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**ADDIS ABABA UNIVERSITY
SCHOOL OF GRADUATE STUDIES
COLLEGE OF LAW AND GOVERNANCE STUDIES
SCHOOL OF LAW**

**CORPORATIZATION IN ETHIOPIA: A MOVE
TOWARDS COPING WITH GLOBALIZATION
AND ACCESSION TO THE WTO**

WONDIMNEW KASSA MERSHA

JUNE 2014

ADDIS ABABA, ETHIOPIA

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A Thesis Submitted in Partial Fulfillment of the Requirements for the Degree of
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(Approval Sheet)

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Declaration

I, the undersigned, declare that this thesis is my original work, has not been presented for a degree in any other university and that all sources of data used in the thesis are dully acknowledged.

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Abstract

The last three decades, facilitated chiefly by the sophisticated transport and communication technology, have markedly exhibited an unprecedented flow of products and capital. This is what is referred as economic globalization. The economic integration process has been pioneered by the international economic organizations (i.e. the IMF, World Bank and the WTO), but in the face of shaking critics. Of course, available empirical evidences also brought to the surface not only the positive results but also the scenarios whereby economic globalization failed to enhance, if not aggravated, the poor living conditions and hampered future development potentials of the poor. So far, the influence of the global South in governance of the international economic order has been very limited so that it has by and large dominated by the rich powers. In fact the share of the South in the global economic operations in terms of cross border trade and investment has also been insignificant.

Ethiopia as part of the international community has been undertaking the integration experiment since 1991. It in particular introduced liberal trade and investment reforms. It is also acceding to the rule-based multilateral trading system (i.e. the WTO). Nonetheless, as different econometric studies uncover, its performance in harnessing the non-reciprocal preferential market accesses has been unsatisfactory suggesting the connotation of becoming a WTO member unless it embarks on large scale export-oriented production. Moreover, FDI's role in narrowing the low level of domestic savings and supplementing investment endeavors has been at a rudimentary level. To the worst, increased FDI inflows and maximum benefits from it demand Ethiopia to reach a level of development by its own effort. Precisely, it is involuntary for Ethiopia to marshal export-oriented production and total factor productivity should it cope with economic globalization and accession to the WTO.

If the question turns out to be how to channel the scarce material and human resources to meaningful businesses, it is argued in this thesis that Ethiopia should promote corporate businesses than ever. Despite the low level of contributions of the modern private sector to Ethiopia's economy and the immature culture of incorporation could restrain development of such ventures in the short-run, it has become certain that to promote internationally competitive firms in corporate lines, the government of Ethiopia should undertake some essential legal and institutional reforms.

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ACRONYMS AND ABBREVIATIONS

IMF=International Monetary Fund	USD=US dollar
WTO=World Trade Organization	IBRD=International Bank for Reconstruction and Development
LDC=Least Developed Country	ITO=International Trade Organization
UNCTD=United Nation Commission for Trade and Development	WW I=World War I
EPRDF=Ethiopian People's Revolutionary Democratic Front	US/USA=Unite States of America
GSP=Generalized System of Preference	UK=United Kingdom
EBA=Everything But Arms	GAB=General Arrangements to Borrow
AGOA=African Growth and Opportunity Act	NAB=New Arrangements to Borrow (
OECD=Organization for Economic Cooperation and Development	SDR=Special Drawing Rights
UNECA=United Nation Economic Commission for Africa	PRDF=Poverty Reduction and Growth Facility
COMESA=Common Market for Eastern and Southern Africa	IBRD=International Bank for Reconstruction and Development
FDI=Foreign Direct Investment	IDA=International Development Association
MNC=Multinational Corporations	IMC=International Monetary Corporation
TNC=Transnational Corporations	MIGA=Multilateral Investment Guarantee Agency
UN=United Nation	ICSID=International Centre for Settlement of Investment Disputes
NGO=Non-governmental Organizations	CDF=Comprehensive Development Framework
CSD=Commission on Sustainable Development	GATT=General Agreement on Tariffs and Trade
WW II=Second World War	NTT=New Trade Theories
SAPRI=Structural Adjustment Participatory Review Initiative	MTN=Multilateral Trade Negotiations
SAPRIN= Structural Adjustment Participatory Review Initiative Network	R&D=Research and Development
FYIE=Fifty Years Is Enough	EU=European Development
CWIS Common Wealth of Independent States	NIE=Newly Industrializing Economies
	M&A=Mergers and Acquisitions

TRIPS=Trade Related Intellectual Properties	EURL=single member private company
EPZ=Export Processing Zones	SAS= <i>Société par Actions Simplifié</i>
GDP=Gross Domestic Product	KAG= <i>Kommanditaktiengesellschaft</i>
IFI=International Financial Institutions	G.m.b.H.s= <i>Gesellschaft mit beschränkter Haftung</i>
GATS=Trade in Services	CSR=Corporate Social Responsibility
TRIPS=Trade related Intellectual Property Rights	LPA=Lagos Plan of Action
DSB=Dispute Settlement Body	NEPAD=New Economic Partnership for Africa's Development
AoA=Agreement on Agriculture	TGE=Transitional Government of Ethiopia
AMS=Aggregate Measurement of Support	ERRP=Emergency Recovery and Reconstruction Programme
SPS=Sanitary and Phytosanitary Measures Agreement	ADF=African Development Fund
MFN=Most Favored Nation treatment	EPPP=Economic Prospects and Programming Paper
TBT=Technical Barriers to Trade Agreement	PFPP=Policy Framework Paper
ATC=Agreement on Textiles and Clothing	SAF=Structural Adjustment Facility
TMB=Textiles Monitoring Body	SPA=Special programme of Assistance for Africa
WIPO=World Intellectual Property Organization	IDA=International Development Agency
TRIMs=Trade-Related Investment Measures	ETB=Ethiopian Birr (or simply Birr)
TPRB=Trade Policy Review Body	UNECA=United Nation Economic Commission for Africa
CHF=	TFTA=Tripartite Free Trade Area
ACP= the African, Caribbean and Pacific Group	GTP Growth and Transformation Plan
SELA=Latin American Economic System	<i>Derg</i> = the Military junta that ruled Ethiopia from 1974-91
FDRE=Federal Democratic Republic of Ethiopia	<i>Et al.</i> = <i>et alii</i>
WPM=Working Party Meetings	Procl. =Proclamation
<i>SA</i> = <i>Société par actions</i>	No. =Number
KA= <i>Kommandit Actiengesellschaft</i>	SEC = Securities Exchange Commission
CA= <i>Commandite par actions</i>	
SARL= <i>Société à Responsabilité Limitée</i>	

MBCA = Model Business Corporation Act

RMBCA = Revised Model Business Corporation Act

NEPAD=New Economic Partnership for African Development

BITS=Bilateral Investment Treaties

DTTs=Double Taxation Avoidance Treaties

CSA = Central Statistical Agency of Ethiopia

A&M = Acquisition and Mergers

PLC = private limited company

SNNPR = Sothern Nations Nationalities and Peoples Region

AASE= Addis Ababa Stock Exchange

Vol. = volume

C. = century

DM = deutsche mark

EGM = Extraordinary General Meeting

H.E. = His Excellency

CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

In the last three decades, globalization has been an entrenched trend on the planet earth. In fact, the integration process took place in almost all affairs of human life. Thus, even if it is difficult to draw the lines separating each segment, the integration process encompasses the economic, financial, business, political, technological, environmental, cultural, educational, international relations and security-related dimensions.¹ Nonetheless, the focus of this thesis is on economic globalization.

Economic globalization, the virtual integration of national economies through increased cross border trade and investment, has been principally facilitated by the ruthless efforts of the World Bank, the International Monetary Fund (IMF) and the World Trade Organization (WTO). Especially the first two were created under the influence of western ideas and finance so that they have been accused for furthering corporate interests. Of course, the globalization process has been taking place in the face of unfading heated debates between the protagonists and the contenders. The groups in support of economic globalization appreciate its role in the growth of economies by facilitating access to capital, transfer of technology and managerial skills, job creation and market access. The antagonists claim environmental destruction, wealth inequality and human insecurities globalization has been aggravating overwhelmingly counts against the positive results.² In the latter's view, the bad effects hit more severely the poorer South than the richer North. Consequently, they call up on reforms of governance of the international economic system in a way that would serve the virtues of humanity, equity, democratic rule, and sustainable development. Put differently, should economic globalization work for the majority, it should be geared to priorities of the world's poor.³

Many Least Developed Countries (LDCs) including Ethiopia have been undertaking the economic liberalization project to satisfy the policy dictates and loan conditions of the international economic organizations. IMF 'conditionalities' and World Bank's structural adjustment programs dictated policies of their clients, often LDCs and developing countries, towards economic liberalization and integration.⁴ The WTO's principles and rules also reiterate the didactics of the former under the premises of "freer trade is good for all".

So far, the principal actors of economic globalization have been the advanced rich countries. They have been taking the lion's share in international trade and investment.⁵ Despite recent improvements in capital inflows to and export from it,⁶ the developing world has been of limited participation in the global economic activities. Empirical evidences also reveal that there are jurisdictions (South East Asia)⁷ where economic liberalization pulled millions out of poverty and jurisdictions (sub-Saharan Africa)⁸ where it worsened the malfunctioning economic conditions and the poor living conditions. There is no evidence as to a possible

¹ DAS, DILIP K., THE ECONOMIC DIMENSIONS OF GLOBALIZATION 9-12 (2004)

² See Chapter Two Section 2.2 of this thesis.

³ STIGLITZ, JOSEPH E., MAKING GLOBALIZATION WORK, 15-19 (2006)

⁴ Kimberly Ann Elliott, et al., *Assessing Globalization's Critics: "Talkers Are No Good Doers?"*, in CHALLENGES OF GLOBALIZATION: ANALYZING THE ECONOMICS, 30 (Baldwin, Robert E. and Winters, L. Alan ed., 2004)

⁵ BENDE-NABENDE, ANTHONY, GLOBALIZATION, FDI, REGIONAL INTEGRATION AND SUSTAINABLE DEVELOPMENT: THEORY, EVIDENCE AND POLICY, 49 (2002)

⁶ UNCTD, <http://unctadstat.unctad.org/TableViewer/tableView.aspx?ReportId=88> (last visited on March 27, 2014)

⁷ Stephen Thomsen, *Southeast Asia: The Role of Foreign Direct Investment Policies in Development 25-27* (OECD, Directorate For Financial, Fiscal And Enterprise Affairs Working Papers On International Investment, 1999).

⁸ See Bende-Nabende, supra note 5, at 80.

reversal of the trend of economic integration in the near future so that LDCs should persistently work to ensure their domestic economies are absorptive and responsive enough to take advantage of opportunities globalization offers and tackle challenges it precipitates.

As can be learned from the discussion in Chapter Four, Ethiopia, on her part, has been carrying out the integrationist experiment, at least, since 1991. It adopted a market-oriented liberal economic policy, albeit under the ideological guises of so-called 'revolutionary democracy' initially and 'developmental state' currently.⁹ It also adopted a long list of policies, programs and strategies and action plans in the various sectors subject to the grand spirit of market economy.

From the view point of foreign investment and trade, it undertook several pro-trade and investment measures stemming from the outward-looking stance and the conviction that foreign trade and investment contribute for the economic transformation of the country and abolition of poverty. Pertaining to foreign trade, the Ethiopian People's Revolutionary Democratic Front (EPRDF)-led government has been implementing "a comprehensive trade reform program in the context of broad liberalization package" since 1992. It then introduced reforms like elimination of quantitative restrictions and export taxes, devaluation of the Birr, price deregulation, introduction of a system of export incentives and establishment of Export Promotion Agency which was later absorbed as a department in the former Ministry of Trade and Industry and later in today's Ministry of Trade.¹⁰

Ethiopia also traveled far towards freer trade by assuming international legal responsibilities¹¹ and is working towards acceding to the WTO. Ethiopia has also been eligible to benefit from the non-reciprocal preferential trade arrangements including the Generalized System of Preference (GSP) offered by many advanced nations to poor nations, Everything But Arms (EBA) offered by the EU, and the African Growth and Opportunity Act (AGOA) presented by the US. These all are hoped to widen the market access for exports from Ethiopia and the market size market-seeking investors may consider in locating their investment in Ethiopia.

