Policy brief

Supporting Investment and Trade in Africa

Ethiopia and investment provisions in the AfCFTA: issues and challenges

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

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Key messages

This briefing paper examines Ethiopia's current investment protection regime (including its challenges) and provides practical suggestions on how Ethiopia can leverage the African Continental Free Trade Area (AfCFTA) Investment Protocol to ensure that it can support a robust, clear, and predictable investment environment in Ethiopia.

Ethiopia's new Investment law liberalises significant sectors of the investment field for foreign investment. It follows the negative list approach, which provides transparency and predictability of the investment administration system, and provides procedures for handling investors' grievances and settlement of investment disputes. However, speedy setup of the new investment council, quick resolution of disputes on land issues by a joint Ethiopian Investment Commission (EIC) and regional authorities committee (until the council begins functioning), and effective and efficient communication with foreign investors that have such problems is necessary.

The African Continental Free Trade Area (AfCFTA) investment protocol can be leveraged to attract foreign direct investment (FDI) to Ethiopia. Synchronising bilateral and multilateral agreements with domestic economic policies, as well as developing a negotiation position on the National Special Economic Zone Policy to attract FDI, will help Ethiopia prepare ahead of time. This policy brief provides possible actions to address these issues.

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1. Introduction

Following the change of government in Ethiopia in 1991, the economic policy of the country changed from a command economy to a market economy. As a result, the government introduced several reforms, including allowing foreign investment, especially in the manufacturing sector, and several state-owned enterprises that were nationalised during the communist government were privatised. Ethiopia has also passed several laws and commitments to attract foreign investment. It has signed 35 bilateral investment treaties (BITs), became a member of the Multilateral Investment Guarantee Agency, and is a member of the Common Market for Eastern and Southern Africa (COMESA). Although Ethiopia has not ratified the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, it has agreed to use the Additional Facility of the International Centre for Settlement of Investment Disputes (ICSID) (Hagos, 2022).

Despite the profound and far-reaching reforms, the economic growth in the 1990s was not encouraging. However, starting from the 2000s, Ethiopia has registered impressive economic growth. Over the last two decades, using official data, the country averaged economic growth of 9% between 2000-2019, resulting in a fall in poverty, increased life expectancy, and other improved human development indicators. However, the economic growth during this period was driven by substantial public investment in infrastructure, the manufacturing sector, energy, transport, and communications, resulting in a rapid pile-up of domestic and foreign debt, acute shortages of foreign exchange, and persistent double-digit inflation between 2011-22 (IMF, 2020).

As a result, in 2018, the new Ethiopian government embarked on a comprehensive economic reform and liberalisation programme – termed 'Homegrown Economic Reform' – running from 2018 to 2021[1]. One of the key features of the reform 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. 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. As a result, the country has passed a new investment proclamation and regulation in 2020 that gives more priority to the private sector to play an active role in the economy for sustainable development.

It is in this environment that Ethiopia has ratified the Africa Continental Free Trade Area (AfCFTA). AfCFTA and its Investment Protocol are important because they offer market and investment opportunities and 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. Moreover, the AfCFTA and its Investment Protocol should be taken as an opportunity to strengthen existing institutions or create new institutions and provide further incentives to shape investment policy generally. Therefore, in addition to the domestic reforms, implementing the AfCFTA and its Investment Protocol represents an opportunity for Ethiopia that could be leveraged to attract investment and significantly shape it for national benefit. For instance, the Ethiopian government is focusing strongly on special economic zones (SEZs) to attract FDI and realise its industrialization 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,

[1] 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%.

with early preparation necessary to prioritise the national interest.

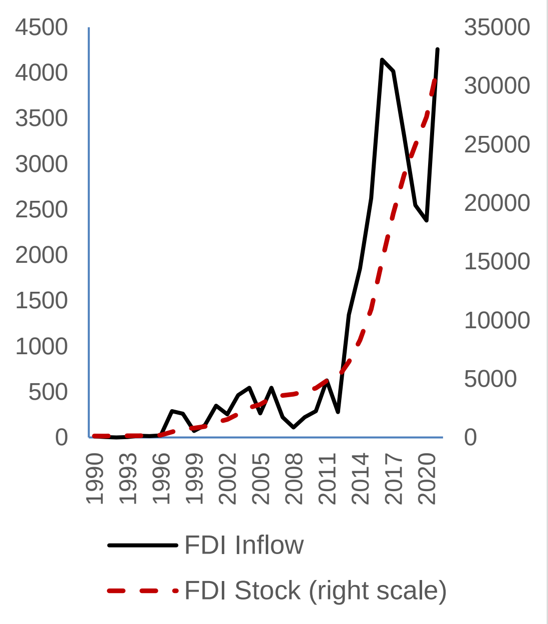
This briefing paper examines Ethiopia's current investment protection regime (including its challenges) and provides practical recommendations on how Ethiopia can leverage the AfCFTA Investment Protocol to ensure that it can support a robust, clear, and predictable investment protection system in Ethiopia.

