

## **INVESTMENT PROMOTION AND INCENTIVES IN ETHIOPIA**

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### **1. INTRODUCTION: THE AFRICAN SETTING**

While the African continent has immense human and natural resources, a combination of factors, including the colonial heritage, structural weaknesses of individual economies, susceptibility to the disastrous effects of natural and man-made disasters as well as endemic diseases, overdependence on the export of basic raw materials and minerals, etc. have rendered African economies weak and fragile. Despite all efforts at development, the continent remains the least developed.

Cognizant of the economic and social problems of the continent, the Heads of State and Government of the OAU passed various resolutions and declarations at different summit meetings, stipulating the need for promoting collective self-reliance and self-sustaining development. This was envisaged to be brought about by creating economic integration units at the national, sub-regional and regional levels, leading to the establishment of an African common market and eventually to an African economic community by the year 2000.

The political will and commitment of the African Heads of State and Government is expressed in the "Lagos Plan of Action for the Economic Development of Africa 1980-2000" following the Summit held in Lagos, Nigeria, from 28 to 29 April 1980. The Final Act of Lagos charted out the stages of implementation of the Lagos Plan of Action [OAU 1981: 128].

Pursuant to the Lagos Plan of Action and the Final Act of Lagos, the Preferential Trade Area (PTA) for Eastern and Southern African countries was established by the signing and ratification of the PTA Treaty in 1982.<sup>1</sup> Twelve of the eighteen member states are classified as least developed countries (LDCs) by the United Nations.<sup>2</sup>

The overall economic growth in the PTA sub-region has averaged 3.2 per cent a year since 1960, and the share of intra-PTA trade to total trade stands at about 6 per cent. This registered growth is only a fraction above the population growth rate in the sub-region. By 1990, total gross domestic product (GDP) was around US\$ 70 billion. Population size is estimated at over 220 million by the PTA secretariat, but projections made on the basis of statistics of The World Bank Atlas put the figure at over 300 million.

The past economic performance of the sub-region, as assessed by the PTA secretariat (1991), is as follows: "Almost immediately after signing the Treaty, the countries of the PTA, together with the rest of sub-Saharan Africa, plunged into a

deep economic and social crises which in many cases wiped out the gains in growth attained in the 1970s".

## 2. THE ETHIOPIAN ECONOMY

### 2.1 Background

It would be in order to have an overview of the structure of the Ethiopian economy. Table 1 below shows the shares<sup>3</sup> of the different sectors of the economy in GDP during the period 1973-1983 (Ethiopian Fiscal Year (EFY)).

Table 1: Average Share in GDP of the Major Sectors (1973 - 1983 (EFY))

Sector	Share in GDP (%)
Agriculture (including agriculture proper, forestry and fishing and hunting)	43.4
Industry (including mining and quarrying, manufacturing, handicrafts and small-scale industries, construction, electricity and water)	16.5
Distribution (including trade, transport and communications)	17.3
Other Services	23.0

Source: ONCCP, Macro Planning Department.

As can be seen from the table, the contribution of agriculture to GDP is about 43 per cent. This sector also contributes about 85 per cent of employment opportunities (even though underemployment is subsumed in it) and more than 70 per cent of total export earnings. It is widely believed that the country has vast unexploited cultivable land. Land-use data of the Ten-Year Perspective Plan [ONCCP 1984] indicate that out of the total land area of the country, i.e., 1.2 million square kilometres, 14.8 per cent is under crops; 51 per cent pasture land; 11.7 per cent forest and shrub land; 0.6 per cent swampy and marsh land; 0.6 per cent lakes and rivers and 21.3 per cent others [ONCCP 1984: 15]. As such, it is considered that more than 65 per cent of the total land area is suitable for cultivation and pasturage. Currently, about 22 per cent of the arable land is actually under cultivation.

With regard to its livestock resources, Ethiopia is considered to be first in Africa. Even if livestock resource figures are divergent, and the impact of drought and villagization programmes have not been taken into account, two sets of data are currently available. According to the National Revolutionary Development Campaign and Central Planning Supreme Council (NRDC-CPSC), the figures are

much higher. According to the Central Statistical Authority (CSA), the figures are much lower. The reasons are taken to be that NRDC-CPSC statistics were compiled before 1974 and when the drought phenomenon did not inflict devastating effects, while CSA figures were compiled recently. In addition, CSA figures did not include Eritrea, Tigray and the nomadic regions of the country [See, for instance, CSA 1990: 38-40; NRDC-CPSC, p. 12] and consider only livestock holdings of the private sector.

