementing institutions.

Fifth, the significant investment–savings gap, trade deficit and associated shortage of foreign exchange in Ethiopia are partly a result of poor development of the export sector, which has not been able to match the dramatic growth in imports of the past decade and half (Ethiopia’s imports today have reached a staggering level of $18 billion while exports have remained stagnant at $3 billion for the past 10 years). This has significant implications for indebtedness and strategic vulnerability. Such problems could be addressed in a sustainable manner by attracting FDI in Ethiopia’s traditional and non-traditional export sectors. The country’s effort to develop its non-traditional export sector (in particular the manufactured export sector) through industrial parks can be fully realised only by attracting FDI.

Six, foreign firms, if correctly guided by a smart investment policy, are also important in creating linkages with local firms and can bring about the development of local firms (domestic investment) through sourcing their raw materials and intermediate inputs domestically as well as by creating market opportunities for local firms in the FDI source (invariably developed) countries – thus acting as a catalyst for domestic investment growth.

Finally, the combined effect and most important benefits of both domestic and foreign investment lie in their contribution to job creation, which is crucial for poverty reduction. These attributes entail developing an appropriate investment policy and regulatory framework that is geared towards realising the national vision of Ethiopia.

Given such major benefits of FDI, implementation of the AfCFTA and its Investment Protocol represents an opportunity for Ethiopia that could be leveraged to attract investment and significantly shape it for the national benefit. The Ethiopian government is currently focusing strongly on special economic zones (SEZs) both to attract FDI and to realise its industrialisation drive. The expected effect of the AfCFTA on industrial development on the continent means that careful examination will be needed to exploit opportunities and also address challenges, with early preparation necessary to prioritise the national interest.

According to a recent survey of SEZs, which are akin to Ethiopia’s industrial parks, by UNCTAD in collaboration with the African Economic Zones Organization, FDI in African SEZs is expected to increase by 15% from other members of the AfCFTA and by 30% from outside Africa (UNCTAD, 2021a). In the survey, the vast majority of African SEZs viewed the AfCFTA with optimism: over 85% of respondents expected FDI from other African countries to increase or significantly increase, while 95% expected investment from outside Africa to do so by considering African SEZs as points of entry into the whole continental market. Thus, those countries with an appropriate legal and institutional setup and the most competitive zones are most likely to attract both regional and global FDI. According to survey respondents, the most promising industries for FDI flows in African SEZs post-AfCFTA implementation are agriculture and food, light manufacturing, textiles and electronics. The Ethiopian SEZ/industrial and agro-industrial parks are specialised in these activities. More and more SEZs are also looking to attract investment in the automotive and construction sectors (UNCTAD, WIR, 2021a).

There is thus an opportunity for Ethiopia here, if it can set its laws and institutions in charge of foreign investment in order. This is also an opportunity for structural transformation and industrialisation (that includes transiting towards non-traditional export growth and significant job creation as envisaged in the 10-year plan). Thus, the AfCFTA Investment Protocol needs the utmost attention of policy-makers and relevant government institutions (EIC) and ministries, not only to attract FDI but also to properly manage and regulate such FDI in a sustainable manner to ensure a win-win outcome for both Ethiopia and foreign investors.
The content of the AfCFTA Investment Protocol has not yet been finalised. Although the existing investment law is open and competitive, the Protocol has the potential\(^8\) to offer a framework for an efficient investment information system, which may emerge as a systemic spillover effect of the agreement on the Investment Protocol. It could also serve as an agency of restraint and increase the confidence of investors, which may in turn facilitate further investment. Finally, if member states can come up with a solid Protocol, this could help individual countries avoid the race to the bottom in a bid to attract investment. This may, however, require addressing the intricate relationship between the AfCFTA Investment Protocol and the various BITs into which each country has already entered, guided by a vision of African structural transformation, job creation and sustainable investment and growth.

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\(^8\) The Protocol can increase cross-border investment through economies of scale even if Ethiopian investment law is good. It could also create forward and backward linkages for regional integration and participation in global value chains.
4. Interactions between AfCFTA provisions and domestic law

The coming into force of the AfCFTA in general, and its Investment Protocol in particular, needs to be synchronised with current investment law as well as the various BITs into which Ethiopia has already entered.