Insofar as investment is concerned, the government of Ethiopia has been introducing several pro-investment measures to solicit resources from both domestic and foreign investors to foster increased production and productivity. *Inter alia*, the government has been liberalizing foreign trade, promulgating liberal investment laws for the promotion and encouragement of private investment, issued a modern labour law, facilitated a forum for consultation between the private sector and the government, enhanced institutional support to the export sector by the strengthening of existing institutions.¹²

1.2. Statement of the Problem and Research Questions

Nevertheless, based on different econometric studies, Ethiopia's performance in international trade, even after trade liberalization and under the preferential trade arrangements, has not been satisfactory. The negative trade balance before liberalization has been constantly widening and exceeds the East Africa's average. Despite a considerable rise in Ethiopia's export to EU, a study conducted by United Nation Economic Commission for Africa (UNECA) reported that Ethiopia utilized only 24% of the EU-ACP agreement.¹³ Concerning the impact of the EBA initiative, a research conducted by the Organization for

⁹ DIGEST OF ETHIOPIA'S NATIONAL POLICIES, STRATEGIES AND PROGRAMS XIII (Taye Assefa ed., 2009).

¹⁰ Bulti Terfassa, *Ethiopia's Trade and Investment Policy*, in DIGEST OF ETHIOPIA'S NATIONAL POLICIES, STRATEGIES AND PROGRAMS 285 (Taye Assefa ed., 2009).

¹¹ See Chapter Four Section 4.1 of this thesis.

¹² See Bulti Terfassa, supra note 10, at 295

¹³ Wolde Bulto Adugna, *Ethiopia's Accession to the WTO with Emphasis on Foreign Market Access* 62 (2006) (unpublished Master's thesis, Addis Ababa University).

Economic Cooperation and Development (OECD) reported that most African countries have hardly ever used the scheme, only with a utilization rate of less than 3% for the possible reason of supply constraints.¹⁴ Moreover, notwithstanding the increasing trend of export to the US, Ethiopia's utilization rate of the AGOA preference, based on UNECA's calculation for 2004, was only 9%.¹⁵ Concerning Ethiopia's trade relationship with the Common Market for Eastern and Southern Africa (COMESA) member countries, it was not satisfactory.¹⁶ From the foregoing discussion, it can be construed that economic openness alone won't ensure beneficence of a country from foreign trade. Moreover, to join the WTO, unless it moves shortly to correct the supply side constraints, will be of no practical importance, if not of negative implications at least in the short run. Stated differently, despite the wider market access trade openness can bring about, the pressing problem has turned out to be how to improve production and productivity in Ethiopia.¹⁷

Moreover, regardless of the reforms aimed at attracting private investment in the country, investment from domestic sources, in proportion to the low level of per capita income and national savings, has been very minimal and disorganized.¹⁸ The call for foreign direct investment (FDI) too has not brought superb results so that FDI inflows to the country, despite relative increases from time to time, has been only at a rudimentary level and posing challenges.¹⁹ Moreover, lack of competitive domestic firms bared the country from reaping the maximum possible advantages from FDI in the form of increased capital inflow, technology transfer, spillover of managerial skills, job opportunities, and resist FDI induced threats to the economy.²⁰

Therefore, if the mere fact that Ethiopia's economy is outward-looking could not warrant economic growth, efficient use of and building domestic capacity appears to be the only solution. It is not only good in its own right but also good to take advantage of and maximize opportunities, and resist problems economic integration tends to spread out.²¹ At this juncture, it would be essential to ask the question this thesis is interested in that whether corporatization can be of any help in the development of internationally competitive domestic firms. The answer appears to be in the positive.

Nevertheless, the business environment in Ethiopia has been inspired by the "kiosk mentality". In other words, the culture of incorporating businesses has been immature. The private sector is highly traditional and the modern wing of the private sector has been principally investing in the services sector and small-sized manufacturing.²² The majority of business establishments in Ethiopia take the form of sole-proprietorship. So, in order to influence the choice of legal form of existing and prospective business establishments in corporate lines, to incentivize incorporation may be the prime and only tool. Save other possible incentive schemes, to devise a pro-incorporation legal and institutional environment, subject to recurrent revisions to ensure utmost satisfaction of investors, is indispensable. Irrespective of how far the business community will be responsive to the reforms in the short run, a set of legal and institutional reforms for the development of internationally competitive domestic corporate businesses and the culture of incorporation in Ethiopia are boldly visible.

Precisely, this thesis aspired to address the following research questions.

¹⁴ Id. at 67

¹⁵ Id. at 70

¹⁶ Id. at 72

¹⁷ See Bulti Terffasa, *supra* note 10, at 291

¹⁸ ETHIOPIAN ECONOMICS ASSOCIATION, REPORT ON THE ETHIOPIAN ECONOMY 196 (2013)

¹⁹ See Chapter Four Section 4.3 of this thesis.

²⁰ Solomon Mamo, *Determinants of FDI in Ethiopia* 42 (2008) (unpublished master's thesis, Maastricht University)

²¹ Id.

²² See ETHIOPIAN ECONOMICS ASSOCIATION, *supra* note 18, p.196

- ❖ How the globalization process reached today?
- ❖ How far is Ethiopia's economy integrated with the international economic system?
- ❖ Having regard to the common problem of LDCs in the globalized economic order is the supply side constraints; could corporatization be of any help for Ethiopia to cope up with economic globalization and accession to the WTO?
- ❖ Recognizing the premature state of corporate business in Ethiopia, what legal and institutional reforms are essential to undertake to foster rapid proliferation of competitive firms?

1.3. Objectives of the Study

1.3.1. General Objectives

Broadly speaking, this research is intended to assess the level of integration of Ethiopia's economy with the global economic order and to evaluate how far corporatization can help Ethiopia take advantages, maximize opportunities and offset challenges the integration may unfold.

1.3.2. Specific Objectives

And more specifically, this thesis is envisioned to:

- Recapture the process of economic globalization and implications it does have on economies of LDCs;
- Assess the extent to which Ethiopia's economy has been globalized and rate its performance in international trade and attracting FDI;
- Assess whether corporatization would be of any help for Ethiopia to boost its performance in and beneficence from the economic globalization; and
- Appreciate some essential legal and institutional reforms to foster rapid incorporation in Ethiopia.

1.4. Significance of the Study

This study is believed to have its own academic and practical importance. It is hoped that it would add a perspective on the experiment of addressing problems economic integration poses and harnessing opportunities it offers to LDCs. Moreover, it may serve as a stepping-board to further studies in the area. Findings of the study and recommendations forwarded may have practical relevance in undertaking policy and legal reforms in particular in the endeavors meant to facilitating proliferation of competitive domestic corporate businesses.

1.5. Scope of the Study

Having regard to time and resource constraints to undertake a comprehensive study in the area, this work is limited to the assessment of economic globalization and no other dimension of globalization. Within this, it is interested in the assessment of the globalization process and the role of different stakeholders (international economic organizations, like the IMF, World Bank, and WTO, regional blocks and national economies), its implications on economies of LDCs in general and Ethiopia in particular, Ethiopia's performance in the international economy and corporatization as a tool of ensuring its better participation and beneficence from the integration.

1.6. Methodology of the Study

In the course of this study, two approaches were employed to solicit relevant data. In the first place, the author explored and looked into published and unpublished literary works including but not limited to books, journals, case reports, websites, etc. in the areas of economic globalization, the WTO system and corporatization. Moreover, this writer analyzed relevant legal instruments, both national laws of Ethiopia and of other jurisdictions, and agreements in the areas of international trade, investment and corporate business. In the second place, attempt was made to solicit firsthand information pertaining to practical matters in the said areas from prominent individuals and government offices. In this way, a wide range of data was obtained from heads of concerned government offices, practitioners, members of the academia, and colleagues from other professions by way of interviews and extended discussions. Except that certain numerical data is used, collected data was predominantly analyzed and interpreted qualitatively using a narrative approach.

1.7. Limitation of the Study

While conducting this research, the writer faced several challenges and obstacles. *Inter alia*, shortage of budget, inaccessibility of interviewees, poor data recording and filing practices of concerned government offices, and scarcity of materials on some specific topics were the critical ones. Yet, the writer devoted a lot to crosscheck authenticity of data by looking into a wide array of sources so that it is believed that the work has presented a significant content on the subject.

1.8. Organization of the Paper

This thesis comprises five chapters. Following this introductory chapter, Chapter Two deals with the process of economic globalization, the role of the 'law givers' of the international economic system, the debate on globalization, and its implications on economies of LDCs. Moreover, it highlights on the rule-based multilateral trading system and the process of accession to the WTO Ethiopia has been pursuing. Taking note of the importance of an efficient private sector in national economies and being considerate of the role corporatization may have in the development of competitive firms in Ethiopia and as a tool of coping with globalization and the advent of accession to the WTO, Chapter Three presents detailed notes on the concept of corporatization, history and common features of corporate laws and businesses across the world, advantages and challenges of incorporation and theories of the firm. Chapter Four, on its part, assesses policy measures Ethiopia took towards economic liberalization, its performance in international trade and FDI attraction, how corporatization can help in boosting its performance in that regard and what legal and institutional reforms would be appropriate for Ethiopia to undergo to marshal rapid incorporation. In the fifth and last chapter, concluding remarks on the findings of the study are made and some recommendations forwarded based on the findings.

NOTE: The citations in this work are based on the common reference of legal citations-the Bluebook²³ published by the Harvard Law Review.

²³ THE BLUEBOOK: A UNIFORM SYSTEM OF CITATION (Harvard Law Review Ass'n et al. eds. 18th ed. 2005).

CHAPTER TWO

GLOBALIZATION

2.1 The Essence of Globalization

Globalization has been part and particle of the vocabulary of economists, policy makers, journalists, politicians, academia and the general public since the 1980s¹ though it was there in reality in the pre-World Wars period. Despite modest disparities in the meanings of the term as a result of differences in the backgrounds and interests of people using it, there are numerous attempts to define the concept. It is not an uncommon exercise in the academia to define terms and concepts at the preliminary so that it would be easy to understand the work holistically. In the same corollary, some definitions of globalization are produced here under and a working definition for this work is formulated.

Dennis Smith defines globalization as “the gradual forging of links between groups and societies until they finally reach around the globe in different directions.”² In an attempt to clarify his definition, he emphasizes on two facets of the process. First, it is the way different values of peoples become shared and institutionalized at the global level. Second, it is about how interests and institutions at the global level influence freedom of action of national states and their citizens. In light of that, globalization aspires to bring about unity and harmony among human beings by ending the “us-versus-them” dichotomy. Nevertheless, thus far, the trend of globalization has been viewed by many as “Americanization,” “Westernization,” “injustice” and so on,³ all contemplating “equality” as the traditional innermost premise of international relations.

In a bit splendid manner, Haque explains globalization as “a process of integrating nations, societies, peoples, and institutions in the economic, political, cultural, and intellectual domains through means such as capital, production, exchange, and information owned and controlled unequally by various states, classes, groups, and individuals.”⁴ He is of the view that the process of contemporary globalization is “integration into the world capitalist system” so that there seems imbalance between influences of the developed and developing world while both have been in and to benefit from it. It is also defined as “a process (or set of processes) which embodies a transformation in the spatial organization of social relations and transactions, assessed in terms of their extensity, intensity, velocity, and impact-generating transcontinental or inter-regional flows and networks of activity, interaction, and the exercise of power.”⁵

As can be construed from the foregoing definitions, the integration takes place in almost all affairs of human life. Thus, even if it is difficult to draw the lines separating each segment of globalization, it seems that the globalization process encompasses the economic, financial, business, political, technological, environmental, cultural, educational, international relations and security-related dimensions.⁶ Nevertheless, it is argued that the driving force of globalization is economics while politics plays a fundamental role in shaping its route.⁷

As noted above, globalization is broader in scope and multidisciplinary in nature so that it calls upon various disciplines to study the different facets. Consequently, it is not practicable and, of course, not intended to cover all issues falling under the sphere of globalization in this study. Hence, this work is engrossed only with the

¹ DAS, DILIP K., THE ECONOMIC DIMENSIONS OF GLOBALIZATION 1 (2004).

² DENNIS SMITH, GLOBALIZATION: THE HIDDEN AGENDA 6 (2006/2007).

³ Halil M. Guven, *Globalization and the Clash of Civilizations*, in GLOBALIZATION AND THE THIRD WORLD: A STUDY OF NEGATIVE CONSEQUENCES 54 (Ghosh, B.N. and Guven, Halil M. eds., 2006).