Despite its low level of development, agriculture is the mainstay of the national economy, and since Ethiopian agriculture is rainfed and backward in terms of modern technological inputs, its susceptibility to drought drastically affects industry, export performance and domestic food supply. This clearly shows the main structural problem of the economy.

As indicated in Table 1, the contribution of industry to GDP is about 16.5 per cent. Even though the current industrial base is narrow, vast potentials exist in this area. In the mining sector, gold, platinum, salt, marble and other industrial minerals are being exploited on a very limited scale. Though deposits of oil, natural gas, gold, platinum, copper, potash, zinc, nickel, coal and iron are known to exist, they are as yet unexploited because of the lack of capital and technology. Some of these deposits such as potash deposits are said to be among the largest in the world.

A rich potential in terms of hydroelectrical and geothermal energy remains only partly exploited. While the total hydroelectric potential is estimated at 60 billion kwh annually, the present generation capacity is 1.2 billion kwh only.

Table 1 also shows that the share of distribution in total GDP is 17 per cent while that of other services is 23 per cent.

## 2.2 Economic and Social Problems

The growth performance of the economy over the last two decades has not been satisfactory, particularly as compared with population growth rates. This can be clearly seen from the data in Table 2.

**Table 2: GDP and Population Growth Rates**  
(GDP at 1973 EFY Constant Factor Cost)

Preliminary	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
GDP growth rates (%)	0.7	8.1	-4.91	-5.94	9.94	9.5	1.9	1.6	-0.92	-5.6
Population growth rates (%)	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9

Sources: i) ONCCP, Macro Planning Department.  
ii) CSA

Because of the structural problem of the country, i.e., its overwhelming dependence on the agricultural sector, the poor performance of the agricultural sector turns out to be the major factor for the poor performance of the other sectors, including foreign trade and industry, even though the linkage between agriculture and industry is at a low level of development.

The overall low GDP growth rate is attributed largely to the low levels investments in all sectors of the national economy, emanating from low levels of savings. The country's inability to generate adequate hard currency and its total dependence on imports of basic developmental inputs and capital goods like agricultural, industrial and transportation machinery and equipment; raw materials, intermediate inputs; fuel; consumer goods etc. are also causes for the low level of investments.

The country's export products have not changed in terms of quality or composition in the past. In certain cases, the volumes of traditional export items have shown significant declines, particularly during the past ten years. Export proceeds fluctuate from time to time, and the general trend of world prices tend to be unfavourable. This is particularly the case with coffee, the country's dominant export crop, that accounts, on the average, for about 51 per cent of export earnings, during the years 1979-1983 EFY.

On the other hand, as a result of increases in the prices of imports of manufactured goods and oil, the growing import bill largely resulted in the deterioration of the country's terms of trade, which again is reflected in balance of payments problems.

The associated social problems of the country are numerous and complex. In brief, these are low levels of per capita income, insufficient basic health services, low levels of primary school enrolment rates, inability to supply potable water, high open unemployment and underemployment, housing and transportation shortages, etc.

The bleak economic and social conditions of the country were brought about by:

- a) lack of investments;
- b) the misguided socio-economic policy of the previous regime; and
- c) the recurrent drought and the protracted internal armed conflict.

The socio-economic policy of the country became socialist-oriented after 1974. The leading role in economic development was taken up by the state; and the private sector at best played a marginal role, and at worst was penalized, harassed and renounced, in order to phase it out completely from all economic activities.

By way of controlling the "commanding heights" of the economy the state embarked upon establishing state farms to produce food crops, industrial raw materials and export crops; nationalized industries and envisaged to launch new

industries; nationalized banks, insurance companies and financial institutions; nationalized all supportive services, including land, air and ocean transportation institutions as well as maritime and transit services; and by establishing state trading organizations, attempted to participate in retail, wholesale, import and export trade.

### 3. MACROECONOMIC INDICATORS

#### 3.1 Savings and Investment

Table 3 shows that, between 1973 and 1983 EFYs, gross domestic savings have never been above 6 per cent of GDP. In the first place, a savings rate of about 4 to 6 per cent of GDP is one of the lowest rates in the entire world. In the second place, an investment level revolving around 11 to 16 per cent of gross domestic expenditure is also the lowest in the world.<sup>4</sup> In the third place, the major part of this low level of investment is financed by external sources; and this entails rising debt burdens of the country, particularly from the point of view of its incapacity to generate adequate hard currency to finance its developmental activities and at the same time service its debts.

