

Chapter Four - Regulation of Investment

- **Regulation** of investment refers to different controls made by governments/states.
- **Which state** regulates investment?
- As investment activities are undertaken in the territory of host state, much of the regulation is made by host state.
 - The right of a state to control foreign investment is unlimited, as it is a right that flows from sovereignty - a universally recognized rule (unless it surrender its rights by treaty, in which case the requirements set by the treaty).
- However, home states to some extent may also regulate the activities of companies headquartered in their territory but investing in other countries.

- **Why home state?**

- The **capital source** is the home state.
- There is a **tax issue** (if the home state impose tax based on nationality). This is why states enter in to a **double tax avoidance** treaty.
- Some developed countries may want **to make sure their companies do not engage in undesired activities** such as corruption, human rights violation, environmental damage.
 - Because developing countries mostly have **no chance to control the TNCs or seek compensation from TNCs**. Based on tort, countries seek compensation from home state (Nigeria vs. Shale/US company).

Stages of Regulation

- Regulation of foreign investment can generally be made in **three different stages**; during entry, establishment and operation, and withdrawal.
- **During the first stage** i.e. at the time of entry, the **main issue is the investment areas allowed for investors**. The areas may be:
 - Exclusively reserved for **the government**
 - Exclusively reserved for **domestic investors**
 - Opened or **closed for foreign** investors
 - **Joint investment** (with a combination of the above, as the case).

- **Why countries classify investment areas as above?**
 - National interest (general objective)
 - To encourage domestic entrepreneurship.
 - To make sure some strategic sectors are in the hand of a government or a national investor.
 - This is depending of level of development (banking sector may be strategic for us but not for Developed ones) and
 - Differ from time to time (a sector strategic for now may not be in the future).
 - National security (e.g., weapon manufacturing).

- The **second stage** regulation (establishment and operation) - much of the regulation is made here.
- Once a foreign investor enters a state, both he and his property are subject to the laws of the host state.
 - The foreign investor has voluntarily subjected himself to the regime of the host state by making entry into it.
- Such regulations relate to;
 - Getting different permits like investment and business license
 - Minimum capital requirements
 - Local equity requirement/requirements related to joint venture
 - Export requirements

- Local content requirement,
- Job creation/employment requirements
- Environment related requirements (such as EIA, if the area needs so and if so the requirement is through out the undertaking/follow up)
- Local research (such as the adaptation of the products to local conditions).
- Requirements related to value addition (There may be a requirement that the processing of minerals should take place locally so that more activity associated with the mineral industry takes place within the state and more value is thereby added to the product within the state before export).
- Any other requirements imposed during establishment and operation such as under tax, labor, laws

- At the **third stage** - regulations by the time a foreign investor withdraws his investment from the territory of a host state.
- Investors cannot withdraw their investment overnight once they decide to discontinue their investment activity.
- Host states impose different procedures that should be followed by investors when they withdraw their capital out of the country;
 - Rules that govern the process of winding up and dissolution of business organizations. For instance, if they have loan, make sure they paid.

Rationales for Regulation of Investment

- As measures to regulate investment are different, the rationales for each measure also differ.
- **The rationale for regulation of investment during entry/admission**
- It mainly relate to issues of the impact of foreign investment on the local economy.
 - It has the task of ensuring that local entrepreneurs are not affected by the entry of a powerful foreign companies into some industrial sectors.
 - The question of discrimination against a foreign national arises, if such measures are taken after entry.

- There are sound economic reasons for excluding foreigners from certain industries.
 - In developing countries, such exclusion is rationalized on the basis that it would be better that basic industries be handled by local entrepreneurs as otherwise a state could be left abandoned by a foreign multinational which relocates at any point in time in the future.
 - Another reason is that the entry of a foreign business giant may stifle the emergence of an entrepreneurial class within the state.

- Care is therefore taken to ensure that, while **high technology** industries which local entrepreneurs cannot handle without help from outside are open to entry to foreigners, **low-technology, labor-intensive areas are reserved for nationals**.
- Industries associated with the **production of military equipment** are rarely open to foreign interests. This is justified on **national security considerations**.