The rest of the briefing is organised as follows. Section 2 presents background information on Ethiopia's FDI performance. Section 3 provides a brief overview of the Ethiopia new investment Proclamation and regulation. Section 4 point out outstanding challenges and the AfCFTA Investment Protocol and challenges. Section 5 provides for policy actions to enhance Ethiopian investment policy.

2. Recent FDI performance

Although the Ethiopian economy was liberalised for foreign investment starting from 1991, the overall FDI inflows to the country were very low until 2013, mainly because of weak private investment policies in the 1990s and early 2000s and the protracted civil war before the 1990s (see Figure 1). 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. This had further increased to $27.5 billion in 2020 – thus, FDI has grown more than fivefold in the past 10 years. The figure also shows that the pandemic has significantly affected the level of FDI in 2020, at $2.4 billion, which was very low compared with the levels registered in 2016–2019, but it has quickly recovered. Preliminary information from the Ethiopian Investment Commission (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 selling the first private telecom license, at $850 million, to Kenya's Safaricom and its consortium of investors.

Figure 1 Pattern of Foreign Direct Investment (FDI) 1991-2020, $ million



Source: Own calculation from UNCTAD

The EIC 2015 data show that China is the primary source of 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 Ethiopia's total stock of FDI (EIC, 2015; Addis, 2022).

Unlike many countries in Africa, where FDI is invariably destined for the natural resource-intensive sector (Alemayehu, 2019), FDI in Ethiopia goes primarily to manufacturing. As a result, the manufacturing sector took about 70% of FDI stock between 1992 and 2017 (45% and is 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).

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 to spur growth and 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 intra-regional 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, 2021).

3. The Ethiopia National investment policy

Ethiopia aims to attract foreign investment. While the country's investment law and environment are critical to attracting foreign investment at the national level, other investment agreements can play a complementary role in encouraging investment. Ethiopia has signed 34 Bilateral Investment Treaties (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.[2] South Africa has also terminated its BITs with Ethiopia.[3] 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,[4] only five are in force – those with Sudan, Tunisia, Egypt, Libya, and Algeria. Ethiopia is a member of the Common Market for Eastern and Southern Africa (COMESA), established in 2000 but has not joined the free trade agreement. 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. Furthermore, Ethiopia also agreed to use the Additional Facility of the International Centre for Settlement of Investment Disputes (ICSID) despite not ratifying the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (Hagos, 2022).[5]

The new Investment Proclamation and Regulation

In 2020, in line with the reform agenda, the Ethiopian government passed a new Investment Proclamation and Regulation (Negarit Gazeta, Proclamation No. 1180/2020). Among others, the new

2 https://investmentpolicy.unctad.org/international-investment-agreements/countries/67/ethiopia

3 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 (UNCTAD, 2000).

4 Sudan, Tunisia, Egypt, Libya, Algeria, Nigeria, South Africa, Morocco and Equatorial Guinea.

5 Different perspectives exist on the impact of bilateral investment agreements and investment flows in a country. For example, Hallward-Driemeier (2003) and UNCTAD (1998) find little evidence of any positive impact of BITs on FDI. On the other hand, Kox and Rojas-Romagosa (2020) and Egger and Pfaffermayr (2004) find a significant and positive impact of ratified BITs on FDI.

investment law's three main features are discussed below.

Liberalisation of the investment filed for foreign investment: The new Investment Proclamation and Regulation enacts and envisages four investment modalities. The first categories are joint investments between the private sector and the government; the second category is investments exclusively reserved for domestic investors, such as financial services, the transmission of electric energy, primary and middle-level health services, wholesale trade, and retail trade. The third categories are investments reserved for joint investment between domestic investors and foreign investors, such as logistics, accounting and auditing services, domestic air transport, and audio-visual services, but the foreign share is restricted not to be more than 49% of the firm's capital. The fourth category is that all other areas of investment not listed in the new Proclamation (and in the Regulation) are open to foreign investment. Furthermore, sectors that were exclusively reserved for the government are now open to either joint investment with the government or domestic investors or for all private investors, such as telecommunication and financial sectors.

Follows the negative list approach: 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. The negative list approach would help to increase investment attraction, retention, and expansion in Ethiopia by making the investment administration system transparent, predictable, and efficient (Hagos, 2022).

Handling of investors' grievance and settlement of investment disputes: The new Proclamation has provided a procedure for filling grievance and settlement of investment disputes. Investors can complain their grievance about their investment to the appropriate investment organ. It aims to provide speedy, equitable and efficient producers. The investor can lodge grievance to the commission's decisions, and to the government executive bodies. The new investment proclamation contains settlement of investment-dispute between an investor and government. The proclamation says that "The Federal Government may agree to resolve investment disputes involving foreign investments through arbitration." It also says, "Where a foreign investor chooses to submit an investment dispute to a competent body with Judicial Power or arbitration, the choice shall be deemed final to the exclusion of the other."

4. The AfCFTA Investment Protocol and challenges

The AfCFTA aims to eventually create a single continental market for goods and services and the free movement of persons. We identify a range of challenges below and discuss the policy implications.