**Table 3: Investment-Saving Relations, 1973-1983 EFY**  
(Percentages Shares of Investments in Gross Domestic Expenditure and of Savings in GDP)

Activity	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Savings	4.9	3.7	4.0	5.3	4.4	3.9	4.8	4.9	5.8	5.7	3.0
Investment	10.6	12.0	12.7	16.0	15.5	14.3	15.8	15.8	13.4	12.2	11.0
GAP	-5.7	-8.3	-8.7	-10.7	-11.1	-10.4	-11.0	-10.9	-7.6	-6.5	-8.0

#### 3.2 Government Revenue and Expenditure

Besides its traditional functions of providing social and governmental services (networking of infrastructural facilities, maintenance of law and order, public administration, etc.), the Ethiopian government took over the leadership in economic activities by shouldering out the private sector. This brought about a lot of problems. To mention just a few of them:

- a) By discouraging entrepreneurship and initiative, the government further narrowed the already narrow revenue base; and its revenue effort (its ability to effectively collect revenues) was emasculated by the recent phenomenon of corruption of its revenue assessors and collectors as well as the inaccessibility of certain regions because of the internal armed conflicts;
- b) Since more than 30 per cent of government revenue is obtained from foreign trade operations, poor performance in export-import activities also affects government revenues directly;
- c) Defence expenditures kept on escalating;

- d) The emphasis was on containing public unrest and containment of political dissents, and the expenditures on the security apparatus and political organs of the state kept on escalating;
- e) Since the government assumed responsibility for taking up the leading role in economic development, it has to finance development projects. Because of the lack of property ownership, responsibility, accountability, unwarranted government interference, etc., the public enterprises, except very few, turned out to be loss-making;
- f) Since its revenues could not cover the ever rising expenditures, the government kept on borrowing from the state-owned banks, and the state-owned banks turned into the deficit financing institutions of the government;
- g) Directly productive activities were deprived of working capital, and this led to the virtual freezing of economic activity, and the unabated deficit financing *modus operandi* entailed inflationary pressures in the national economy.

### **3.3 Balance of Trade**

Because of the primary nature of export products and the unfavourable international market prices as well as the unchanging or shrinking volumes of these export products, on the one hand, and the need for importing capital goods and other developmental inputs, whose prices keep on escalating, on the other, the trade deficit has been ever widening. This has brought about acute balance of payments problems. Traditionally, such deficits used to be financed by external loans and grants and by running down the foreign exchange reserves of the country. These deficit financing modalities are not adequate and readily forthcoming. As such, the country has been forced to accumulate arrears on its debt obligations. This, in turn, has damaged the credit standing of the country and has hindered the capacity of the country to raise new external loans.

While the foreign exchange reserve position of the country during the early 1970s was adequate to cover eight to twelve months of forward import requirements, currently we are considering a reserve position of a week's time import requirement coverage. Since the private sector has been marginalized in economic activities, allocation of foreign exchange to the private sector was on the wane. This state of affairs led to the mushrooming of illegal and illicit trading activities which militated against government revenue, because of tax-evasion; and also against the country's ability to manage its foreign currency resources, because of the rampant parallel trade. Conversely, it has recently been legalized to import commercial quantities of capital goods, raw materials, etc., without the National Bank having allocated any foreign exchange for such imports. This is commonly known as *franco-valuta* imports, and is considered a gift from relatives abroad to those in Ethiopia. The magnitude of such *franco-valuta* imports has been increasing by leaps and bounds that, for instance, in 1978 EFY, while the legal export proceeds stood at Birr 961 million and the legal\* imports at Birr 2 billion, *franco-valuta* imports (as registered by the National Bank of Ethiopia) stood at Birr 1.6 billion. In 1983 EFY, the figures for

legal exports, legal imports and *franco-valuta* imports stood at Birr 662 million, Birr 2.4 billion and Birr 737 million respectively. It is believed that *franco-valuta* imports are the result of wide practices of unrecorded trade across borders. Again, it is widely believed that out of the unrecorded illicit export proceeds, part of it comes back into the country in the form of *franco-valuta* imports. In any case, since there are acute shortages of virtually all commodities, *franco-valuta* imports satisfy part of the import demand of the country even though, in principle, this type of activity should be replaced by legal import-export trade.