The AfCFTA contains 30 articles organised into seven parts. Part I introduces terminologies while Part II presents the establishment, objectives, principles and scope of the Agreement. Part III is devoted to administration and organisation issues while Part IV covers transparency. Issues related to continental preferences are presented in Part V and dispute settlement articles in Part VI, with the last part presenting final provisions. There are three annexes to the Agreement: the Protocol on Trade in Goods, the Protocol on Trade in Services and the Protocol on Rules and Procedures on the Settlement of Disputes. Nine Annexes to the Protocol on Trade in goods are also being prepared. Among these, the Annex on Schedules of Tariff Concession (Annex I) and Annex II on Rules of Origin have not yet been finalised. The remaining seven, i.e., Customs Cooperation and Mutual administrative assistance (Annex 3), trade facilitation (Annex 4), non-tariff barriers (Annex 5), technical barriers to trade (Annex 6), Sanitary and Phytosanitary Measures (Annex 7), Transit (Annex 8) and Trade Remedies (Annex 9) are completed.

PIAC is another document that is expected to shape the negotiations of the AfCFTA Agreement but it is not binding to member African countries. The PIAC defines the rights and obligations of member states as well as investors in the territory of member states. It is expected to be used as a guiding instrument by both (UNECA, 2016).

4.1. Points of convergence

The PIAC does not affect the rights and obligations of member states deriving from any existing investment agreement, whereas it is expected that the incoming Investment Protocol might be the basis for replacing the intra-African BITs or investment chapters in intra-African trade agreements in the future. Member countries are nevertheless currently expected to take into account the provisions of the PIAC when entering into any new agreement with a third country in order to avoid any conflict between their present or future obligations under this Code and their obligations in other agreements. We use the PIAC as a reference in our discussion here not because it is binding but because we presume it will be a framework that informs the incoming AfCFTA Protocol.

The latest Ethiopian investment laws provide sufficient protection and incentives to attract and retain foreign investment, as described above. A detailed analysis reveals significant similarities and complementarity between national and regional laws, especially with regard to the protection of investment (the AfCFTA Agreement and the PIAC). Further, there is a clear article on safeguarding investment through restrictions on expropriation or nationalisation in both Ethiopian law and the PIAC. Expropriation is allowed only under limited conditions, and
the PAIC provides a detailed explanation not only on the conditions of expropriation but also on the procedures and techniques to be followed (Articles 11 and 12).

The AfCFTA Agreement and the PAIC also support competition and take it as the default mode of doing business, and have rules and regulations to support it. This is presented in Article 28 of the PAIC as ‘Competition Law and Policy’. Ethiopia has a separate Trade Competition and Consumers Protection Proclamation to promote competition and protect consumers. Meanwhile, in 2021, the parliament approved a new Commercial Code, to replace the 62-year-old Commercial Code that has governed business operations since 1960. This Code also supports competition and fair trade (see Proclamation No. 166/1960 and Proclamation No. 1243/2021).

In the PAIC, decisions regarding potential areas of investment and whether these are to be handled by domestic, foreign or government investors are left to the member states to decide based on their strategic needs and challenges. We expect this provision will inform the AfCFTA Investment Protocol. This goes very well with the interests and intentions of the Ethiopian government, as our interviews revealed. Such provisions are already seen in Ethiopian laws. Thus, in Ethiopia, the priority areas open for potential foreign and domestic investors, including partnership with government, as presented in Regulation 474/2020, will be a guide for the AfCFTA Investment Protocol. Ethiopian law reserves special areas of investment for joint venture with the government or domestic investors. It can also exclude any form of foreign investment if it is deemed in the national interest to do so. Such provisions in Ethiopian law will be generally in line with the AfCFTA framework if it replicates the PAIC. The AfCFTA Agreement also acknowledges the existence of ‘state trading enterprises’ and requires member states to notify the Secretariat of such enterprises for transmission to other state parties for transparency.

Standards of treatment of investors and investments normally follow MFN and national treatment standards in a more liberalised framework. Ethiopia has around 20 BITs that have entered into force, which require MFN treatment from policy-makers and administrators. The PAIC allows for an exceptional case of treatment where a regulatory measure is taken by a member state to protect or enhance legitimate public welfare objectives, such as public health, safety and the environment and where this act does not constitute a breach of the MFN principles. Similarly, member states may adopt measures that derogate from the national treatment principle and that do not constitute a breach of the national treatment principle if such measures are not arbitrary and the measures are designed and applied to protect or enhance legitimate public welfare objectives, such as national interests, public health, safety and the environment.

There is no inconsistency and conflict observed between the national and regional laws with regard to technology support, traditional knowledge and environmental protection, social responsibility, public–private partnerships, etc.; all share similar views on supporting the above-listed activities.

4.2. Points of divergence

In this section we assess the Ethiopian national investment law to explore if there are points of divergence vis-à-vis the AfCFTA. In this regard, particular points relate to minimum capital requirement for foreign investors, capital share restriction in joint investments, employment of expatriate staff; conditions to own immovable assets; foreign exchange use and transfer of funds; and dispute settlement mechanisms and arbitration procedure.