- **Some of the regulations and their rationales during establishment and operation.**
- Minimum capital/capitalization requirement. Foreign investors are required to bring some amount of capital from the outside world to a host state rather than coming to a host state with the aim of raising capital domestically.
- States may require that a foreign investor seeking entry should bring in the capital from overseas. Otherwise;
 - Local savings/funds that could be utilized for some project of benefit to the state (to finance local entrepreneurs or projects) would be absorbed in serving the interests of the foreign investor.
 - Plus the assumed benefit of foreign investment – capital inflow – will be nullified if the investor raises his capital on the local markets.

- Export requirements; The strategy of development adopted by developing states has moved away from manufacturing within the state to substitute imports to a strategy of earning income through the export of goods.
 - Shift from import substitution to export-led growth.
 - With this aim, there have been efforts made to encourage exports by multinational corporations by the conferment of privileges or through tax and other incentives.
 - The model for such development is provided by the newly industrializing states – Singapore, South Korea, Taiwan and Hong Kong.

- Joint ventures/requirements relating to local equity; requiring a foreign investor to give a share for either the host state government or domestic investor.
 - It enables a more effective transfer of management and technology to the local joint venture partner – maximizes one of the assumed benefits of foreign investment.
 - A smaller proportion of the profits will be repatriated abroad,
 - It ensures that the state has a direct or indirect control over the venture.
 - Helps the emergence of a local entrepreneurial class (benefited from its association with foreign investors through the acquisition of managerial and business skills).
- Employment requirement.
 - To reduce the level of unemployment in the host state, thus ensuring that the perceived benefits of job creation, the transfer of skills to the local labor and management are made a reality.

Regulation of Investment in Ethiopia

- Currently the governing laws or the main **legal frameworks** **are;**
 - Proclamation No. 1180/2020
 - Regulation No. 474/2020
 - Regulation No. 270/2012, relating to incentives
 - Proclamation No. 886/2015 and Regulation No. 417/2017; **concerning Industrial Parks.**
- Art 6 (2) proc. No 1180/2020 states that areas of investment reserved for joint investment with the Government, for domestic investors, and for joint investment with domestic investors shall be specified by Regulation (Investment Regulation No 474/2020).

Regulation at entry

Art 3 of the regulation provides Investment areas Reserved For joint investment with government

- Manufacturing of weapons and ammunitions – national security
- Import and export of electrical power- It's a basic industry and private investors may not fix fair price, gov't will balance accessibility and export
- International air transport service - to protect the public enterprise (Ethiopian air line)
- Bus rapid transit - private investors may not fix fair price
- Postal service, except courier service (such as DHL) - fair price or affordability. Security issue used to be a justification but currently not much accepted since as a result of technological advancement secret information of a government can be exchanged by other means.

Art 4 of the regulation provide Investment areas Reserved For domestic investors

- Banking, insurance, microfinance businesses - the need to control basic or strategic sectors in the hands of Ethiopian nationals
- Transmission and distribution of electrical energy through integrated national grid system
- Primary and middle health service
- Wholesale/Retail trade excluding wholesale/retail of electronic commerce and own products produced in Ethiopia
- Import trade excluding liquefied petroleum gas and bitumen
- Export trade of raw coffee, khat, oilseeds, pulses, minerals, hides and skins, products of natural forest, chicken and livestock bought on the market

- Construction and drilling service below Grade 1
- Hotel, lodge, resort, motel, guesthouse and pension services, excluding those that are star designated
- Restaurant, tea room, coffee shops, bars, night club and catering services excluding star designated national cuisine restaurant services,
- Tour operation, travel agency, travel ticket sales and travel auxiliary services
- Operating lease of equipments, machineries and vehicles, excluding industry specific heavy equipments, machineries and specialized vehicles

- Transport service excluding rail way, cable car, cold chain, freight transport having a capacity of more than 25 tones
- Making indigenous traditional medicines
- Producing bakery products and pastries for domestic market
- Grinding mills
- Barber shop and beauty salon services, and tailoring except by garment factories
- Maintenance and repair services including aircrafts, but excluding heavy industry machineries and medical equipments
- Media service

- Brick and block manufacturing
- Lottery and sports betting
- Laundry service except on industrial scale
- Translation and secretarial services
- Security and brokerage services
- Attorney and legal consultancy services
- Private employment agency, except for seafarers and other similar professionals that require high expertise and international experience and network