The overall result of the misguided socio-economic policy, the very low level of development of the country, the recurrent drought and internal armed conflict were:

- a) a very low level of investment emanating from low levels of savings;
- b) foreign trade deficits which entailed balance of payments problems, budgetary deficits and debt servicing problems;
- c) acute inflationary pressures and the overvaluation of the local currency;
- d) problems of open unemployment and underemployment; population growth rates which outstrip GDP growth rates; and finally,
- e) penury of the vast majority of people.

#### **4. INVESTMENT PROMOTION AND INCENTIVES IN ETHIOPIA**

An old saying has it that "identifying problems is half-solving them". With a population of about 51 million (mid-1990) and enormous unexploited natural resources, why is it that the country is in the unfortunate category of "the least developed countries" of the United Nations? What should be done to bring about a breakthrough in economic development?

If we feel that we have identified our problems, then it is not impossible to solve them according to a clearly defined action programme. To bring about a breakthrough in economic development, there is no option to investments. In order to encourage investments, it is essential to issue and implement positive policies that are comprehensive and consistent so as to bring about sustainable economic development. It is also worthwhile to consider the current global scene with respect to the severe competition for capital and technology by many developing countries and recently by the East European countries. The world market is also being dominated by economic blocks in Western Europe, North America, Asia and Latin America. As such, the most appropriate socio-economic policy would be one which does not lose sight of these developments.

##### **4.1 Historical Record**

Since about the end of the Second World War and up to 1973, the economic policy of the country was a free economy, and the private sector played the leading role in economic activities. Later on, the Commercial Code of Ethiopia was published in 1960, and virtually all economic activities were guided by it.

The 1974 change in government and the orientation of the regime reversed the situation and the state assumed leadership in economic activities to the extent that the government engaged itself in trading activities down to the retail level. While it is recognized that governments in developing countries should play a central role in activating economic activities, the Ethiopian government assumed an unwarranted role, in an economy which has been and is structurally weak and fragile, where the degree of monetization of the national economy is highly limited; and where the ability of the government to mobilize investible resources both domestically and externally was virtually absent. On top of all these, the limited national resources were employed in non-productive activities, including defence, sprawling bureaucracy, projects with longer gestation periods, etc. The low levels of investments were virtually financed from external sources, thus increasing the debt burden. In the face of high population growth rates, recurrent drought, shortage of foreign exchange, etc. acute shortages for basic commodities brought about painful inflationary pressures. The situation was further exacerbated by non-structural problems motivated by ideological and political considerations with respect to price controls, grain movement controls, etc. These, in turn, led to the mushrooming of illicit and illegal trading activities. Legality in its different modalities has been mocked at.

In order to build a strong national economy and achieve a higher standard of living, and effect the transfer of foreign technology, Proclamation No. 235 of 1990 was issued to provide for the establishment of joint ventures through participation of foreign capital with Ethiopian public capital.<sup>5</sup> Because of a host of factors, nothing of substance came of the proclamation.

The main problems associated with the Joint Venture Law can be categorized in two broad areas, and they are:

- a) Problems associated with implementation, including highly bureaucratized procedures for approving joint venture proposals; at least five governmental ministries and agencies are required to endorse the proposal; and the lack of a focal institution;
  - problems of interpretation with regard to investment goods eligible for exemptions from import duties, government and municipal taxes;
  - problems of streamlining the follow-up and monitoring of joint venture projects from the points of view of the objectives of the law; the lack of promotional footage abroad in order to interest potential investors.
- b) Policy-related problems including the following:
  - The joint venture law permitted participation of Ethiopian public capital with foreign private or public capital only, and excluded Ethiopian private capital. While potential foreign investors prefer domestic private partners, the stipulation of the Law made foreign private capital shy



away from investing in Ethiopia because of the lack of confidence in the sincerity of the Law.