⁴ Haque, M. Shamsul, *Globalization, New Political Economy and Governance: A Third World Viewpoint, Administrative Theory and Praxis*, 105 (2002) (accessed online on January 04, 2013 07:22 at <http://www.jstor.org/stable/25611565>).

⁵ See DAS, DILIP K., supra note 1, p.7

⁶ Id, pp.9-12

⁷ STIGLITZ, JOSEPH E., MAKING GLOBALIZATION WORK 4 (2006).

economic dimension of globalization. But it does not mean that reference to and discussion of non-economic segments won't be made at times when to do so happens indispensable.

Now, let us dwell on economic globalization. In definition, economic globalism/globalization/ may be taken to mean "the process of liberalization and integration of goods and factor markets". Alternatively, it can be stated as "integration of goods, capital and labor markets, which have thus far functioned separately."⁸

The World Bank's official definition of globalization goes: "freedom and ability of individuals and firms to initiate voluntary economic transactions with residents of other countries."⁹ This definition, as is expected, is about the economic aspect of the interplay. Similarly, Friedman opined that "globalization is the integration of markets, finance, and technologies in a way that is shrinking the world from size medium to size small and enabling each of us to reach around the world faster and cheaper than ever before."¹⁰

Therefore, economic globalization may be taken to mean the virtual integration of national economies through increased cross border trade and investment. For the purpose of this work globalization, unless expressly used differently, is equivalent to economic globalization, the latter to mean enhanced 'liberalization in trade and investment'.

Yet, of whatever pace and intensity it might be, the present phase of economic globalization is far away from being a universal institution. Statistically, the World Bank in 2002 identified forty nine developing countries, the majority in Africa, homing more than two billion people, are not well integrated with global networks, if not isolated at all.¹¹ Collectively, these economies have been named as "non-globalizing economies." The low-impulse response to the economic integration in these economies is attributed to poor macroeconomic policies, failure to harness their 'comparative advantages', poor infrastructure, inaccessible and low quality education, tariff and non-tariff trade barriers, fundamental disadvantage of location, poor governance, rampant corruption, etc.

2.2 The Debate on Globalization

Economic globalization has got protagonists, often economists, and antagonists from all over the world. On both sides are extremists, those who firmly allege the contemporary route of economic globalization is the safe way to prosperity so that it should not be altered¹² and those who argue for the total abrogation of economic integration. In between are the optimists who recognize the potential significance of economic integration and the unassailable rectification project on the contemporary system. The latter group is labeled as the "alternative globalization movement"¹³ that it does not ignore the need of the integration altogether but it also has no patience to live with the ills of the game. In this part of this work, we will be shedding light on certain views of this movement.

The critique against globalization, one way or the other, revolves around the international economic organizations (i.e. the World Bank, the IMF, and the World Trade Organization) because they make rules governing the game while the play makers are mostly multinational corporations (MNCs) and transnational corporations (TNCs), as investors and/or traders. The subject matters of the critics embrace the question of

⁸ See DAS, DILIP K., *supra* note 1, at 7

⁹ *Id.*

¹⁰ *Id.* at 6

¹¹ *Id.* at 16

¹² RICHARD PEET, *UNHOLY TRINITY: THE IMF, WORLD BANK AND WTO*, 62 (2nd ed. 2009)

¹³ Kimberly Ann Elliott, Debayani Kar, and J. David Richardson, *Assessing Globalization's Critics: "Talkers Are No Good Doers?"*, in *CHALLENGES OF GLOBALIZATION: ANALYZING THE ECONOMICS* 19 (Baldwin, Robert E. and Winters, L. Alan eds., 2004).

externalities on the environment, equitable share of the benefits and burdens of globalization between the 'North' and the 'South' and within national economies, and human insecurities the economic integration has been perpetuating.

The focus areas of the antagonists are hardly new because advocates of human rights were there since the 18th and 19th centuries and the persistent struggle for protection and promotion of labour rights has been in motion for long. It is the environmental issue which is more recent to the global activists but it grew rapidly following the 1972 United Nations (UN) Conference on the Environment.¹⁴ The increased efforts of the pro-globalization forces should have pushed the anti-globalization movements to become fierce and more organized.

Most of the anti-globalization movements take the form of non-governmental organizations (NGOs). In the late 1990s it was estimated that there were 15,000-20,000 transnational NGOs, the majority formed in the 1970s with different areas of interest.¹⁵ Of these, hundreds, and perhaps thousands, are estimated to be affiliated with the movement contending economic globalization. Some specialize on the environment, the human and workers rights, or development and poverty while some others work on multiple issues. They also differ in the role they play in the movement like organization, mobilization, research, advocacy, campaign, provision of information of action, education, etc, and the style of struggle they pursue.¹⁶

2.2.1 Globalization Vs. the Environment

The environmental issue forms one of the cornerstones in the globalization debate. It has been the UN that advocates on environmental issues transnationally and with an institutional focus. At the 1972 Conference on Human Environment, the UN Environmental Program¹⁷ was created in a move to guarding the common abode. Alongside, NGOs, often with the requisite expertise, took the environment agenda and started to challenge environment-unfriendly measures on the international fora. The concerted effort the civil society exerted from the beginning coupled with the internal motive in the UN to acknowledge the role they might play, urged the formation of an NGO office in 1973. More than 200 multilateral agreements, in the negotiation and implementation of which NGOs played an important role, were made then after.

Two decades later, the UN hosted a Conference on Environment and Development wherein the focus was to integrate environmental issues with the sustainable development agendum.¹⁸ Not less than eight hundred NGOs from 160 countries took part in the conference. A long list of issues, some called "*Agenda 21*", were tabled for discussion and a plan of action for addressing them was prepared under the guardianship of the Commission on Sustainable Development (CSD). The Conference also formed the NGOs Steering Committee implying the persistent credit given to their incessant appearance. The committee accredited 400 NGOs by the end of 2001.¹⁹

The *first* perspective of the critics contends that the international economic organizations missed the very purposes they were destined to originally. For instance, the WTO was formed under the theme of "fairer and freer trade is good". Nevertheless, it did last short while retaining its scope and promise. The WTO, according to the critic, has been promoting corporate rights and interests over the broader social agenda. It also took power on areas not related to trade including the environment as manifested in the rulings it passed on disputes

¹⁴ Id.

¹⁵ Id. at 23.

¹⁶ Id. at 25-26.

¹⁷ Id. at 19.

¹⁸ Id.

¹⁹ Id.

involving environmental issues that encroach domestic environmental policies in particular.²⁰ It is also accused for having hosted agreements having a bearing on the environment while it is not an environment protection agency. The primacy the WTO has given to 'free trade and investment at any cost' became catastrophic to other virtues like protection of the environment, working people, small farmers and cultural diversity, and ended up with an inequitable wealth distribution. As a solution, the critics propose reduction of the power of the WTO and the strengthening of accountability at the national and regional levels regarding the environment.

The critics also discredit the World Bank and the International Monetary Fund (IMF). Initially, the Bank was created to supply fund in the form of long-term loans at low interest rates for the reconstruction of the world destroyed by the Second World War (WW II). But, after the 1980s it has made a substantial change in approach by putting the "structural adjustment" of developing country policies towards privatization, deregulation, trade and investment liberalization, and the like. To the anti-globalization activists, the Bank is not only too far to reach the people on the ground, it also implanted a wrong economic model that place a premium on free trade and investment than the environment, workers, and financial stability.²¹

In a decade time, the Bank funded more than 120 environment linked projects worth of 9 billion USD.²² But the anti-globalization activists remain skeptical as to how far "green" the World Bank funding really is. They also discredit the Bank-funded projects on the grounds of their susceptibility to corruption and increased indebtedness they caused to the borrowers.²³ Some others reject the Fund's "conditionalities" and Bank's "structural adjustment programs", both geared to more trade and financial liberalization. They demand the Bank to allow more preventive measures ahead of potential financial crisis including but not limited to international Tobin tax and more national controls on capital flows.²⁴

Moreover, a joint review exercise in seven countries,²⁵ with steering boards equitably composed of local civil societies represented by the Structural Adjustment Participatory Review Initiative (SAPRI)²⁶ Network (SAPRIN), governments and the World Bank started in 1997. Research into the effects of structural adjustment in each of the fifteen countries was undertaken in four stages²⁷ and a final report, published in April 2002. The report reached the following conclusions implying drawbacks of the structural adjustment programs:²⁸

- i. *Trade and financial sector liberalization, the weakening of state support and reduction of demand for local goods and services have devastated local industries, especially small and medium-sized enterprises providing most national employment;*

²⁰ BENDE-NABENDE, ANTHONY, GLOBALIZATION, FDI, REGIONAL INTEGRATION AND SUSTAINABLE DEVELOPMENT: THEORY, EVIDENCE AND POLICY, 89-90 (2002).

²¹ Id. at 92.

²² Id.

²³ Bladwin, Robert E., Supra note 13, p.29.

²⁴ Id. at 30.

²⁵ (Ghana, Uganda, Zimbabwe, Ecuador, El Salvador, Bangladesh and Hungary)

²⁶ The SAPRI was conceived in 1995 and supposed to be a cooperative effort between the Bank and a network of 250 NGOs with the stated purpose being 'to improve understanding about the impacts of adjustment policies as well as about how the participation of local, broad-based civil society can improve economic policymaking'. See The Structural Adjustment Participatory Review International Network (SAPRIN) (2002), The Policy Roots of Economic Crisis And Poverty, Based on Results of the Joint World Bank/Civil Society/Government Structural Adjustment Participatory Review Initiative (SAPRI) and the Citizens' Assessment of Structural Adjustment (CASA), 1st Ed., p.11

²⁷ Id. The four steps the research passed through were:

- (i) mobilization of a broad cross-section of local populations affected by structural adjustment;
- (ii) national public forums organized by local civil society steering committees in conjunction with Bank and government officials;
- (iii) participatory research by World Bank and SAPRIN teams into selected issues to deepen analysis; and
- (iv) public review of the results of the forums and the research at a second national forum with modifications suggested for a final report.

²⁸ Id. at 26-173.

- ii. *Structural and sectoral policy reforms in agriculture and mining have undermined the viability of small farms, weakened food security and damaged the natural environment;*
- iii. *A combination of labor market reforms, lay-offs resulting from privatization and the shrinking of labor-intensive productive sectors has undermined the position of workers causing employment to drop, real wages to fall, and workers' rights to weaken;*
- iv. *Privatization of public utilities and the application of user fees to healthcare and education have disproportionately reduced the poor's access to affordable services;*
- v. *Increased impoverishment caused by structural adjustment has affected women more than men;*
- vi. *Many of the anticipated gains in efficiency, competitiveness, savings and revenues from privatization have failed to materialize. Trade liberalization has increased rather than decreased current-account deficits and external debt, while transnational corporations have become more powerful in the structurally adjusted countries.*

Center for Economic and Policy Research also reported the lack of growth in the many developing countries during the rapid globalization under the sponsorship of the Bank, Fund and the WTO.²⁹ According to the report, the 'neoliberal' Washington Consensus is not benefiting the majority of the world's poor. Another group by the name Fifty Years Is Enough (FYIE) demands reparations for the poor for the mal-effects of the structural adjustment policies and for the social and environmental effects of Bank projects.³⁰

Oxfam International on its part condemns the unfairness of the international trade and investment regimes to the developing countries. To wither the unfairness of the rules of the game, Oxfam International recommended:³¹

- *"Transition periods for implementing WTO agreements [that are] based on development milestones not arbitrary dates";*
- *Replacement of the single undertaking to give developing countries more flexibility in signing on to WTO agreements;*
- *Reform of the dispute settlement understanding to make it fairer and more workable for the less-developed countries (LDCs) and to ensure that rulings take into account poverty, human rights, and environmental effects (consider joint panels with specialized UN bodies);*
- *Increased technical assistance and capacity building for LDCs;*
- *Craft a decision-making processes that "increase effective participation of developing countries;" and*
- *Increased access to documents and public scrutiny through "more active involvement of national parliaments and regular consultation with civil society."*

The *second* perspective of the arguments of the environmental anti-globalization groups stands against the view that 'entrenched trade liberalization would lead to fast and broader production' for fear of the consequent environmental damage that threatens the wellbeing of mankind. The fact that the current trend of production is export-oriented and industrial-style mechanized agriculture suggests that the environmental issue is visible and more global. If emission of greenhouse gases continues at the present rate, there is a prediction that mean temperature of the globe will rise by 2-4°C making the global warming unbearable to ecosystems and humans to adapt.³² The critics admit that the increased production of goods and services is in the interest of better human

²⁹ Id. at 30.