**Art 5 (1) of the regulation provides Investment areas Reserved
For joint investment with domestic and foreign investors;**

- Freight forwarding and shipping agency services
- Domestic air transport service
- Cross-country public transport service using buses with a seating capacity of more than 45 passengers
- Urban mass transport service with large carrying capacity
- Advertisement and promotion services
- Audiovisual services, motion picture and video recording, production and distribution
- Accounting and auditing services
- Art 5 (2) of the regulation states that a foreign investor jointly investing with a domestic investor shall not hold more than 49% of the share capital of the enterprise

Regulation during establishment and operation

(1) Minimum Capital Requirement for foreign investors

- One of the purposes of attracting foreign direct investment is to attract foreign capital to the host state. To achieve this, a foreign investor is required to allocate the following minimum capital.
- **Art 9(1) of the proc** Any foreign investor, to be allowed to invest shall be required to allocate a minimum capital of USD 200,000.00 for a single investment project
- **Art 9(2)** the minimum capital required of a foreign investor jointly investing with a domestic investor shall be USD 150,000.00. these is to encourage foreign investors to invest in joint venture with domestic investors.

- **Art 9(3)** the minimum capital required of a foreign investor investing in architectural or engineering works or related technical consultancy services, technical testing and analysis shall be: (a) USD 100,000.00 if the investment is made on his own; (b) USD 50,000.00 (fifty thousand) if the investment is made jointly with a domestic investor.
- The reason may be, for one thing, the areas mentioned are more of intellectual works that do not as such require the movement of huge capital. For another, the areas cannot be easily undertaken by local people as there is lack of experts in these areas in the country. Therefore, it is a means of encouragement for foreign investors to invest in these areas. This is aimed at filling the gap of shortage of expertise in the country through foreign investment.

➤ **Art 9(4)** The minimum capital requirement under this Article shall not apply to:

(a) Foreign investor re-investing his profits or dividends generated from his existing enterprise. The main aim of this arrangement is targeted at reducing the amount of money that might be repatriated outside of the country in the form of dividend.

(b) Persons elected as members of board of directors following the change of a private limited company to share company; (legitimizing the concept and practice of nominal shareholding to qualify as director) and

(c) A foreign investor buying the entirety of an existing enterprise owned by a foreign investor.

➤ in order to effectively control whether foreign investors have the minimum capital required by law, Art. 9(5) obligates foreign investors having brought investment capital into the country to register the capital at the Commission and obtain a certificate of registration and send a copy of the certificate to the National Bank of Ethiopia.

- **(2) Performance Requirement:** is restriction on foreign direct investment or measures which the host state may impose on investors. It can take several forms such as;
 - Local content requirement
 - Export requirement/trade balancing
 - Job creation requirement
 - Duty to make research
- Art 22 (4) of the proclamation states that an investor who employs foreigners shall be responsible for replacing, within a limited period of time, such foreign workers by Ethiopians by arranging and providing the necessary training.

Chapter Five

Investment Incentives and Guarantees in Ethiopia

- **Incentives** are any measurable economic advantages afforded to specific enterprises or categories of enterprises by a government. Investment incentives are granted to attract investment in general and FDI in particular; to turn investment into favored sectors, activities or regions; or to influence the character of an investment. Sometimes, incentives are geared towards large projects or specific foreign investors, for example, where advanced technologies that can only be provided by foreign Investors
- **Types of incentives:** The following are the main types of incentives used:
 - ✓ Financial incentives: includes government grants, subsidized credits etc. Developed countries make more use of financial incentives than fiscal ones.
 - ✓ Fiscal incentives: includes tax holidays; exemptions or reduction of income tax or tariffs (import duties, export duties). Developing countries adopt fiscal incentives because they lack the resources needed to provide financial incentives

- ✓ Regulatory incentives: includes lowering of environmental, health, safety or labor standards.
- ✓ Stabilization clauses guaranteeing that existing regulations will not be amended to the detriment of investors.
- ✓ Subsidized infrastructure: providing electricity, water, telecommunication with a price less than the market price.
- ✓ Subsidized Services for implementing and managing projects, carrying out pre investment studies, informant on markets, advice on production process, and marketing techniques.
- ✓ Market privileges: includes granting of monopoly rights, protection from import competition, closing the