- While the issue of nationalization is fresh in the minds of domestic as well as foreign investors after it was undertaken in Ethiopia in 1974, the 1983 Joint Venture Law stipulated that the government might nationalize joint venture projects because of national interest considerations.
- It also stipulated that compensation would be paid on the basis of the book-value of the assets so nationalized. This raised a number of problems. In the first place, articulating the issue in the law, nine years after nationalization, was unwarranted and a warning signal. If at all the issue had to be mentioned, the Law should have stipulated that assets *will not* be nationalized, in order to attract investors. In the second place, any sovereign state can nationalize assets for national security or for strategy purposes, and prompt and fair compensation is paid according to the going market price of assets. But the stipulation of the Ethiopian Joint Venture Law that book-values would be the bases for valuation of assets for compensation purposes, and without any time limit as to the date of compensation, left potential investors with serious doubt.
- In the capital structure of the joint venture project, the foreign participant can contribute his/her equity in cash or in kind. Foreign partners, particularly those from the former socialist countries, invariably want and pressurize to contribute in kind, i.e., in machinery and equipment, whose technological efficiency and price valuation cannot be verified.
- The stipulation of the Law that the Ethiopian partner should own at least 51 per cent of the equity did not seriously consider the number of possible joint venture projects or the magnitude of investment outlays required for launching each project. The government over-estimated its investible resource mobilizing capability. Similarly, the contribution of the domestic partner towards the equity structure of the joint venture project would take the forms of use rights of land and water, different technical services and local currency. While assigning values to contributions in kind are difficult in themselves, the total of these contributions may not add up to the 51 per cent equity requirement of the Law, and it has never been clear in how many joint venture projects the government wanted to participate.
- In the absence of policy guidelines, or laws or regulations with regard to the transfer of technology, i.e., choice of technology, permissive situations for transfer of technology, the obligations of the technology owner; royalty payments; patent and trade mark rights and protection, training of national counterparts, etc. potential investors with know-how and new research findings would not be encouraged to participate in joint venture projects in Ethiopia.

There was no treaty in force to which Ethiopia is signatory with respect to taxes and investments. In the absence of tax treaties to avoid double taxation and investment treaties to ensure protection of investments, foreign potential investors would not feel confident in investment opportunities in the country.

The joint Venture Law stipulated that the maximum life time of a project should not exceed 25 years. As is known, projects differ in their investment magnitudes, sectors, the simplicity or complexity of technological inputs, etc. While 25 years might be too long for some, it might be too short for others. Hence the Law implicitly encouraged simple projects with shorter gestation periods.

The net effect of the joint venture law was that not even one project could be implemented.<sup>6</sup>

#### **4.2 The Economic Reform Program (ERP)**

There were so many compelling reasons for changing the economic policy of Ethiopia, and as a result, the Economic Reform Programme (ERP) was declared in March 1990. The main elements of the programme include:

- a) promotion of mixed economy;
- b) significantly greater use of the market mechanism to guide economic decisions;
- c) active encouragement of the private sector through a series of new incentives;
- d) reorienting public sector management towards competitiveness and profitability;
- e) formation of co-operatives along strictly voluntary basis; and
- f) greater decentralization of economic decision-making [PDRE 1990:20].

The ERP implies a reversal of orientation of governmental policy from socialist-oriented National Democratic Revolution and centralized planning to market mechanisms. Following the declaration of the ERP, a series of legislations were issued in order to implement the new policy direction, and these include:

- a) Special Decree No. 17/1990 which is an umbrella investment legislation; and pursuant to this Special Decree, the following regulations were issued:
  - i) Regulation No. 7/1990 on licensing of agricultural projects;
  - ii) Regulation No. 8/1990 on licensing of industrial projects;
  - iii) Regulation No. 9/1990 on licensing of hotels and tourism; and
  - iv) Regulation No. 10/1990 with regard to the modalities of participation of foreign investors.
- b) Decree No. 39/1990 which ratified the convention establishing the Multilateral Investment Guarantee Agency (MIGA)<sup>7</sup>;

- c) Proclamation No. 32/1989 on joint ventures was also to continue in force.

To expedite the implementation of the ERP, the Office of Investments and Joint Ventures (OIJV) was established as a one-stop agency or a focal institution, while other sectoral investment facilitating units have been set up in different ministries and agencies.<sup>8</sup>

#### **4.3 Objectives of the Investment Legislations**

The economic and social objectives to be achieved through investments in the form of joint ventures or other forms of business organizations, such as ordinary partnerships, general partnerships, limited partnerships, share companies and private limited companies, include:

- a) the acceleration of transfer, adoption and absorption of needed foreign technology and know-how, including the upgrading of skills;
- b) the intensification of the extraction, conversion, and utilization of the country's natural resources, including the mobilization of its human resources for economic activities thereby generating employment opportunities;
- c) the saving or generation of foreign exchange through import-substitution production or export-promotion strategies; and
- d) bringing about strong inter-sectoral and inter-regional linkages.