³⁰ Id. at 31.

³¹ OXFAM INTERNATIONAL, EXECUTIVE SUMMARY AND POLICY PROPOSALS 9-10 (2001).

³² See BENDE-NABENDE, ANTHONY, *supra* note 20, at 70.

life, but their claim is how much out of the commercial benefits has been reinvested to environmental protection projects.³³

The environmental-unfriendly production is growing in the developing countries too in an unprecedented rate while their concern to the environment has reached, perhaps, the maximum in history. The share of developing countries in the emission of greenhouse gases is estimated to go up from 25% in 1990 to 37% in 2020³⁴ so that the traditional attribution of the responsibility to the rising greenhouse effects to the rich countries seems no more plausible. Yet, the critics do not get off from the shoulders of the rich 'North'. They keep holding the rich countries answerable for the rising emission of greenhouse gases even in the poor 'South' through relocating FDI mostly with risky terms taking advantage of their need to attract more of it.³⁵ In other words, it is the rich countries that send pollution-intensive production to take advantage of the lax environmental standards or being confident of the poor's inability, perhaps for lack of resources and expertise, to inspect, monitor, and enforce appropriate environmental legislation.

Nevertheless, proponents of free trade argue that had it not been for globalization, the environment would have been exposed to irreversible depletion than it is exposed today because it facilitates freer flow of resources irrespective of national boundaries while limited movement of resources would have entailed overexploitation of resources in limited supply. So, proponents of trade liberalization are of the view that international trade has done something important towards the environmental protection project.³⁶ Nevertheless, the critics do not buy the latter view and contend that even if international trade has anything in the positive towards the environmental protection, it won't last for eternity. The world is limited so that the role international trade in channeling resources to the most efficient use ends once MNCs and TNCs explored the entire globe. Furthermore, they exclaimed, "sustained growth is inversely related to pollution."³⁷

2.2.2 Globalization Vs. Wealth Inequality

The other cluster of critics is interested in the North-South equity divide. International trade and investment, so far the rich countries doing the majority the business in both fields,³⁸ have been the fundamental engines of the economic globalization. It is the USA that enjoys the maximum capital inflow.³⁹ Recently East Asia also appeared as a new FDI destination zone. Some benefit from this discourse while people in some regions like those in sub-Saharan Africa are betrayed by it.

By the late 1990s the advanced rich countries, home of one fifth of the world population, owned 86% of the world GDP, 82% of the world export markets, 68% of FDI inflow, and 74% of the world telephone line and internet facilities,⁴⁰ showing advancement in all respects. In the same period more than 80 countries had percapita incomes lower than they were a decade or more ago while only 40 others were able to manage a sustained average percapita income growth of 3% a year since 1990.⁴¹ To the worst, 55 others, most of them in sub-Saharan Africa, Eastern Europe, and Common Wealth of Independent States (CWIS) had declining percapita incomes.⁴² Poverty has reached 40% in the last two decades the worst failure being Africa. Extreme

³³ Id. at 77.

³⁴ Id. at 71.

³⁵ Id. at 81.

³⁶ Id. at 77-78.

³⁷ Id.

³⁸ Id. at 80.

³⁹ Id.

⁴⁰ Id. at 81.

⁴¹ Id.

⁴² Id.

poverty rise in Africa from 41.6% in 1981 to 46.9% in 2001.⁴³ There is no evidence as to the reversal of this situation then after.

Such incomparable disparity in wealth, according to the critics, is consequent to the discriminatory nature of the globalization process. For the sake of clarity we present some manifestations of this concern. *First*, the global labour market is favorable to highly skilled personnel.⁴⁴ This may be attributed to higher return of investments in technologically-intensive industries naturally making the global 'North' a preferred destination of such investments and pushing unskilled labour, the majority in the global 'South', to the margin in terms of payment and working conditions. In other words, people with the requisite know-how, the majority in the 'North', would secure better jobs, pays and savings so that they have a good accumulation of wealth. The aggregate, no doubt, has in part led to the prevalent imbalance in economic power between the 'North' and the 'South'.

Second, the global 'North' homes the majority of MNCs and TNCs, especially the ones operating in the automobile, oil, high-tech and banking sectors.⁴⁵ They sponsor not less than three fourth of world FDI outflow and make the highest profits therefrom.⁴⁶ According to the critics the returns are not obtained in a reasonable manner. It is in fact unfair to deny the higher motive of and fierce competition among the developing countries to attract FDI as much as they can and the positive effects of FDI to the poor host countries so that the governments in the 'South' should take their respective share of the blame.⁴⁷

Third, the critics also assert that TNCs and MNCs influence international negotiations pertaining to the environment, trade, investment, and other sectors that potentially have any implication on their investments. To the antagonists, the existing rules on trade and property rights have been written for the monopolies, at times, disregarding the interest of the poor in the 'South' and, some other times, incorporating smooth languages to overshadow the explicit dishonesty and conspiracy of the 'North'. Anthony Bende-Nabende argues that "what has locked poor countries out of the global trade and into perpetual poverty is not globalization but lack of it".⁴⁸ The protected and subsidized Western agricultural sector hampered the poor 'South' from harnessing their "comparative advantages".⁴⁹ Joseph E. Stiglitz, a Nobel Laureate economist, also noted the irregularity of the international trade regime by saying "a European cow gets a subsidy of US dollar (USD) 2 a day (the World Bank measure of poverty); more than half of the people in the developing world live on less than that. It appears that it is better to be a cow in Europe than to be a poor person in a developing country."⁵⁰

Fourth, the advanced rich countries have been accused by the anti-globalization activists for using double standards with respect to their environment-related competition and trade policies. On the one hand their stringent environment policies and standards, which mean an increased cost of production to MNCs and TNCs, urges the latter to relocate themselves in the "pollution havens", often the 'South' where environmental standards are lax, to reduce such cost. On the other hand, they resort to, as authors in the field call, "green protectionism."⁵¹ Green protectionism is a deliberate move by the advanced rich countries to narrow down the gate to their markets for fear of competition from foreign products under the guise of tighter environmental, health or social standards and thereby forcing small and medium sized companies in developing countries

⁴³ See STIGLITZ, JOSEPH E., supra note 7, at 11.

⁴⁴ See BENDE-NABENDE, ANTHONY, supra note 20, at 82.

⁴⁵ Id.

⁴⁶ Id.

⁴⁷ Id.

⁴⁸ Id. at 67.

⁴⁹ It is estimated that agricultural subsidies in the USA, EU and Japan, including the hidden ones, amounts at least 75% of income of sub-Saharan Africa. See STIGLITZ, JOSEPH E., supra note 7, at 85.

⁵⁰ Id.

⁵¹ See BENDE-NABENDE, ANTHONY, supra note 20, at 86-87.

surrender to the giant 'Northerners'. "National eco-labeling programs" geared to scrutinizing the production process in terms of raw materials, technologies, monitoring procedures and the like are expositions of the green protectionism projects. To cut a long story short, "corporate-led globalization creates two worlds; one gaining benefits from investment and trade, and one losing out."⁵²

2.2.3 Globalization Vs. Human Insecurities

As is envisaged in the international human rights instruments, national governments have been given a fundamental role in ensuring the protection and promotion of human rights. Globalization, however, is characterized by a diminishing power of national governments and ever increasing power of TNCs which in turn diminishes the role of the state in the protection and promotion of human rights.⁵³ So, globalization is consequent to disempowerment of local communities and strengthening of international governance. It eroded local livelihoods, jobs and community self-reliance. It exposed people to repeated economic volatility leaving the human impacts even after the economic recovery.⁵⁴ Globalization spread chemical and bio-tech intensive agro-business that pushed small scale farmers, who mainly produce staple foods for local consumption, off their lands. Besides, to date, seeds are in the monopolistic control of a small number of corporations that concentrate on commercial producers in favorable production environments, while neglecting subsistence farmers, who do not represent an attractive market for hybrid seed, in the margins.⁵⁵ In the face of these all, therefore, food security and safety of the poor is highly threatened.

Moreover, antagonists of economic globalization air that rules of the game give primacy to proprietary interests than to workers' rights. The globalization process advocates for increased mobility of capital and not labour which, in economic terms, is working for increased economic benefits of capital against labour, especially low-skilled labour.⁵⁶ Furthermore, globalization is characterized by job and income insecurity. The frequent financial volatility and economic insecurity globalization has precipitated and the temporally changing comparative advantage economies offer to TNCs and MNCs would constantly lead to migration of jobs from one location to another location. This would leave employees in the deserted location with no job or ones with minimal pay. The critics also demand the international financial institutions to be sensitive to workers' concerns when responding to financial crises and planning development projects.

It is true that, though yet to a limited degree compared to movement of products and capital, it is in the present phase of globalization that movement of people has become easier and frequent. Advances in information and communication technology, and cheaper transportation make distance less material, if not immaterial. Nevertheless, people move with evils in them. The increased movements of persons posed a dramatic spread of killer disease including HIV/AIDS. It is in this phase of globalization that criminal behaviors have got a transnational character. Illicit trade in drugs, human trafficking, money laundering, piracy, terrorism, etc. have become frequent in tandem with the increased integration.

⁵² Id.

⁵³ Downsizing of the public sector has been a strategy advocated by the World Bank, an element of its structural adjustment programs, and regional Development Banks. For example the World Bank and the Asian Development Bank urged Malaysia to take measures to reduce the size of the public service, the Philippines to streamlining the bureaucracy to reduce staff by 5%-10%, Singapore to inculcate a "zero man power growth policy," Thailand to frozen new employment and reduce underutilized public employees, India to reduce public employment by 30% , Nepal to frozen all vacant positions and reduce the size of the public sector, Sri Lanka to adopt early retirement policy. Africa and Latin America also have been in the same trajectory towards small government. It is reported that the ratio of central government employees with the total population has decreased in a decade time (between 1980s and 1990s) in Asia from 2.6% to 1.1%, in Africa from 1.8% to 1.1%, and in Latin America from 2.4% to 1.5%. See also Haque, M. Shamsul, supra note 4, at 109-110.

⁵⁴ See BENDE-NABENDE, ANTHONY, supra note 20, at 98-99.

⁵⁵ Morris, Michael L., *The Development of the Seed Industry Under Globalization*, in GLOBALIZATION AND THE DEVELOPING COUNTRIES: EMERGING STRATEGIES FOR RURAL DEVELOPMENT AND POVERTY ALLEVIATION 216 (David Bigman ed., 2002).

⁵⁶ See BENDE-NABENDE, ANTHONY, supra note 20, at 98-99.

It is also a shared view that “cultural, biological, social, and economic diversity are central to a dignified, interesting and healthy life”.⁵⁷ Globalization as a process of all-inclusive integration is not limited to the economic dimension. Rather, it involves the increased flow of knowledge, cultures and ideas too. Nevertheless, the interaction, more often than not, is heavily weighted in one direction. To that end some critics tend to name the whole process as “Westernization,” “Americanization,” and so forth to explain the one way flow of cultures and knowledge. Cultures move to the South as capital and technology do. Communications technologies bring Hollywood to remote villages. The growth of a global “consumer culture” with respect to some global brands signifies that exogenous social standards, potentially with a discontent to local values, are being set. Some dare to call it “cultural imperialism”. The cultural hegemony would in turn pose all sorts of ethical dilemma in the South.

2.3 Agents of the Economic Globalization

As noted earlier, economic globalization is the increased integration and interdependence of national economies. The level of integration the global economic order reached today is not accomplished over night. It rather is a process in the development of which several stakeholders contribute a part. Haque notes that the main actors in the process of economic globalization are external non-state entities including international agencies,⁵⁸ MNCs and TNCs, regional trade blocs,⁵⁹ world media networks, and top government leaders and policy elites who often served interests of TNCs.⁶⁰ The rapid integration process also take advantage of the demise of communism and emergence of market-based neoliberal ideology as the only path of development, erosion of nationalism in the third world countries, globalization of consumer culture, information network like the internet,⁶¹ and fast growing knowledge industry. Nevertheless, not all agents of globalization are covered in this thesis. Rather, emphasis will be given to what are in general named as “international economic organizations”. In the forthcoming sections, attempt is made to highlight on the contributions of these actors to the present state of globalization.