Minimum capital requirement and maximum shareholding restrictions under joint ventures by foreign investors in Ethiopia are presented in Proclamation No. 1180/2020 and Regulation No. 474/2020. A foreign investor jointly investing with a domestic investor in selected services
sector areas is not allowed to hold more than 49% of the capital,\(^9\) while limitations on the participation of foreign capital in terms of maximum percentage limits on foreign shareholding or the total value of individual or aggregate foreign investment is allowed in the services sector under the AfCFTA Agreement.\(^{10}\) The condition is that the member state needs to specify such requirements (i.e. the ownership percentage cap) in its schedule of commitment. During the negotiation process on the Protocol on Trade in Services, Ethiopia needs to indicate to the other state parties that it wishes to maintain these measures and include them in its schedule. If it fails to include these in its schedule, it cannot do so subsequently. These are areas worth the attention of Ethiopian policy-makers as well as negotiators on the AfCFTA Investment Protocol.

Concerning minimum required capital to be invested by foreign investors in Ethiopia, the amount varies by sector of investment, as noted above (FDRE, 2020a). On the other hand, drafts of the text of the AfCFTA investment code do not set minimum requirement on capital to be invested, as is generally the case in international agreements. Ownership of a dwelling house is conditional on the amount of investment in Ethiopia, as presented in Article 17 of Regulation No. 474/2020. A foreign investor is entitled to own a dwelling house only when the minimum investment has reached $10 million. However, a foreign investor’s right of ownership of immovable property for the purpose of the investment is recognised under the investment law.

In Ethiopian investment law, employment of expats with work permits is possible for top management positions, including those of chief executive officer, chief operations officer and chief finance officer, without restriction. However, employment of other expatriate staff members is possible only when it can be ascertained that Ethiopians possessing similar qualifications or experience required by the sector are not available. For the types of foreign workers permitted, a work permit for employment for up to three years will be issued, and renewed every year subject to verification, as appropriate. A variation with the AfCFTA Investment Protocol on this issue is a real possibility, given the high level of liberalisation in many, especially small (in terms of population size), African countries, according to our key informants in the Ethiopian government.

Other areas where there are similarities between national and regional laws but where there may be differences in practice relate to the treatment of transfers of remittances and funds. The PAIC stipulates that member states shall, subject to national laws, permit all transfers relating to an investment to be made freely and without delay. The latest Investment Proclamation also allows any foreign investor to remit several types of payments and earnings, such as profits and dividends, loan repayments, payments related to collaboration and technology transfer, proceeds from the sale and transfer of shares, etc. out of Ethiopia in a convertible foreign currency at the prevailing exchange rate on the date of transfer. However, the Proclamation limits the right to transfer funds by a domestic investor investing jointly with a foreign investor. Even for the foreign investor, this right could be challenged through a shortage of foreign currency.

Related to this, according to the PAIC, regarding the management of foreign exchange, investors shall have free access to foreign exchange subject to the applicable laws, regulations and monetary policies in member states. However, a member state may adopt or maintain temporary restrictive measures that will be phased out progressively depending on changes in the initial circumstances that have led to the use of the measures. In Ethiopia, the NBE is the main authority in foreign exchange management, and there have been many directives issued to this effect. Given the lingering problem of shortage of foreign currency reserves in Ethiopia, the NBE has been rationing foreign exchange and has been issuing restrictive policies on foreign exchange management. As discussed previously, for instance, the latest NBE directive (No. fdx-79-2022) requires all private banks to surrender 70% of the

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\(^9\) Article 5, Sub-article 2 of Regulation No. 474/2020.
\(^{10}\) Protocol on Trade in Services, Article 19, Sub-article 2(f).
foreign exchange generated by their clients to the NBE, with the exporter receiving only 20% of the foreign exchange amount in foreign currency. The remaining 10% of the foreign exchange generated is sold to the respective bank of the client at the current buying rate. According to the protocols on trade in goods and services, such measures shall be equitable, non-discriminatory, in good faith and of limited duration and may not go beyond what is necessary to remedy the balance of payments situation. When the balance of payments problem is structural and has been around for a long period, the regulator actions may contradict with the provision in the regional investment code, as is the case (and would also be the case) in Ethiopia.