The objectives are fairly broad-based that they could also be made to contribute towards the country's overall social and economic development, conservation and utilization of its natural resources, development of science, technology and know-how, diversification of exports, etc.

The newly launched investment legislations and the joint venture law provide a wide range of fiscal incentives and tax concessions including:

- a) exemption from payment of customs duties and government and municipal taxes on all imported machinery, equipment and initial supply of spare parts;
- b) total or partial exemption from the above duties and taxes for imports of raw materials, components, and intermediate inputs, for specified periods, if the form of business organization is a joint venture;<sup>9</sup>
- c) exemption from payment of customs duties and transaction taxes on products exported;
- d) income tax holidays, ranging from two to five years;
- e) exemption from income taxes on re-invested profits by a foreign investor, as a joint venture project partner;
- f) exemption from all taxes on proceeds received by a foreign investor, participating in a joint venture project, from the liquidation, sale or transfer of shares;
- g) exemption from personal income taxes for expatriate employees;

- h) the right for repatriation of profits and dividends, after a payment of a flat rate tax of 10 per cent;

#### **4.4 Set of Guarantees**

In addition to the constitutional provisions of protection of private investments, Ethiopia has acceded to the Multilateral Investment Guarantee Agency.

Hence, once the administrative framework, the array of incentives and the set of guarantees have been put in place, through a series of investment promotion measures, it was expected to attract as many investors as possible.

#### **4.5 Efforts at Promotion**

- a) In recognition of the fact that "time is money" and in order to radically cut down the bureaucratic red tape in making the rounds to the different ministries and agencies for obtaining information or licences, the OIJV was established as a one-stop agency for prospective investors. But so far, the OIJV has been issuing "certificates of approval" for joint venture projects only. Other investors, domestic as well as foreign, are required to obtain their operating licences from the relevant sector ministry or agency and apply to OIJV for incentives. Since its establishment, in July 1990 the OIJV has:
  - i) Issued two certificates of approval for two joint venture projects; one other joint venture proposal was rejected. So far 19 joint venture proposals have been submitted to the Office, but could not be processed because of the change in government. The sectoral orientation of these joint venture project proposals are: four in agriculture; nine in industry; four in mining; and one in construction. They will be finalized after the issuance of the Transitional Government Economic Policy.
  - ii) Since the issuance of Special Decree No. 17/1990, a total of 86 applications have been submitted to the OIJV for incentives. Out of these 75 have been granted the incentives, and the rest were rejected. The sectoral orientation of the applications are 80 in industry, five in construction, and one in hotels.<sup>10</sup>
- b) Since its establishment in July 1990, the OIJV has been able to publish and distribute investment guidelines and brochures indicating investment potentials and opportunities in Ethiopia, the procedures for investment applications, etc. Some fifty project profiles have also been prepared and distributed to interest potential investors in joint venture projects.
- c) Two workshops were organized and undertaken: one to discuss the coverage and relevance of the draft investment guidelines, and the other on "Negotiating Joint Venture and Transfer of Technology Agreements."

- d) Investment promotion visits have been mounted abroad, such as Germany the United Kingdom, France, Belgium, Netherlands, India, Hong Kong and South Korea. These types of promotional visits were meant to continue. The United Nations Development Programme (UNDP) and the United Nations Centre on Transnational Corporations (UNCTC) have provided invaluable financial and technical support, not only in the promotional visits but also in the publication of investment promotion guidelines and investment-related study tours to countries considered successful in attracting foreign investments.
- e) The OIJV, as a focal institution for facilitating investments, has been engaged in responding promptly through letters, fax messages, telephone calls, etc. to enquiries from abroad and from local entrepreneurs with regard to investment opportunities, procedural issues, etc.
- f) The OIJV has prepared action programmes for 1991 and 1992, which were partly carried out as mentioned above. The remaining activities scheduled include the preparation of multilingual video films for investment promotion purposes. Audio-visual investment promotion is considered effective because it assists in creating lasting impressions than other forms of documentation;
- g) Since a mass of information is required to promote investments related to national and international demand and supply situations, technology, investment areas and opportunities, etc., a modest attempt has been made to create a well-organized documentation centre and a reference library through computerization.