2.3.1 The Bretton Woods’ Institutions (the IMF and the World Bank)

The UN Monetary and Financial Conference, in which delegates from some 44 countries took part, was held at the Bretton Woods from 1 to 22 of July 1944 to discuss economic plans for the post-war peace. The conference envisaged regulation of the international economic order by three institutions namely the IMF, IBRD (which later becomes the World Bank), and ITO which remained inactive till the WTO assumed its mission in 1994.⁶²

To have a brief note on the politico-economic context of the pre-Bretton Woods conference world would be crucial to well comprehend the forces that necessitated governance of the ‘new international economic order’ and why the conference culminated by giving birth to the IMF and the IBRD only. It was both political (imperialism) and economic (trade, investment, and flow of technology) forces that cemented interactions of

⁵⁷ Id. at 100-101

⁵⁸ The list includes the World Bank, IMF, WTO, IFC, Asian Development Bank, Inter-American Development Bank, African Development Bank, etc.

⁵⁹ In the list are the Organization for Economic Cooperation and Development (OECD), Asia-Pacific Economic Cooperation, EU, North American Free Trade Area (NAFTA), Association of South East Asian Nations, Latin American Integration Association, Common Market for Eastern and Southern Africa (COMESA), Central European Free Trade Area, etc.

⁶⁰ See Haque, M. Shamsul, *supra* note 4, at 106.

⁶¹ The number of internet users rise from about 26 million in 1995 to 143 million in 1998 while internet hosts increase from 100,000 to 36 million in the same period. The number of internet users reached 360, 985, 492 in 2000 and 2,405, 518, 376 in 2012. See www.internetworldstats.com.

⁶² See RICHARD PEET, *supra* note 12, at 36.

the pre-war world.⁶³ The pre-World War I (WW I) period is characterized by self-regulating economies, natural flow of money and capital, and dissociation of politics from economics and national economies from international economies.⁶⁴ Hence, controlling the political environment was the only concern of the victorious Allies at the Versailles Conference that signified the end of WW I.

The ensuing economic crises in consequence to the cost of the war, protection of domestic production,⁶⁵ printing of inconvertible money which in turn led to increased inflation and unemployment in the West⁶⁶ while Russia, the then obstacle to capitalism, was rapidly industrializing, precipitated signs of economic collaboration among developed capitalist countries in the post-war years.

The understanding took off by the creation of the Economic and Financial Organization, a specialized agency of the League of Nations though it hanged only to financing conferences. Concomitantly, attempts to establish a bank that supports post-war reconstruction projects was firstly proposed in Brussels in 1920. Efforts continued at Genoa in 1922 and Geneva in 1927, but became a reality only after WW II at the Bretton Woods Conference where, it is believed that, economics and politics came together.⁶⁷

In the post-Wars period the leading economic discourse was that “trade prevents war and brings about peace.”⁶⁸ The Bretton Woods Institutions were therefore supposed to thwart wars then after by defeating the “anarchy in the inter-wars time”. This notion assumes mutual dependence, reciprocity and relative equality in economic and political-military powers among nation states where as the Bretton Woods was conceived in a world characterized by extreme inequality and aggressive desire to expand the didactics of the capitalist market to the world scale.⁶⁹ In light of these conditions, trade among countries of an incomparable economic and political power does not and cannot work to bring about global peace and prosperity. The recommendations of different writers of our own times towards more “fairer trade” and to that end “differential and special treatment”⁷⁰ of the third-world countries, seems to stem from this theoretical foundation.

The 1930s economic depression made the need for prudent state intervention in the economy explicit. At the international level in parallel, the collective responsibility for managing the international economic system became a new spectrum. Development of such a multilateral system of governance should be considerate of three ideas; state sovereignty (as resembled in the UN) exercise of which is best expressed by entering in to agreements that limit such sovereignty, belief that economic integration would lead to efficiency and prosperity, and power. Abrogating its “isolationist” stance in the pre-WW II period, the US appeared in the post-war period ready for participation in and leadership by formulating plans for “a new order of world economy”.⁷¹ The US mercilessly started to view and use multilateral organizations as instruments of foreign policy to be used in support of specific aims and objectives.⁷²

As noted above, the Bretton Woods Conference was predated by the power concentration in North America and Western Europe, maximum interest and belief in classical liberalism tempered by Keynesianism, and

⁶³ In the second half of the 19th Century, international trade expanded rapidly and integrated by trade relations and investment flows than any time before, and arguably, more than any time since, including globalization of the turn of the 20th C.

⁶⁴ See RICHARD PEET, *supra* note 12, at 37.

⁶⁵ Typically, in 1930 a Republican-dominated US Congress passed the Smoot–Hawley Tariff Act, which increased tariffs on imports by an average of 52 percent.

⁶⁶ Unemployment in the 1930s reached 27% in the USA and 44% in Germany.

⁶⁷ See RICHARD PEET, *supra* note 12, at 40.

⁶⁸ *Id.* at 41.

⁶⁹ *Id.* at 42.

⁷⁰ See STIGLITZ, JOSEPH E., *supra* note 7, at 83.

⁷¹ See RICHARD PEET, *supra* note 12, at 46.

⁷² *Id.* at 47.

willingness and ability of the US to assume global leadership. The US and UK joined by China and Russia invited some other nations at Claridge Hotel in Atlantic City in the pre-conference drafting stage to test what challenges might surface at the actual conference and remedy them at the earliest possibility.⁷³ The assignment of quotas was the heatedly debated issue there because the voting power was deemed based on them. China claimed for a fourth place, France and India claimed for fifth place, smaller countries in the third-world requested for more quotas, and Australia screamed for more privileges exceeding of its size and importance in the international arena.⁷⁴

Hence, the Bretton Woods conference was meant only to formalizing what was agreed up on between the US and the UK. Put differently, the conference was “a drafting meeting with the substance having been largely settled previously by the US and UK delegations supported by the Canadians”,⁷⁵ and later among their supporters. The West was therefore such hegemonic while most representatives from the third world were hardly knowledgeable about the business on the table and did not even speak English, the medium of communication of the Conference.

The UK assumed a relatively quite distinct stance in many instances, usually supported by the Netherlands, Greece and the Commonwealth countries, during negotiation of the agreement to put its finger prints on the governance of the global economy. For example it wanted to maintain “imperial preference” while the US firmly rushed for “free trade”.⁷⁶ Furthermore, the US sought after a large political organization staffed by permanent employees while the UK wanted for ‘part time organizations’ hosting discussions of economic and financial intelligential.⁷⁷ Once more, the US persisted on the stance that the right to borrow from the institutions should be conditional while the UK intended to inculcate a right to borrow on request and respect to national autonomy to pursue whatever policies countries may be pleased with.⁷⁸ Nonetheless, the US had the upper-hand to foil such challenges and dictate its positions in the grand agreement⁷⁹ and the UK, as to some writers, ratified the agreement being subject to pressure of indebtedness to the US which threatened the “free will” of the UK.⁸⁰

At last, the US managed to host the inaugural meeting of the Board of Governors of the IMF and the IBRD in Savannah, Georgia, in January 1946 wherein 34 countries that had already ratified the agreement took part. The meeting decided that the two organizations be headquartered in Washington, D.C.⁸¹ Having said this much about the general background of them, in the following few paragraphs, specific discussions on the IMF, World Bank, and WTO are due.

⁷³ The invited countries were Australia, Belgium, Brazil, Canada, Chile, Cuba, Czechoslovakia, the French National Committee of Liberation, India, Mexico, the Netherlands, and the Philippines. See RICHARD PEET, *supra* note 12, at 52

⁷⁴ See RICHARD PEET, *supra* note 12, at 52.

⁷⁵ *Id.* at 49.

⁷⁶ *Id.* at 50.

⁷⁷ *Id.* at 50-54.

⁷⁸ *Id.* at 59.

⁷⁹ *Id.*

(As planned by White [US representative], the Bretton Woods conference was conducted through the means of three commissions: Commission I (International Monetary Fund), of which White was chairman; Commission II (Bank for Reconstruction and Development), chaired by Keynes [UK representative]; and Commission III (Other Means of International Financial Cooperation), chaired by Eduardo Suarez of Mexico. Each commission had several committees with non-US chairs and reporters. Washington usually had the support of the Latin American delegates. In return, the US representatives assured them that they would be able to select two directors, for the IBRD and the IMF. ... White neutralized Keynes, the only person seriously able to upset his plans, by appointing him chairman of the Commission on the IBRD. That kept the British so busy that they were unable to interfere with committee meetings regarding the IMF)

⁸⁰ *Id.* at 60.

⁸¹ *Id.* at 61.

2.3.1.1 The International Monetary Fund (the IMF)

The IMF is an international agency established, as noted earlier, in 1945 by signature of the articles of agreement by 29 nations resulting from the Bretton Woods Conference. It started operation in 1947. It was basically meant to provide a framework that facilitates the exchange of goods, services, and capital among countries. Its primary objective was regulating exchange rates and facilitate balance of payments by extending loans so that a stable global economic condition can be maintained.⁸² Even if its mission statement remains the same till today, it has undergone changes that accumulated its power and influence in the governance of the global economy. To imply the increased dominance of the IMF, some tend to name it as “a single powerful non-state governance institution in the world.”⁸³

Structurally, the IMF has got a Board of Governors, Executive Board (forum for 24 executive directors), Managing Director, staff, and committees. At the apex of the ladder is the Board of Governors that meets twice a year at the joint meetings of the Fund and the Bank, and decides on major policy issues. The Executive Board on the other hand meets three times a week at IMF’s headquarter in Washington, D.C., and undertakes the day-to-day operations of the Fund.⁸⁴ It is a gentleman’s agreement that the Managing Director is chosen by European members for a term of five years and the First Deputy Managing Director by the US government.⁸⁵ The other two deputies are appointed by the Executive Board.

In the Executive Board are representatives of the major shareholders i.e. USA, Japan, Germany, France, UK, China, Russia, and Saudi Arabia on a permanent basis while other 16 Executive Directors who are elected for two years time by groups of countries called “constituencies.” That in simple mathematics means the Executive Board involves 24 seats in which ten are taken by developing countries but only with 26% of voting shares. Forty five sub-Saharan countries are allocated with only 4.4% out of the 26% of voting shares.⁸⁶ A new formula of calculating voting weights can be considered only during reviews of the quotas assigned to each country. At the 2006 Annual Meeting in Singapore, the IMF agreed for ad hoc increases in quotas to China, Korea, Mexico and Turkey.⁸⁷

In the IMF framework, decisions are often made by consensus⁸⁸ which is a matter of persuading the ones having a view different from the one proposed. The influence of advanced rich countries is automatic given the nature of the process. At times when unanimity is difficult to reach, decision is made by majority vote in which

⁸² Articles of Agreement of the International Monetary Fund (IMF) in Art.I provides:

The purposes of the International Monetary Fund are:

- To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems,
- To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
- To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
- To assist in the establishment of a multilateral system of payments in respect of **current transactions** between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade,
- To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members, the Fund shall be guided in all its policies and decisions by the purposes set forth in this Article.

⁸³ See RICHARD PEET, supra note 12, at 66.

⁸⁴ Articles of Agreement of the IMF, Art.XII.

⁸⁵ See RICHARD PEET, supra note 12, at 69.

⁸⁶ Id. at 70.

⁸⁷ Id. at 126.

⁸⁸ Id. at 70.

case again the wealthy countries are appropriated with the upper-hand, the US individually taking 17% of voting shares.⁸⁹

The financial resources of the IMF come from the capital subscriptions that countries pay when joining the organization or following review, and under the two sets of standing arrangements. The first arrangement is known as the General Arrangements to Borrow (GAB). It was established in 1962 by 11 participants. The second one is known as the New Arrangements to Borrow (NAB). It was introduced in 1997 by 25 participating countries and their financial institutions. So far, the IMF has got USD 46 billion or SDR 34 billion for emergencies under the two arrangements.⁹⁰

IMF financing is available only when a member faces balance of payments problems which may grow to the level of financial turmoil with a spillover effect to adjacent economies or beyond to the level of its integration in the global economy. A member country is entitled to receive a loan of 25% of its quota, technically a “tranche,” instantaneously and unconditionally. Should yet the problem persists, it can draw up three fold of its original quotas, referred as “upper tranche,”⁹¹ subject to conditions specified by the Executive Board of the Fund. The “conditionalities” are sets of policies that the borrowing government has to adopt and implement under closer surveillance of the Fund.⁹² So far, the Fund has adopted six loans “arrangements” and “facilities” involving different sets of conditionalities.⁹³ Loans under the Poverty Reduction and Growth Facility (PRGF), which replaced the Enhanced Structural Adjustment Facility in 1999, for instance, is conditioned up on the commitment of the borrowing lowest income country punched by a protracted balance of payment problems to comply with prescriptions set by the IMF in the areas of public sector employment, privatization, public enterprise reforms, trade policy, pricing, social security systems and ‘systemic’ reforms.⁹⁴

IMF conditionalities increase over time under the guise of devising “policies aiming more generally at improvements on the economy’s underlying structure to foster growth, and facilitate adjustment to exogenous shocks.” Currently, the Fund ascribes to itself the right to engage in much broader reforms including trade liberalization, pricing and marketing, labor market reorganization and generic institutional or regulatory changes.⁹⁵ The question however is on the legality of these extensions.⁹⁶

In the pre-1970s half of IMF financing went to the developed countries the first borrower being France. Then after the majority of its borrowers are developing countries. Mockingly, however, the Fund extends only a small portion of the country’s external financing request even in the situations where the “conditionalities” are well

⁸⁹ Articles of Agreement of the IMF, Art.XII, Sec.5

⁹⁰ See RICHARD PEET, supra note 12, at 71.