- **NB** different incentives may attract different investors. For example, the export-oriented investors give more value to fiscal incentives than market protection or other incentives. On the hand, market-seeking investors value market protection more than fiscal incentives. Thus, it is important to consider different incentives to attract investors

Incentives under Ethiopian law

- Art 17 of the investment proclamation states that investment areas eligible for investment incentives as well as the type and amount of investment incentives shall be determined by a Regulation. Investment regulation No 474/2020 under its Art 21 states that the provisions of regulation No 270/2012 relating to investment incentives shall remain valid until they are replaced by another law. The regulation provides for the types and extent of investment incentives. These are;

- **Exemption from the payment of income tax**
- Art 5 (1) of regulation No 270/2012 - any investor who invests to establish a new enterprise shall be entitled to income tax exemption as provided in the schedule attached.
- the schedule has provided a different period of income tax exemption between investments made in “Addis Ababa and special zones of Oromia surrounding Addis Ababa” and “other areas”. The exemption period entitled to investors in the so called “other areas” mostly is one or two years longer than what is entitled to investors in “Addis Ababa and special zones of Oromia surrounding Addis Ababa”. E.g. exemption for a starting for food industry is 3 years in Addis Ababa and its surrounding, while its 5 years for other areas, for manufacture of alcoholic beverage 1 and 2 years, tanning of hides and skins up to finished level 5 and 6 years, respectively.
- The period of exemption from income tax shall begin from the commencement date of production or provision of service by the investor, (Art 10 of the regulation).

- The schedule also provides some areas of investment which are not eligible for income tax exemption, such as tanning of hides and skins below unfinished level, printing industry, publishing, manufacture of cement (in Addis Ababa and its surrounding, but 4 years exemption is provided for other areas), real estate development, (education, training and health services) by constructing own building, wholesale of own product, etc.
- Art 5 (2) of the regulation states that “An investor who invests in Gambella, Benshagul Gumuz, Afar, Somali, guji and Borena Zones (in oromia), south omo, segen, bench-maji, sheka, dawro, keffa zones (in a southern nation and nationalities) shall be entitled to an income tax deduction of 30% for 3 consecutive years in addition to the exemption entitled to other areas. This provision is intended to encourage investment in these areas more than other regions and thus accelerate development in these less developed regions.

- Art 6 – an investor expanding or upgrading his existing enterprise shall be entitled to income tax exemption for the additional income generated as a result of the expansion or upgrading. As of Art 2 (8) of the proclamation **“Expansion” or “Upgrading”** means increasing in volume, by at least 50 percent of the attainable production or service rendering capacity of an existing enterprise, or increasing in variety by at least 100 percent by introducing new production or service rendering line of an existing enterprise, or increment by both.
- Art 7 – any investor who exports or supplies to an exporter at least 60% of his products or services shall be entitled to income tax exemption for 2 years in

- Art 12 (loss carry forward) - “an investor who has incurred loss within the period of income tax exemption shall be allowed to carry forward his loss for half of the income tax exemption period, after the expiry of such period. But in any case loss carry forward is not allowed for more than 5 income tax period (Art 12 (3)).
- Art 8 conditions for reducing incentives – an exemption to be granted to an investor who engages in manufacturing industry or ICT development without constructing his own production or service rendering building, shall be one year lesser than what is provided in the schedule

Exemption of capital goods and construction materials from custom duty –

- Art 2 (5) capital goods- means machinery, equipment and their accessories needed to produce goods or render services and include workshop and laboratory machinery and equipment necessary for same
- Art 2 (6) construction material – includes basic inputs necessary for the construction of investment projects
- Art 13 (1) - investors are allowed to import to Ethiopia capital goods and construction materials that are necessary for the establishment of a new enterprise or for the expansion or upgrading of an existing enterprise.
- its purpose is to encourage the investor to establish a new enterprise to invest or to upgrade the already existing enterprise.