## 5. PROBLEMS ENCOUNTERED

The long-standing and rigid ideological orientation of the previous regime, which assumed the leading role in economic activities and development, and which, in express policy, marginalized the private sector, left the country and people in shambles. The immediate and long-standing problems to be addressed include:

- i) rampant speculative trade;
- ii) overvaluation of the local currency;
- iii) inability to mobilize savings and hence increase the investment levels required to ameliorate the bleak economic and social conditions of the vast majority of people;
- iv) the lack of compensation for nationalized assets of nationals, who could not feel confident in the credibility or stability of the government or the investment legislations in place;
- v) the apathy and indolence of the bureaucracy to the needs of potential investors with regard to providing efficient service to investments, including the issuance of licences, land acquisition, etc.
- vi) prohibitive import duties, surtaxes and other charges of equivalent effect, which are rigid, and which do not take the domestic demand and supply situations, and which in the final analysis, discourage investments and make speculative trading activities much more tantalizing;

- vii) prohibitive marginal tax rates, which do not permit savings and hence also investments;
- viii) the limitations of investment incentives in terms of sectoral, and investment input coverage;
- ix) the marginalization of the private sector, which faced shortages of working capital, because public enterprises and co-operatives were accorded priority in obtaining lines of credit, or in the allocation of foreign exchange;
- x) trade and budget deficits which do not enable the realization of investment objectives;
- xi) the labour law, which favours labour and discourages entrepreneurs;
- xii) the political instability of the country which limits the attractiveness of the country as an investment country;
- xiii) the lack of efficient transportation, banking, storage and forwarding services for the smooth functioning of investment activities; and, finally,
- xiv) the lack of policy responses to the developmental needs of the country.

## **6. CONCLUSIONS AND RECOMMENDATIONS**

### **6.1 Conclusion**

In spite of the penury of the vast majority of people, the Ethiopian economy somehow survived during the past two decades, because of the subsistent nature of the economy. The degree of monetization of the national economy is thus assumed to be limited by the degree of its subsistence. A breakthrough in economic development is possible in an environment where there prevails positive policy that encourages the mobilization of the country's material and human resources for economic activities.

Ethiopian trade policy has been categorized as inward-oriented during the period 1973-85 [World Bank 1987: 2-5]. Even today, the country pursues the same trade policy with all its ills.

Currently, the relative prevalent peaceful situation is expected to bring about an economic boom if supported by a permissive economic policy. The economic policy and the follow-up investment legislations are expected to be encouraging and supportive to the unrestricted participation of domestic private capital. If these are obtaining, then the attitude of foreign investors would be "what is there in it for me" and "what is good for nationals is also good for me". The prevalence of such attitudes would enhance the participation of nationals and foreigners in investment activities. It is said that "investors have a herd instinct", i.e., if a few investors venture into investments, others are likely to follow.

### **6.2 Recommendations**

- i) Ethiopia has tremendous economic potentials for investments in all sectors of the economy, but this calls for bringing about a change in the image of

- the country and the people which has so far been depicted as war-torn, socialist-oriented and which discourages private investment. By concentrating on the 'credits' of the country, image-building and investment-promotion campaigns should be mounted as soon as possible.
- ii) In order to ensure a self-sustained development the investment/GDP ratio should be raised from the present level of 11-16 per cent to a minimum level of 25 per cent.
  - iii) It has been mentioned time and again that the overvaluation of the Birr has brought about multifaceted distortions in the economy. Even if the need for exchange rate adjustment is appreciated, it should be looked into in detail, with all its implications and reassessed after a certain level of economic reactivation has been achieved in the country.
  - iv) The full and unrestricted participation of the private sector must be encouraged and supported in order to mobilize adequate resources for investment purposes. In order to mobilize investible resources, stock-dealing would have to be mounted, possibly through the banks.
  - v) Some sort of compensatory mechanism should be established for nationalized assets in order to instill confidence in investment activities.
  - vi) Decision-making processes should be decentralized, and sectoral ministries and agencies should have the authority and the accountability with regard to the efficient execution of their respective fields of responsibility.
  - vii) The prohibitive import duties, surtaxes and other charges of equivalent effect should be overhauled, streamlined and made encouraging to investment activities. The overall indirect tax scheme must be reviewed and rationalized to encourage savings, to widen the tax base and to increase the revenue yield to the government.
  - viii) The marginal tax rate, which has been burdensome and which had led to speculative trading activities, has been reduced from 89 per cent to 59 per cent following the ERP. But, in order to encourage reinvestments, the rate should be reduced further to about 35-40 per cent.
  - ix) The bank ability of enterprises, including the allocation of foreign exchange should be based on financial profitability and economic viability of projects, and should not be subject to government intervention motivated by political considerations.
  - x) In order to encourage exports and hence generate adequate foreign exchange, export duties and other charges of equivalent effect should be abolished. The expenditures of government revenue should be rationalized so as to spearhead investment activities, and should concentrate on infrastructural development.
  - xi) The labour law in force should be rationalized to ensure its consistency with profitability and competitiveness, and also to ensure the supremacy of the law.
  - xii) In order to protect investments, Ethiopia has acceded to MIGA, and in order to enhance the image-building effort as an attractive country, it might be necessary to conclude tax treaties and bilateral investment promotion and protection agreements with capital and technology exporting countries.