Regarding the AfCFTA Investment Protocol, the government had participated in two preliminary meetings held by March 2022. These meetings generally focused on the modalities for the discussion of the upcoming Investment Protocol. As such, the government has not yet made any specific decisions on the details of obligations to bring forward in negotiations on the Investment Protocol. During the research we were informed that, at the AfCFTA Secretariat level, a zero draft of the Protocol has already been produced, and the protocol has now been finalised.

The first challenge relates to synchronising national investment laws with the various BITs and the AfCFTA Investment Protocol. Ethiopia has signed 35 BITs, of which 22 of are in force, while 12 recently signed treaties are not yet in force. As aforementioned, Ethiopia passed a new investment Proclamation and Regulation in 2020. The negotiation of the Investment Protocol offers Ethiopia the opportunity to synchronise various disparities in the BITs and investment laws. The synchronisation can also be extended to incorporate dispute settlement issues. The new Ethiopia investment Proclamation and Regulation provides guidance on how investors lodge their grievances. If not solved with discussion and arbitration, the new investment proclamation provides investor-state dispute settlement mechanisms, which were not available in the previous investment law. The AfCFTA Investment Protocol is expected to cover standards of protection that relate to (1) expropriation and compensation, (2) the most-favoured-nation (MFN) treatment, (3) the national treatment, and (4) the free transfer of funds (Erasmus, 2021). The Ethiopian government needs to ensure that such foreign investment laws must be harmonised with the AfCFTA Investment Protocol.

Other areas of disparities that require further consideration for harmonisation include ownership rights of immovable property; the minimum capital required from foreign investors; capital share restrictions; employment of expatriate staff; and foreign exchange use and transfer of funds. The Government of Ethiopia must work on these areas ahead of time so the country can benefit from the AfCFTA Investment Protocol.

The second challenge relates to capacity to properly implement the laws. The new Ethiopian investment law is an improvement from the previous law in terms of liberalising several sectors of the economy that were either exclusively granted to the state, or domestic sectors providing a mechanism to lodge a grievance and investor-state dispute settlement mechanics. However, there is a need for proper implementation and enforcement of investment and other laws. The challenges of proper implementation of laws are pervasive in relation to access to land for investment contracts enforcement and a 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 governments. Furthermore, there is need for a trusted judicial system that is independent, efficient, and competent to handle investment disputes to implement the law successfully (Hagos, 2022).

As the capacity challenges noted above are related to the institutional dimension of implementation, this will also have implications for the AfCFTA investment protocol negotiations and implementation once the agreement is signed up. The Investment Protocol may not effectively facilitate investment in 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, continuously engaging in significant capacity-building at the EIC 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. Attracting foreign investment usually requires a stable macroeconomic environment. The National Bank of Ethiopia (NBE) frequently changes the foreign currency surrender rate, creating uncertainty and unpredictability. In addition, the current foreign currency surrender rate stands at 70%, which is relatively high for the investor, and could cripple any incentive to invest more in the future. Furthermore, it may also lead to illicit activities (such as over- and underinvoicing of imports and exports, respectively) for those already engaged in Ethiopia.

The fourth challenge relates to the costs of doing business in Ethiopia. Ethiopia is a landlocked country with underdeveloped infrastructure and associated high land transportation costs, bureaucratic delays, delays at customs, and corruption. 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, and more.

5. Possible actions

The AfCFTA and its Investment Protocol envisage creating a common market for goods and services, investment, and free labour movement. The agreement can lock in a country's good policies by serving as agencies of restraint that force a country to follow the commitments it has made in such arrangements. The table below summarises the policy implications of this briefing, both for the Government of Ethiopia and support agencies. The AfCFTA and its Investment Protocol should be taken as one such opportunity for sustainable development and growth.

Table 1 Possible actions around AfCFTA and investment issues in Ethiopia.

Investment Protocol issue	Link to AfCFTA	Possible action/options for government in relation to investment (short run)	Further complementary actions/support needed (medium run)
Aligning existing laws and the AfCFTA Investment Protocol	Provisions on investment protection in AfCFTA	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	Deeper studies and/or capacity-building on strategy and scenarios for negotiation
Implementation of laws, especially by regional governments, that include disputes with land access and use issues	Investment facilitation in AfCFTA Investment Protocol	(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	(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 supported by transparent ITC platform
Stable political and macroeconomic environment	AfCFTA to lead to better public–private dialogue that can help address these issues	Inclusive politics and peaceful resolution of conflicts	Capacity-building in macroeconomic management
Foreign exchange shortage and rationing	Not explicitly related to AfCFTA (it is, rather, a national problem)	A special focus on investment facilitation and enhanced incentives, including extended access to foreign exchange, for investors engaged in exporting and import-substituting industries	Attracting investment from the African region, including limited offering of equities in profitable public firms
The use of industrial parks (SEZs)	Possible issues around harmonisation of investment protocol and SEZ policies	Developing a negotiation position about their further use in the context of the Investment Protocol will help Ethiopia prepare ahead of time	
Implications of investment financing from emerging economies for FDI	Upcoming negotiations on the Investment Protocol of the AfCFTA	Deliberating on this issue during the negotiations on the Investment Protocol	A deeper study on implications for attracting FDI and how to handle both types of investment in the future

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