There are some issues not covered in the AfCFTA Agreement and the PAIC but that are considered essential in domestic laws, such as reporting periods and investment termination conditions, as discussed above. Other issues that violate the provisions of the Ethiopian Investment Proclamation, and its regulations and directives, include intentionally or negligently presenting incorrect reports; obtaining or renewing investment permits fraudulently or by submitting false information or statements; using investment permits incompatibly with the objective for which they were issued; failure to renew a permit without good cause; failure to complete a project within the time limit (two years after the permit is issued); and delaying completion of a project by two years from the time to be agreed with the appropriate investment organ.

Another issue of concern in administering international investment is the dispute settlement system. The PAIC and the AfCFTA Agreement present two different approaches to solving disputes in the region. The PAIC provides for both state–state and investor–state dispute settlement, while the AfCFTA dispute settlement protocol provides only for state–state dispute settlement, similar to the WTO mechanism. It is important to note, then, that the dispute settlement system of the AfCFTA does not entertain investor–state disputes. Investors can be represented by their respective states in the dispute settlement process, and this provides limited access to investor protection. However, the PAIC provides mechanisms to solve investor–state disputes that could be considered in the development of the AfCFTA Investment Protocol.

According to the PAIC, for a state–state dispute involving arbitration, such arbitration shall be conducted at any established African public or African alternative dispute resolution centre. If they are unable to resolve disputes at the centre, any of the disputing member states may refer the matter to the African Court of Justice, whose decision shall be final and binding.

For investor–state disputes, exhaustion of local remedies is an essential requirement before proceeding to arbitration, and the investor and the member state should initially seek to resolve the dispute within six months, through consultations and negotiations, which may include the use of non-binding third-party mediation or other mechanisms. The dispute may be resolved through arbitration; where recourse is made to arbitration, this may be conducted at any established African public or African private alternative dispute resolution centre based on United Nations Commission on International Trade Law (UNCITRAL) rules.

The national (Ethiopia’s) dispute settlement mechanisms share some common foundations with dispute settlement mechanisms in the region, such as in giving priority to consultation or negotiation to solve the problem amicably (this is without prejudice to the party’s right of access to justice through a competent body). The government may also agree to resolve investment disputes involving foreign investments through arbitration, and the court selected could be in Addis Ababa or in a foreign country depending on the agreement between the investor and the Ethiopian government. Some investors prefer International Chamber of Commerce arbitration as an avenue for settlement of any potential disputes.

Overall, with just a few discrepancies between national and pan-African investment laws (the latter is not mandatory but could be influential, as noted), we see several similarities and complementarities between the two. Areas of disparity that require further consideration for
harmonisation include ownership rights of a dwelling house, which is conditional on the amount of investment in Ethiopia. Other points of attention include the minimum capital required from foreign investors; the capital share restriction on foreign investors in joint investment scenarios; employment of expatriate staff; foreign exchange use and transfer of funds; and dispute settlement mechanisms and arbitration procedures, where the national law seems generally limiting. It is important that Ethiopia negotiators identify important areas in the PAIC that could help them negotiate in the Investment Protocol with the aim of benefiting fully from the finished product.
5. Conclusions: priority actions and support measures

The AfCFTA and its Investment Protocol envisages to create a common market for goods and services, investment and free movement of labour. The agreement can lock in policies of a country by serving as agencies of restraint that force a country to follow the commitments it has made in such arrangements. This could provide a more attractive investment environment which can help to attract FDI. Attracting FDI has various benefits including bringing new capital, transfer of technology and managerial skills, promoting employment and reducing poverty. These are major reasons to design incentive schemes to attract FDI. However, the experience of successful African economies over the last four decades shows that a country’s investment policy needs to be designed in a broader context. Investment policies need to encourage investments that bring about structural transformation/industrialisation, raise productivity in agriculture and benefit small and medium-sized enterprises, which are all key factors in inclusive growth and poverty reduction through decent job creation. The AfCFTA and its Investment Protocol should be taken as one such opportunity for sustainable development and growth.

This briefing has highlighted the major challenges and benefits of the Protocol (which is expected to be concluded later this year). A deeper understanding of the issues will require addressing the gaps identified in this briefing and in potential future sector-specific studies.

To benefit from the Investment Protocol’s opportunities, Ethiopia needs to address the following challenges. Each of the challenges identified is followed immediately by its implications for policy.

*The first challenge relates to synchronising national investment laws with the various BITs, WTO provisions (when Ethiopia accedes) and the AfCFTA Investment Protocol.* Ethiopia has signed 35 BITs so far, and 22 of them are in force while 12 recently signed treaties are not in force. Negotiation of the Investment Protocol offers Ethiopia the opportunity to address this challenge. The process of synchronisation needs to be guided by Ethiopia’s vision of structural transformation and job creation through supporting strategic sectors, especially those with strong backward and forward linkages and job creation.