- xiii) In order to afford investors competitive edges, and because of the formidable transportation, storage, and forwarding problems of potential export-oriented investors, the need for establishing Export Processing Zones (EPZs) is justified.
- xiv) The country is at the bottom rungs of the development ladder. As such, rigidity in the choice of technology should be avoided until such time that it attains a certain level of development.
- xv) Investment incentives are granted by government to guide the investment decisions of investors to sectors deemed to have wider national impacts. As such, all directly productive sectors such as agriculture, industry and mining as well as investments in educational and health service facilities should be made beneficiaries of incentives. Similarly, if certain raw materials and intermediate inputs are not available domestically, or are available in insufficient quantities, modalities for making such imports beneficiaries of incentives should be devised.

In conclusion, the economic policy and the instruments of its implementation, i.e., the investment legislations should see to it that linkage effects and consistency must be observed. Development is multifaceted and all efforts and incentives must be streamlined to bring about an integrated development.

#### NOTES

1. The PTA presently comprises Angola, Burundi, Comoros, Djibouti, Ethiopia, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Rwanda, Somalia, Sudan, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe.
2. These are: Angola, Burundi, Comoros, Djibouti, Ethiopia, Lesotho, Malawi, Mozambique, Rwanda, Sudan, Tanzania, and Uganda.
3. Moving averages have been compiled for the purpose of this paper.
4. See, for instance, ONCCP, *The First-Five Year (1982-86 EFY) and 1982 EFY One-Year Development Plan: Targets and Preparation Guidelines*, Volume I, General, pp. 37 and 41 for a comparison of share of savings and investment in GDP for selected African countries.
5. See preamble of Proclamation No. 235/1990.
6. For further details, consult the Office of Investments and Joint Ventures, P.O.Box 2438, A.A. or Telephone No. 15-79-62.
7. The Multilateral Investment Guarantee Agency (MIGA):



- i) is an affiliate of the World Bank Group and provides investment guarantees against the risks of currency transfer, expropriation, war and civil disturbance and breach of contract of the host government; and
- ii) provides advisory services to developing member countries on means of improving their attractiveness to foreign investment.

MIGA was established on April 12, 1988 and as of August 6, 1991 has 104 member states. Ethiopia signed the Convention on September 21, 1990 and deposited the instrument of ratification with MIGA on February 21, 1991.

8. These include the Ministry of Agriculture, the Ministry of Industry, the Hotels and Tourism Commission, and the Ministry of Construction. All other ministries and agencies did not succeed in creating such investment facilitating units in their respective fields of responsibility.
9. A joint venture, as stipulated in the Ethiopian investment legislation does not follow the dictionary definition. There are two specific preconditions to fulfill the requirements of a joint venture, namely:
  - i) Domestic and foreign financial, material or technological resources must be combined.
  - ii) There must always be public participation on the Ethiopian side.

If these two conditions are not obtaining, then the business organization is not a joint venture. It can operate by other forms of business organizations.

10. Special Decree No. 17/1990 entitles four sectors as eligible for incentives. The beneficiaries of the incentives are the agricultural sector, the industrial sector, hotels, and the construction sector. Only joint venture projects are entitled for incentives in which ever sector they are launched according to Proclamation No. 32/1989. It should also be mentioned here that investors that are not entitled for incentives can obtain their operating licenses from the relevant sectoral ministries and agencies and commence operation without having to apply to the OIJV. Because of the inability to grant land for commercial agricultural activities, no application for incentives has ever been submitted to the OIJV.

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