- Art 13 (3) – if an investor eligible for duty free incentives buys capital goods and construction materials from local manufacturing industries he shall be refunded with the customs duty paid for the raw materials or the components used as an input to the production of such goods.
- This provision is based on the rationale to encourage the use of domestic products. Specially if the goods produced in Ethiopia are competitive in quality and price with those produced abroad, it would be more preferable to the investor to buy the goods in a domestic market as it saves transportation cost that would have been paid had it been exported from abroad; it would also save the time for the investor; it also offers an advantage for the two managers of the businesses for more frequent person-to-person contact.

- The capital goods that are used in the investment naturally require spare parts to service. Thus Art 13 (4) allows investor eligible for duty free incentives to import spare parts the value of which is not greater than 15% of the total value of the capital good, within 5 years from the commencement of his project.

Exemption of motor vehicles from custom duties

Art 14 - exemption of motor vehicles from custom duties shall be determined by a directive (No 3/2011).

- Eligible sectors (Art 3) - manufacturing industry, agriculture, tourism, star designated hotels, motels, restaurant, lodge, ICT development and construction, water whole digging and building contractors

- waste disposal vehicles (for a manufacturing industries which requires them), delivery vans (for products which should not be exposed to dust, sun and rain when they are transported), cars with refrigerator (e.g. for meat, fruit and milk related products), pick up cars, freight/cargo cars (lorry), motor bicycles (mostly for agriculture related investments), bus and mini buses (for transportation service of employees, at least for investments which employees more than 25 workers) boat (if the project is near to a water body)
- Art 12 if an investor eligible for duty free incentives buys vehicles from local vehicle assembling/manufacturing industries he shall be refunded with the customs duty paid for the raw materials or the components used as an input to the production of such vehicles.
- Art 13 an investor expanding or upgrading his existing enterprise shall be entitled to an additional custom free vehicle for the expanded or upgraded investment.

- *Transfer of custom free products* - Art 15 (1) of the regulation – capital goods or construction materials or motor vehicles imported free of custom may be transferred to persons with similar duty free privilege. The basic purpose of the incentive is to encourage investment irrespective of who carries out it. Therefore, no interest would be jeopardized if the capital goods are transferred to an investor who is entitled to a similar privilege.
- But if the investors transferred such goods to persons who have no similar duty free privileges, they should be liable for the payment of the appropriate custom duty (Art 15 (2)).

Guaranties to investment

- Despite the fact that incentives are available, investors may not decide to invest unless guarantees are available for their investment; such as right to “repatriation of capitals”, “guaranties against expropriation”.

Repatriation of Capital and Profits/remittance of funds

- Repatriation is the right to transfer capital and profits from the investment to the nation of the investor. In our law the right of repatriation is granted to foreign investors and expatriate workers.
- Art 20 (1) of investment proc. No 1180/2020 - any foreign investor have the right, in respect of his investment, to remit the following payments and earnings out of Ethiopia in convertible foreign currency at the prevailing exchange rate on the date of transfer:

- **a)** Profits and dividends accruing from his investment;
- **b)** Principal and interest payments on external loans; (art 21 of the proc. any investor may acquire external loan for his investment as per the applicable Directive of the National Bank of Ethiopia).
- **c)** Payment related to technology transfer agreement (registered by the investment commission, if not it shall not have legal recognition with the Commission, as of Art 15 (2) of the proclamation) **“Transfer of Technology”** means the transfer of systematic knowledge for the manufacture of a product, the application or improvement of a process or for rendering service, including management and technical know-how as well as marketing technologies, but may not extend to transactions involving mere sale or lease of goods (Art 2(9) of the proc).

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- **d)** Payments related to collaboration agreement – e.g. Art 2(10) of the proclamation incorporates **“Export-Oriented Non-equity Based Foreign Enterprise Collaboration”** which means a 100% export-oriented contractual agreement between a domestic investor and foreign enterprise in which the foreign enterprise provides, guaranteed external market access; Production know-how of products for export market; Export business management and marketing know-how, etc. But if collaboration agreement is not registered with the commission it should not have legal recognition with the Commission (Art 16(2), so payments or earnings resulting from it cannot be repatriated...