The government of Ethiopia should address the following areas ahead of time if the country wants to benefit from the AfCFTA Investment Protocol:

- The Investment Protocol needs to ensure that market actors do not abuse market power, restrict market entry or focus on rent extraction with little value added. Thus, the protection of investors needs to be balanced with regulating the activities of investors and investment facilitation, which are becoming increasingly important features of modern agreements.
- Ethiopia should be ready to exploit the AfCFTA’s potential to address anticompetitive practices by negotiation alignment with its competition law. The synchronisation can also be extended to incorporate dispute settlement issues.
- Areas to consider around harmonisation of investment law include ownership rights of immovable property; minimum capital required from foreign investors; capital share...
restrictions; employment of expatriate staff; and foreign exchange use and transfer of funds.

The second challenge relates to the proper implementation of laws. The Ethiopian investment law provides generous incentives to attract FDI and is also well targeted to indigenous ownership, job creation and related safeguard measures. However, there needs to be a proper implementation of laws in an efficient, timely, cost-effective and transparent manner. The challenges of proper implementation of laws are found to be pervasive in relation to access to land for investment contracts enforcement, lack of internal coordination between regional states and the federal state in deciding on investment-related issues, especially on land. The government could focus on the following areas:

- **Strong supervision and review of FDI applications to restrict fraudulent investments** as the country has incurred loss and experienced abuse of the law by some foreign investors in recent years.
- **Improve the capacity problems in implementation agencies, especially in regional government.** The list of responsibilities given to the EIC are enormous, ranging from policy formulation to implementation. And yet it appears that the EIC does not have sufficient capacity to undertake them in an efficient and cost-effective manner. Therefore, first there is a need to streamline and simplify the activity of the EIC and coordinating its work with regional bureaus of investment and establishing clear responsibilities for the implementing organs of the institution and making them accountable when they fail to perform their duties in a time-bound context. Second, in the medium to long run, engaging in significant capacity-building at the EIC continuously and implementing appropriate staff retention schemes to avoid high staff turnover will be important. Unless these investment implementation challenges are addressed upfront, any further improvement in the investment law through the AfCFTA Agreement to attract and benefit from foreign investment will be less effective.
- **Make the implementation steps and responsibilities transparent through an open information technology system that can be monitored both by investors and by responsible higher authorities.**
- **Speedy establishment of the proposed investment council; quick resolution of land disputes jointly through the EIC and regional authorities until the council begins functioning; and efficient communication with existing foreign investors who have such problems are some of the policy actions that authorities could take as a positive signal in attracting investment.**

The third challenge is the lack of a stable political and macroeconomic environment. For more than two decades, there have been persistent and chronic foreign exchange shortages, high inflation and a chronic balance of payments deficit. In addition, the National Bank of Ethiopia frequently changes the foreign currency surrender rate, which is 70% at the moment. Furthermore, there is periodic violent conflict that at times leads to destruction of property (in short, political instability). These are challenges to attract FDI. Therefore, government should consider to

- **Provide better access to foreign exchange for investors engaged in exporting and import-substituting activities.** This would be a short-term policy direction worth looking into to alleviate the chronic foreign exchange problem and attract foreign investment at the same time.
- **Engage in less frequent change of the surrender rate provides confidence to business and reduce uncertainty.**
- **Making sure the success of industrial parks across the country.** These policies are important to attract FDI and most likely consistent with the multilateral and bilateral trade and investment agreements the country aims to join.
The fourth challenge relates to the high cost of doing business in Ethiopia and its implications for foreign investment. Ethiopia remains below regional and world averages in the rankings on cost of doing business. This relates to poor scores on current logistics infrastructure and associated high land transportation costs, bureaucratic delays in general and delays at customs in particular and corruption. In addition, Ethiopia is a land locked country with the majority of imports and exports pass through land via Djibouti. The government should consider to

- Focus on investment facilitation and enhanced incentives,
- Streamline organisations responsible for import and export licenses, tax payments, commercial bank permit for hard currency, etc
- Open import and export transit corridors and seaports, and
- Strengthen and implement the decision to allow international logistic services to participate and invest in the country.

Finally, in many African countries, an emerging trend relates to the significant engagement of firms from emerging economies such as China, India and Turkey, among others, both in traditional FDI sectors and also in major investments of host countries financed by credit (or vendor financing) from governments of these emerging economies. This is a new grey area of ‘foreign’ investment which requires the attention of policy-makers because of its sheer magnitude and fast growth. Vendor financing-based investment from China’s EXIM bank in Ethiopia, for instance, is much more important than Chinese FDI in Ethiopia. This area is also worth studying in more detail.
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