⁹¹ Id. at 72.

⁹² Articles of Agreement of the IMF, Art.V Sec.3 a. provides that:

The Fund shall adopt policies on the use of its general resources, including policies on stand-by or similar arrangements, and may adopt special policies for special balance of payments problems, that will assist members to solve their balance of payments problems in a manner consistent with the provisions of this Agreement and that will establish adequate safeguards for the temporary use of the general resources of the Fund.

⁹³ These includes:

- Stand-by Arrangements,
- The Extended Fund Facility,
- The Poverty Reduction and Growth Facility,
- The Supplemental Reserve Facility,
- Contingent Credit Lines, and
- Emergency Assistance

⁹⁴ See RICHARD PEET, supra note 12, at 72.

⁹⁵ Id.

⁹⁶ Independent Evaluation Office of the International Monetary Fund, *The IMF’s Approach to International Trade Policy Issues*, (Issues Paper for an Evaluation by The Independent Evaluation Office (IEO) 2008).

met.⁹⁷ Nowadays, what has become more important than the actual IMF loan is its approval that the country's economic policies are on the "right track" which would serve as "banker's guide to creditworthiness" to generate additional loans from other sources.⁹⁸

So far, IMF's crisis intervention endeavors end up being failed experiences.⁹⁹ Its ever increasing exposition on original issues of trade and capital liberalization than its principal agenda of facilitation of balance of payments and stabilization of exchange rates, bring the IMF to the forefront of global economic governance. While it was meant to assist the liberalization of trade and investment by supplying the framework for unrestricted current international payments, its encroachment on purely and primarily trade and investment matters may be consequent to the desire of the capitalist West to evade the relative fair representation of the poor and democratic procedures in the WTO, and drive the issues in the way they like using their unrestrained power in the IMF.

2.3.1.2 The World Bank (Group)

Discussions at Bretton Woods dwelt principally on the IMF.¹⁰⁰ The IBRD was therefore a mere addendum to help reconstruction of the war-devastated Europe. This is to the extent in support of the allegation that the rich countries have given little, if not no, place to the rest of the world, what they then labeled as "the colonies," and their concerns. While the World Bank Group, a conglomeration of five specialist institutions,¹⁰¹ has been a global development agency with a motto "a world without poverty," the name World Bank is usually used in reference to the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA) so that it is used in this work to mean the same.

The Bank was originally meant to:¹⁰²

1. *Assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including the restoration of economies destroyed or disrupted by war, the reconversion of productive facilities to peacetime needs and the encouragement of the development of productive facilities and resources in less developed countries;*
2. *Promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital,¹⁰³ funds raised by it and its other resources;*

⁹⁷ See RICHARD PEET, supra note 12, at 74.

⁹⁸ Id.

⁹⁹ Id. at 125.

¹⁰⁰ Id. at 127.

¹⁰¹ The World Bank Group consists of five specialist institutions.

- ❖ The **International Bank for Reconstruction and Development (IBRD)** extends development loans at low interest rate to a 'creditworthy' member country by selling bonds in private capital markets in the developed world, guarantee loans, and supplies analytical and advisory services.
- ❖ The **International Development Association (IDA)** in its part gives loans to developing countries that are 'not usually creditworthy' at the international financial markets at zero interest rate but at a 0.75% annual administrative charge. It is funded from national budgets of member countries.
- ❖ The **International Monetary Corporation (IMC)** is the largest multilateral source of loan and equity financing for private sector projects in the developing world.
- ❖ The **Multilateral Investment Guarantee Agency (MIGA)** provides investment insurance.
- ❖ The **International Centre for Settlement of Investment Disputes (ICSID)** facilitates settlement of investment disputes between investors and host governments.

¹⁰² Articles of Agreement of the International Bank for Reconstruction and Development (July 22, 1944), Art.I

¹⁰³ The World Bank has a capital stock subscribed by its member countries and divided into shares. The original capital subscription was USD 9.1 billion, of which USD 3.2 billion or 34.9% was from the USA. In 1946, when the Bank formally began operations, its initial

3. *Promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living and conditions of labor in their territories;*
4. *Arrange the loans made or guaranteed by it in relation to inter-national loans through other channels so that the more useful and urgent projects, large and small alike, will be dealt with first;*
5. *Conduct its operations with due regard to the effect of inter-national investment on business conditions in the territories of members and, in the immediate postwar years, to assist in bringing about a smooth transition from a wartime to a peacetime economy.*

In its early years, the Bank was enormously under US dictation in terms of leadership and capital contributions.¹⁰⁴ It started operation, as intended, by lending to Western European governments for reconstruction in the late 1940s. No later, they showed reluctance to borrow from the Bank so that its attention shifted toward 'third world richer countries' in the 1950s. During this time, according to commentators on the topic, the main mission of the Bank was to establish good will among private investors, especially those on Wall Street by "insisting on fiscal and monetary discipline" on the part of borrowing countries and engaging in "sound banking practices."¹⁰⁵

A "sound banking practice" was then equivalent to a "restrictive version of project lending." That time the World Bank "essentially loaned money for infrastructure projects that could be shown to be viable in terms of prospective interest and principal repayments." Though, the loan facilities stretched overtime to include projects in social areas like education and health, the Bank persists on loaning when it is convinced that repayment is certain.¹⁰⁶

In the 1950s the Bank showed interest in broader issues of income distribution and poverty so that lending was directed to the poor countries. The agricultural sector, as expected, became the prime focus for the obvious reason that it has been the source of subsistence to the majority in these countries. Besides, IDA, poor countries having an exclusive borrowing privilege from it, came in to being in 1959. The Bank adopted a broader perspective on development lending that gave premium to poverty alleviation and provision of basic needs.¹⁰⁷

In response to the diminishing investment opportunities in the infrastructures of its traditional client countries, it underwent financing more risky programs like 'sites and services' projects (i.e. providing new house sites and public services to an area and then housing upgrading in slum areas) and 'integrated rural development projects' (i.e. large rural development schemes focused on small farmers as its main vehicle for direct poverty alleviation).¹⁰⁸ Nevertheless, these all moves to eradicate poverty and enhance living standards of the poor in ecologically and culturally sophisticated areas were outlined in Washington, far away from the problems and thus equally far away from the remedies. At last, the Bank's own Operations Evaluation Department called most such projects 'failures'¹⁰⁹ ending borrowers up with entrenched indebtedness and balance of payments problems.

authorized capital had risen to USD 12 billion. In the first ten years, additional 85% of bonds of the Bank were denominated in USA dollars and sold on Wall Street.

¹⁰⁴ Id.

¹⁰⁵ Id. at 130.

¹⁰⁶ Id.

¹⁰⁷ Id. at 131-136.

¹⁰⁸ Id.

¹⁰⁹ Id. at 136.

It then devised structural adjustment lending as a way out. The new lending program would provide loans that were policy-based, rather than project-based, as 'domestic policy inadequacies',¹¹⁰ extending over several years, were identified to be the lead hindrances of productivity, and it would provide direct support for specific policy reforms decided upon during 'dialog' with the borrowing country. The major policy changes advocated for were trade policies favorable to increase international competitiveness, macroeconomic stability, and equitable resource allocation and complementary policies. The Bank persistently manifested its firm conviction towards market fundamentalism and the risk of reluctance and delaying openness by magnifying on the 'success stories' of outward-oriented economies of East Asia.¹¹¹

Besides the demarcation lines between mandates of the IMF and the World Bank have tended to fade over time and agreement has tended to cohere on the direction of policy prescription (i.e. Bank's structural adjustment lending and IMF's conditionality), the Bank ended up with another season of failure. At the odds with reports of the Bank and its affiliates labeled ones by the *New York Times* as the "Berkeley Mafia", a UNICEF report titled *Adjustment with a Human Face* pointed to the deteriorating health and education conditions, the worsening employment situations and the falling incomes in countries undergoing structural adjustment.¹¹² Moreover, the Wapenhans Report, titled *Effective implementation: key to development impact* found out that "at least twenty percent of the 1800-odd projects in 113 countries contained in the Bank's USD 140 billion loan portfolio presented major problems."¹¹³ The Bank's own Operations Evaluation Department also found out that, over all, the structural adjustment lending in sub-Saharan African countries remained a 'failure' too.¹¹⁴

The over enduring critics against the structural adjustment lending in the late 1980s and early 1990s¹¹⁵ forced the Bank to revise its stance towards a revised neoliberal model stressing 'market-friendly' state intervention and good governance (political pluralism, accountability and the rule of law) with a renewed emphasis on social issues such as poverty and education, and a dedication to debt reduction.¹¹⁶ Thus, the World Bank, as revealed in various *World Bank Development Reports* of the 1990s and 2000s, outlined a new 'holistic approach' to development involving social safety nets, poverty, health, education, environment, rural areas and gender considerations and the conventionally neoliberal areas, such as increased property rights, trade liberalization and privatization. The Bank suggested an integrated approach to development based on a framework articulated and 'owned' by the country itself and aimed at poverty reduction and sustainable development, known as the *Comprehensive Development Framework (CDF)*.¹¹⁷ It might be taken as a revelation of interest on the side of the Bank to work in collaboration with other stake holders like the UN, NGOs, OECD, etc.

The responsiveness of the Bank to public concerns, as observed at different times, certainly by adjusting its image, and arguably by modifying its substantive policies makes it relatively different from the other sister-organizations. Some consider this critic receptiveness of the Bank as a desirable and genuine attempt to remain dynamic. Some others are skeptical about the response of the Bank which, according to them, is a mere 'window dressing' while retaining the status quo. The latter view corresponds to the accusation that the Bank

¹¹⁰ Id. at 137.

¹¹¹ WORLD DEVELOPMENT REPORT (of the years 1983-1987).

¹¹² See RICHARD PEET, supra note 12, at 144.

¹¹³ Id.

¹¹⁴ Id. at 145.

¹¹⁵ The loudly pronounced angers against the Polonoeste highway project in Brazil and the Sardar Sarovar dam project on the Narmada River in India are worth of mention.

¹¹⁶ See RICHARD PEET, supra note 12, at 145.

¹¹⁷ Id.

has been making use of even ‘research’ findings to legitimize and defend the neoliberal free-market paradigm over the past three decades.¹¹⁸

2.3.2 The World Trade Organization (WTO)

The base for promotion of free international trade lies on Adam Smith’s theory of “absolute advantage” as latter advanced by David Ricardo’s theory of “comparative advantage”. The latter in turn has been subject to additions to generalize the production model because it was limited to “comparative labor productivity advantage”.¹¹⁹ According to the absolute advantage theory, should a country benefit from international trade, it must be the most efficient in production of certain items. Whereas, Ricardo maintained the view that countries can be better off notwithstanding the fact that they lack absolute advantage by specializing in produces they have a comparative advantage, meaning in areas they can do better.

New Trade Theories (NTT)¹²⁰ have also been added to the economics debate overtime though an independent study is needed to rate the actual influence they have on industrial policies and trade. The NTT uncover the impact of relative factor endowment differences, economies of scale and trade costs on trade patterns and the fact that trade in all models is gainful despite the gains won’t be divided evenly so that there would be ultimate losers.¹²¹ Despite the fact that the theories of international trade assume two trading partners, the reality of contemporary trade is multilateral. Moreover, it may not be easy to tell which theory of trade persuaded governments in devising trade policies and modeling trade patterns.