- **e)** Proceeds from the transfer of shares or conferral/transfer of partial or total ownership of an enterprise to another investor – in previous investment laws, e.g. proc. No 769/2012 to secure the right of repatriation the transfer of shares or ownership of an enterprise should be made to a domestic investor.
- **f)** Proceeds from the sale, capital reduction or liquidation of an enterprise; and
- **g)** Compensation paid to an investor in time of expropriation
- Expatriates employed for investments carried out pursuant to this Proclamation whose permanent residence is outside of Ethiopia may remit, salaries accruing from their employment in convertible foreign currency at the prevailing exchange rate on the date of transfer (Art 20(3))

Guarantee against Expropriation

- Private property may be taken by a government through, **nationalization and expropriation**.
 - Both are **acts of a government** (a government acting in its sovereign capacity).
 - *Nationalization* is **a transfer of ownership from private to public**, while, in case of *expropriation* ownership may be transferred **either to the public or private**.
 - *Nationalization* generally **covers an entire industry or geographic region** and it typically occurs in the context of a major social, political or economic change. However, *expropriation* targets only **a specific entity**.
- Confiscation is seizure of private property by a government as a punishment for breach of law.

- BIT's and national laws provide requirements for an expropriation to be lawful.
- Art 4 (1) of Ethio-china BIT states that neither contracting party shall expropriate, nationalize or take any other similar measures against the investments unless the following conditions are met; (a) for the public interest, (b) under domestic legal procedures, (c) without discrimination, (d) against compensation. Sub (2) of the same states that the compensation shall be equivalent to the value of the expropriated investment at the time of expropriation, be convertible and freely transferable and it shall be paid without unreasonable delay.
- **Art 19(1)** of proc. No 1180/2020 states that the Government may expropriate any investment undertaken under this Proclamation for public interest, in conformity with requirements of the law, and on a non-discriminatory basis.

- Sub (2) of the same stipulates that In case of expropriation of an investment adequate compensation corresponding to the prevailing market value shall be paid in advance.
- Both the BIT's Ethiopia is a contracting party and national law of Ethiopia adopts the **Hull Standard of compensation**, i.e. Prompt, adequate and effective compensation. 'Prompt' means without delay, 'adequate' means the compensation must be equivalent to the fair market value of the investment immediately before the expropriation took place, 'effective' means that compensation must be convertible and freely transferable.
- **Appropriate compensation-** This standard contemplates that equitable principles should be the guide in the matter of assessing compensation rather than a hard and fast rule relating to market value. It implies a variable standard that permits consideration of past practices, the depletion of natural resources, possible lack of foreign exchange and other factors such as environmental damage.

- Expropriation can be;
 - **Direct**- when there is **transfer of ownership**. It is an outright taking of the property of the investor.
 - **Indirect** - no transfer of ownership. It is any unreasonable interference that the owner there will not be able to use, enjoy or dispose of the property within a reasonable period of time after the inception of such interference. is an encumbrance on the right of ownership which cripples the usus, fructus and abusus rights of owner.
- indirect taking of investment property in different ways; .

- Creeping expropriation - the slow and incremental encroachment on one or more of the ownership rights of a foreign investor that diminishes the value of its investment.” It includes: forced sales of property; forced sale of shares; forced divestment of shares of a company (forced sale of subsidiary business interest or investments); interference in the right of management; appointment of managers; exercising management control over the property; refusal of access to labor or raw materials; excessive or exorbitant taxation.
- Regulatory takings - are those takings of property that may arise from state measures like measures to regulate the environment, health, morals, culture (e.g. indigenization measures) or economy of a host country. Administrative decisions which cancel licenses and permits necessary for the foreign business to function within the state may take place under such state measures.

- Failure of host states government to provide protection when there is interference with the property of the foreign investor.
- Inducing others to physically take over the property.
- Acts of harassment such as the freezing of bank accounts, promoting of strikes, lockouts and labor shortages.

Assignment

- 1. WTO and foreign investment
- The aim of WTO to liberalize trade, yet, it has also investment aspect since certain trades are connected with investment. Most notably TRIMs and GATS (General Agreement on Trade in Services); cross border service delivery.
- (TRIMs); it has a connection with FI, even if not directly.
- It is concerned with performance requirements or measures which the host state may impose on investors such as;
 - Local content requirement
 - Export requirement/trade balancing
 - Job creation requirement
 - Duty to make research