That being as it may, effective moves towards trade liberalization, in the form of both unilateral lifting of restrictions on cross border trade and bilateral arrangements, dates back to the second half of the 19th century in response to unprecedented rapid expansion of international trade and investment, perhaps “more than any time including globalization of the turn of the 20th century.”¹²² The unilateral revocation of the Corn Laws in 1846 by the then mighty, Great Britain, and arguably the first effective official trade negotiation with France in 1860 that gave life to the Cobden-Chevalier Treaty¹²³ are cases in point. Other bilateral agreements in favor of free trade were done in Europe. However, such endeavors towards trade liberalization did not last long because the world resorted back to protectionism during the inter-Wars period.¹²⁴

The desire to create an international organization specializing in trade matters dates back to the time when the Bretton Woods Institutions were conceived. As was the case with the Bretton Woods Institutions, the modern trading system too was principally the creation of the US and the UK. The US chaired the first conference to draft a charter for the International Trade Organization (ITO) in 1943. The US-draft ITO charter was heavily amended at the UN which engendered disobedience in the US congress.¹²⁵ The Congress’ refusal to ratify the agreement stemmed from the disbelief that it would erode US’s influence in the organization inspired by UN-type democracy (i.e. one state one vote which runs at the odds with US’s perception that it is far more than one country in terms of economic power and political might).¹²⁶ Total abrogation of the ITO agendum in the 1950s by the US government withered others’ confidence in the need and efficacy of the ITO in her absence.

¹¹⁸ See RICHARD PEET, *supra* note 12, at 150-152.

¹¹⁹ ANDERSON, JAMES E., *INTERNATIONAL TRADE THEORY*, 3 (Boston College).

¹²⁰ Sunanda Sen, *International Trade Theory and Policy: A Review of the Literature*, 6 (Levy Economics Institute of Bard College, Working Paper No. 635, 2010).

¹²¹ *Id.*

¹²² See RICHARD PEET, *supra* note 12, at 179.

¹²³ CRAIG VANGRASSTEK, *THE HISTORY AND FUTURE OF THE WORLD TRADE ORGANIZATION* 41 (2013).

¹²⁴ *Id.*

¹²⁵ See RICHARD PEET, *supra* note 12, at 181.

¹²⁶ *Id.*

Unluckily, the aim to create the ITO at a UN Conference on Trade and Employment in Havana, Cuba, in November 1947 remained a nightmare.

It was in the mean time that some fifteen countries began talks in December 1945 to reduce and bind tariffs believing the task of liberalizing trade was important to reverse the protectionist legacy of the pre-WW II period.¹²⁷ Such talks ended up with the thirty eight articles General Agreements on Tariffs and Trade (GATT) signed by 23 countries¹²⁸ on 30 October 1947 in Geneva. Then the GATT stood alone for half a century being “provisional” and at times being considered as an international organization¹²⁹ while it remained, named properly, as the ‘rule book’ governing the world’s commerce in commodities.

Once the ITO failed to take off the ground, governments reverted to the GATT. Yet, the GATT lacked an organizational structure so that the Interim Commission for the ITO (within the UN) served as an administrative body regulating the General Agreement.¹³⁰ The provisional GATT Secretariat coordinated eight rounds of Multilateral Trade Negotiations (MTNs) over the next half century. The MTNs showed advancement in terms of number of participant countries and mix of issues covered.

As can be understood from the table below, the issue of tariff reduction has been a concern in all the conferences whereas non-tariff barriers to trade, transforming the traditional conception of trade to mean principally or exclusively the movement of goods, started to be discussed during and in the post-Kennedy Rounds. Agreements that elaborate provisions of the GATT or breaking entirely new ground on wide range of issues including trade in services, investment, and intellectual property were made. But, the widening trend in the subjects of trade negotiations meant contraction of space of “national trade policies”.

The formal enforcing body (i.e. WTO) in the area of international trade was created at the Uruguay Round and commenced operation on 1 January 1995 while the multilateral trading system is more than half a century old. Put differently, the WTO succeeded the original GATT but it has obtained authority over ever increasing “trade related matters.” Its mission is to help trade flow as freely as possible in the belief that “trade is good for economic development and general well-being”.¹³¹ To that end, the WTO serves as a negotiating forum for members to simplify trade barriers of any variety by defining minimum standards in the form of sets of rules, and helps members settle disputes by interpreting the rules. In general, it is meant to ensure transparency and predictability of the international trading system.

So far, the bulk of WTO’s work comes from agreements concluded in the eight rounds of GATT negotiations. That is why the modern global trading system is described as “rule based” in the sense that nearly all matters are subject to negotiated agreements. Despite the specific agreements forming the WTO regime are quite a few,¹³²

¹²⁷ Following the adoption of the so-called Smoot-Hawley Tariff Act, which raised average US tariffs from 38 to 52 percent, US trading partners imposed retaliatory trade restrictions.

¹²⁸ They were the governments of the Commonwealth of Australia, the Kingdom of Belgium, the United States of Brazil, Burma, Canada, Ceylon, the Republic of Chile, the Republic of China, the Republic of Cuba, the Czechoslovak Republic, the French Republic, India, Lebanon, the Grand-Duchy of Luxemburg, the Kingdom of the Netherlands, New Zealand, the Kingdom of Norway, Pakistan, Southern Rhodesia, Syria, the Union of South Africa, the United Kingdom of Great Britain And Northern Ireland, and the United States of America. See the preamble of the original GATT 1947 available on <http://www.wto.org>.

¹²⁹ HOEKMAN, BERNARD M. AND MAVROIDIS, PETROS C., *THE WORLD TRADE ORGANIZATION: LAW, ECONOMICS, AND POLITICS* 8 (2007)

¹³⁰ See RICHARD PEET, *supra* note 12, at 183.

¹³¹ HOEKMAN, BERNARD M. AND MAVROIDIS, PETROS C., *supra* note 130, at 7.

¹³² The table of contents of “The Results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Texts” is a daunting list of about 60 agreements, annexes, decisions and understandings.

the main agreements include the ones that govern trade in goods (the GATT and annexes),¹³³ trade in services (GATS and annexes),¹³⁴ trade-related intellectual property rights (TRIPS), dispute settlement mechanism (DSB), and review of government's trade policies.

Table 1: Multilateral Trade Negotiations (MTNs) under the GATT

Year	Place/ Name	Subjects Covered	Number of Participant Countries
1947	Geneva	Tariffs	23
1949	Annecy	Tariffs	13* (29)
1951	Torquay	Tariffs	38* (32)
1956	Geneva	Tariffs	26* (33)
1960-1961	Geneva (Dillon Round)	Tariffs	26* (39)
1964-1967	Geneva (Kennedy Round)	Tariffs and anti-dumping measures	62* (46)
1973-1979	Geneva (Tokyo Round)	Tariffs, non-tariff measures, "framework" agreements	102
1986-1994	Geneva (Uruguay Round)	Tariffs, non-tariff measures, rules, services, intellectual property, dispute settlement, textiles, agriculture, creation of WTO, etc.	123

Source: WTO's fact file available on its official website (<http://www.wto.org>).

* This author also came across a different account on the number of countries (numbers in the brackets) that took part in the conferences.¹³⁵

The WTO agreements cover goods, services and intellectual property in general and diverse sub-sectors and specific issues in each sector. They spell out the principles of liberalization subject to exceptions, and individual countries' commitments to loosen up their tariff and non-tariff barriers and open services markets. Procedures for settling disputes are also set by agreements. Moreover, they prescribe rules for special treatment of developing countries,¹³⁶ and require governments to make their trade policies transparent by notifying the WTO about laws in force and measures adopted. Regular reviews and reports by the secretariat on countries' trade policies are also meant for checking the palatability of national trade policies with the multilateral norms and practices.

In fact, there are also agreements designated as "plurilateral trade agreements",¹³⁷ agreements not binding on all members but only on signatories. Moreover, agreements are not static so that members can undo what they did or alter in any other way they deem necessary. Accordingly, many of the agreements are now being renegotiated

¹³³ The GATT and agreements annexed to it cover a wide range of issues including agriculture, health regulations for farm products (SPS), textiles and clothing, product standards (TBT), investment measures, anti-dumping measures, customs valuation methods, preshipment inspection, rules of origin, import licensing, subsidies and countermeasures, and safeguards.

¹³⁴ The GATS annexes deal with movement of natural persons, air transport, financial services, shipping, and telecommunications.

¹³⁵ Id. at 183-184.

¹³⁶ THE WTO, UNDERSTANDING THE WTO 100 (5th ed. 2011).

¹³⁷ So far, there are four agreements of this kind: the agreement on trade in civil aircraft, government procurement, dairy, and bovine meat. Nonetheless, the last two were terminated in 1997 so that only two of them are in place.

under the Doha Development Agenda, launched by WTO trade ministers in Doha, Qatar, in November 2001. The “Doha Development Agenda” was locked in “an uncertain but unenviable state” for long. It is only in the first week of December 2013, the WTO managed to break out of the deadlock by giving life to agreements under the collective name of “Bali Packages”. Yet, commentators described the new agreements as “low hanging fruits” meaning the fundamental results intended by the Agenda are hitherto far away.

2.3.2.1 Fundamental Principles of the WTO

As noted above, the WTO agreements are lengthy and complex due to diversity of issues they cover. But it does not mean that they do not have any thing in common. Thus, the system involves some basic principles shared across all of the agreements and forming pillars of the system. Here in below, attempt is made to put some of them into focus.

2.3.2.1.1 Trade without Discrimination

Discrimination in international trade may appear either between products of foreign origin or between products of a nation and imported ones. The potential discrimination between imported products is governed by the principle of most favoured nation (MFN), and the one between products of a nation and imported ones by the principle of national treatment. MFN in short means “treating one, treating all others.” Each member treats all the other members equally as “most-favoured” trading partners. Hence, under the WTO agreements, countries cannot normally discriminate between their trading partners. It is a rule across the major WTO agreements covering all the three main areas of trade except slight differences.¹³⁸

Nonetheless, some exceptions are allowed subject to strict conditions. Regarding trade in goods, a member can legally discriminate against goods when it is part of a free trade agreement that applies only to goods traded within the group.¹³⁹ Another case in point is a special access to markets offered to products from developing countries. In services, countries are allowed, in limited circumstances, to discriminate.¹⁴⁰

The National Treatment principle is meant for equal treatment of imported and locally produced goods and services, and traded intellectual properties in the domestic market. The principle of “national treatment” simply means giving others the same treatment as one’s own nationals. It is recognized by the three main WTO agreements although once again the principle is handled slightly differently in each of them.¹⁴¹

2.3.2.1.2 Progressive Liberalization

One way or the other, the multilateral trading system is destined to facilitate freer international trade. To that effect, the international community has endeavored to lower trade barriers such as tariffs, import bans or quotas that restrict quantities selectively, and ease non-tariff barriers such as red tape and exchange rate policies. Multilateral trade negotiations (MLTNs) under the GATT and in earlier days of the WTO (1947-mid 1990s) focused on lowering tariffs (customs duties) on imported goods. But by the 1980s, the negotiations had expanded to cover non-tariff barriers on goods, and to the new areas such as services and intellectual property.¹⁴²

¹³⁸ GATT, Art. I, GATS, Art. II, and TRIPS, Art.4.

¹³⁹ GATT, Art. I(2)

¹⁴⁰ GATS, Art. II(2)

¹⁴¹ GATT, Art. III, GATS, Art. XVII and TRIPS, Art.3

¹⁴² THE WTO, supra note 137, at 11.

Even if opening markets can be beneficial, the agreements are cognizant of the need to make it happen gradually through “progressive liberalization”. To that end, MLTNs have been under way including the most recent 9th Ministerial Conference at Bali that culminated by adopting the Bali Agreements. This very event signified the breaking of the deadlock the Doha Development Agenda was confined in to retain the dictum of progressive liberalization, developing countries are usually given a longer period to fulfill their obligations.

2.3.2.1.3 Predictability

In the WTO, when countries agree to open their markets for goods and services, they “bind” their commitments. Commitments not to raise trade barriers are of twofold benefits. Firstly, to lower barriers to trade will allow traders have access to local markets at lower costs. Secondly, the “bound” nature of the promises gives businesses a clearer view of their future opportunities. Hence, the multilateral trading system is an attempt by governments to make the business environment stable and predictable. The stability and predictability of the trading system is in the interest of investors, workers and consumers.

The stance to discourage the use of quotas and other measures to limit quantities of imports and/or encourage exports, and to make countries’ trade rules as clear and “transparent” as possible are the other ways the system employs to improve predictability and stability. As noted earlier, many WTO agreements require governments to disclose their policies and practices publicly within the country or by notifying the WTO. The regular surveillance of national trade policies through the Trade Policy Review Mechanism also provides an additional means of encouraging transparency both domestically and at the multilateral level.

2.3.2.1.4 Promoting Fair Competition

The WTO is a system of rules dedicated to open, fair and undistorted competition so that it is not all about freer trade. The rules on non-discrimination (i.e. MFN and national treatment) are designed to secure fair conditions of trade. So too are those on dumping and subsidies. The issues are complex, and the rules try to establish what is fair or unfair, and how governments can respond in particular by charging additional import duties calculated to compensate for damage caused by unfair trade.

Many of the other WTO agreements aim to support fair competition in agriculture, intellectual property, government procurement and services.

2.3.2.2 Membership to the WTO and Ethiopia in the Accession Process

The WTO is currently a forum for some 160 members. Even if many of them are “original” members because they signed the Uruguay Agreement at Marrakesh, the rest became part of the system through “accession negotiations”. Subsequent membership through accession¹⁴³ or ‘succession’,¹⁴⁴ the latter not having its counterpart in the WTO, was not strange in the GATT period too. The whole system is characterized by a canon of give-and-take so that an applicant country can enjoy the privileges that other members give to it and the security that the trading rules provide only up on making commitments to open its market and to abide by the rules. Countries (e.g. Ethiopia) negotiating for membership are WTO “observers”. Having regard to Ethiopia’s status, the discussion in the following few paragraphs is dedicated to assessing the accession process.

¹⁴³ GATT, Art.XXXIII

¹⁴⁴ GATT, Art.XXVI:5(C)

2.3.2.2.1 The Accession Process in General

Any state or customs territory exercising full autonomy in the conduct of its trade policies may accede to the WTO, but WTO members must agree on the terms.¹⁴⁵ From 1995 to the end of 2013, some thirty one countries have become members while some other twenty four including Ethiopia and Yemen have been seeking to accede. Yemen's accession application was approved at the 9th Ministerial Conference at Bali, Indonesia on 4 December 2013. It is now left only with ratification of the agreement supposed to be done before 2 June 2014 and for Yemen to become the latest member.¹⁴⁶ The acceding countries collectively account for a relatively small share of global GDP (2.2%) as well as exports (2.1%) and imports (1.7%) but a higher share of the global population (6.4%).¹⁴⁷ Hence, the WTO will come very close to an organization comprising universal membership once the pending accessions are completed. Accession to the WTO, unlike joining other international organizations like the UN, is a lengthy process of examination and negotiation in which the applicant is obliged to pay for.

Broadly speaking, the accession process goes through four phases as discussed subsequently.

First, "tell us about yourself". The accession process starts with the filing by the acceding government of a formal written request. Subsequently, a Memorandum on the Foreign-Trade Regime (MFTR) describing all aspects of its trade and economic policies and legal regimes that have a bearing on WTO agreements will be submitted to the Secretariat. The Director-General, upon receipt of the memorandum, will hand it over to the working party established by the General Council to examine the country's application. The working party is open to all WTO members to let them find facts about the would be member economy, and the UN, UNCTAD, IMF, the World Bank and others have observer status in any working party by virtue of their agreements with the WTO.¹⁴⁸

Second, "work out with us individually what you have to offer". When the working party has made sufficient progress on principles and policies, bilateral talks begin between the applicant country and individual countries on matters contained in the MFTR and initial offers for goods and services. Question-and-answering, a member asking about any trade or related matter and the applicant responding, make up the principal way of communication in these talks. Though negotiated bilaterally, the commitments accruing from the bilateral deals apply to all WTO members by virtue of the non-discrimination rules. Thus, the talks determine the benefits (in the form of export opportunities and guarantees) other WTO members can expect when a new member joins. In parallel, multilateral negotiations in which the WTO membership collectively bargains with the applicant country over tariff rates, specific market access commitments, and other policies in goods and services trade take place.

It is worth to note that the talks can be highly complicated and lingering¹⁴⁹ for reasons including considerable adjustment costs in order to meet WTO standards, the severity of the demands that are made by the incumbent members, and the vigor with which the applicant bargains over these matters with the WTO member countries.

Third, "let's draft membership terms". The core of the accession negotiations lies in the determination of the terms of accession though a defined guidance on terms to go for is missing. Once the working party has completed its

¹⁴⁵ Agreement Establishing the WTO (the Marrakesh Agreement), Art.12

¹⁴⁶ The WTO, http://www.wto.org/english/news_e/news13_e/acc_yem_03dec13_e.htm (last visited on January 21, 2014).

¹⁴⁷ CRAIG VANGRASSTEK, supra note 164, at 122.

¹⁴⁸ Id.

¹⁴⁹ The WTO, http://www.wto.org/english/thewto_e/acc_e/acc_e.htm, (last visited on January 20, 2014)

The briefest negotiations were with the Kyrgyz Republic, which took only two years, eight months; the longest have been with the Russian Federation, which lasted 19 years and two months. The negotiations over the accession of Algeria had, as of 2013, been underway for a quarter of a century and showed no sign of ending soon. Of the 24 countries that are still in the process of accession, 16 have already been at it for over 12 years.

examination of the applicant's trade regime, and the bilateral negotiations are complete, these all are reduced into a draft membership treaty, properly named as an "accession protocol" or "accession package".

Finally, "General Council or Ministerial Conference decides". The final accession package is presented to the WTO General Council or Ministerial Conference to decide on the fate of the accession. If a two-thirds majority¹⁵⁰ of WTO members vote in its favour, the applicant is free to sign the protocol and to accede to the organization. More often than not, the agreement, as is the case with respect to other international agreements, is subject to ratification by the country's legislature.

2.3.2.2.2 The Special Guidelines for Accession of LDCs

Being cognizant of the fact that Ethiopia is an LDC, it is a must to consider the accession guidelines for LDCs. Resembling the generally acknowledged rhetoric of special treatment accorded in WTO agreements to developing countries in general and LDCs in particular, a "fast track" accession procedure for LDCs was proposed by the European Community in 1999.¹⁵¹ The guideline came to the scene only in 2002. It aspired for 'simplified and streamlined accession procedures' with a view to concluding negotiations as quickly as possible.¹⁵² To that end, the guideline imposes "restraint in seeking concessions and commitments on trade in goods and services from acceding LDCs" and requires LDCs to "offer access through reasonable concessions and commitments on trade in goods and services commensurate with their individual development, financial and trade needs". In actualities, however, LDCs that completed their accessions then after were not given much favoritism in terms of market access commitments and binding coverages.¹⁵³

With a view to rectifying limitations of the 2002 guidelines, on 25 July 2012, the General Council adopted new guidelines for the accession of LDCs. The new guidelines aimed at limiting the commitments that LDCs are obliged to make taking into account the level of commitments undertaken by existing LDC members while also providing for transparency in the negotiations and the provision of technical assistance. The guidelines establish principles and benchmarks for LDCs' market access commitments on goods while urging members to explore possible benchmarks in the area of services.

Regarding commitments on goods, the new guidelines provide for application of "some flexibility." Moreover, negotiations "should ensure the appropriate balance between predictability of tariff concessions of acceding LDCs and their need to address specific constraints or difficulties as well as to pursue their legitimate development objectives", says the guidelines. Yet, "each accession is unique" and tariff concessions could vary depending on circumstances of the LDC in question.

The new guidelines still require acceding LDCs to bind all of their agricultural tariff lines, but may do so at an overall average rate of 50%. On non-agricultural tariff lines, they are generally to bind 95% of their tariff lines at an overall average rate of 35%. Alternatively, they may undertake comprehensive bindings which would in exchange afford them a proportionately higher overall average rates as well as transition periods of up to ten years for up to 10% of their tariff lines.

On services commitments, the guidelines recognize "the serious difficulty of acceding LDCs in undertaking commitments, in view of their special economic situation and their individual development, financial and trade needs," and provide for "flexibility for acceding LDCs for opening fewer sectors, liberalizing fewer types of

¹⁵⁰ Agreement Establishing the World Trade Organization, Art.XII(2)

¹⁵¹ CRAIG VANGRASSTEK, *supra* note 164, at 133.

¹⁵² The WTO, *Accession of Least-Developed Countries*, the Decision of 10 December 2002.

¹⁵³ International Centre for Trade and Sustainable Development, *An Analysis of the WTO Accession Guidelines for Least Developed Countries*, 2-3 (Information Note, November 2012).

transactions and progressively extending market access in line with their development situation.” They are not expected to offer full national treatment, nor are they required to undertake commitments “on regulatory issues which may go beyond their institutional, regulatory, and administrative capacities.” The guidelines provide more specifically for reasonable offers from LDCs that are “commensurate with their individual development, financial and trade needs”. In addition, LDCs are assured that they “won’t be required to undertake commitment beyond those that have been committed by existing WTO LDC members, nor in sectors and sub-sectors that do not correspond to their individual development, financial and trade needs.” The guidelines also include provisions with respect to special and differential treatment, and transition periods.

2.3.2.2.3 Ethiopia in the Accession Process

Ethiopia has been eligible for many of the preferential trade arrangements with the major trading partners so that it already enjoys equal treatments, if not better, without being a member of the WTO.¹⁵⁴ So much so that, the question what would accession to the WTO adds to Ethiopia is worth consideration. It is argued that such preferential arrangements remain uncertain and unpredictable, as they could be withdrawn by the states granting them without fear of any subsequent sanctions. So, securing WTO membership will thus stabilize Ethiopia’s trade relations with its major trading partners through the unconditional MFN treatment and without being subjected to the annual reviews required by the national laws of these countries. The disadvantage of the unfavorable image in the eyes of potential investors of not being a WTO member also weighs heavily on the decision to accede.

As implied in different policy documents of the Federal Democratic Republic of Ethiopia (FDRE),¹⁵⁵ the government of Ethiopia decided to accede to the WTO noting that “that it does not worth staying outside the multilateral system and it is time to be part of the rule based family”.¹⁵⁶ Ethiopia applied for an observer status and has been observing since October 1997. The formal accession request was made in January 2003. A working party was established in February under the chairmanship of Mr. N. McMillan (UK, May 2003-May 2009) succeed by H.E. Dr. Steffen Smidt (Denmark, October 2010-). It then submitted its MFTR in December 2006 which members received in January 2007. It received a total of 197 questions from the US and Canada in

¹⁵⁴ Even if how much valuable the preferential trade arrangements are remains an issue for later discussions in Chapter Four, Ethiopia has been eligible to the Generalized System of Preference (GSP), EU and the Countries of Africa, Caribbean, and Pacific Trade Agreement (EU-ACP), Everything But Arms (EBA), the African Growth and Opportunity Act (AGOA), and Common Market for Eastern and Southern Africa (COMESA)

¹⁵⁵ The Foreign Affairs & National Security Policy & Strategy (2002) in its part provides that:

- (The efforts in our country to bring about rapid development, democracy and good governance **cannot be seen outside the regional and global contexts**. In the process of globalization, the world economy has become interconnected and an international division of labour has been introduced. It is impossible to operate outside of this context.
- We cannot attain development and democracy by **closing our doors and taking refuge in our mountains**. It is only when we accept the fact that **we have no choice** but to **enter the global economy**, and when we aim to transform ourselves from the state of dependency to that of being a producer, and a better producer in time. It is through fully exploiting the opportunities globalization provides us, lessening the constraints it creates, and becoming active participants in the process of globalization....Therefore, a policy that fully exploits the opportunities globalization provides us and that withstands the negative effects of the process, is useful and appropriate. ...) (at 19).

The Growth and Transformation Plan (GTP) (2010/11) also affirm the stance. It provides:

(In the trade sector ... a key implementation strategy is **to integrate the country into the multilateral trading system**. This will be achieved by **successfully completing the World Trade Organization accession** process and strengthening regional trade integration with the Inter-Governmental Authority on Development, Sana’a’ Forum, the Common Market for Eastern and Southern Africa (COMESA) and the COMESA-East African Community-Southern Africa Development Community Tripartite. The Purpose of this action is to transform trade negotiation process to a higher level of effectiveness. A further task is to, conclude the Economic Partnership Agreement with European Union. Finally, bilateral trade relation and negotiation will be improved with all parties where mutual advantages are identified.”) (at 72).

¹⁵⁶ Geremew Ayalew (Director General, Trade Relation and Negotiation Directorate General, Ministry of Trade), *The Status of Ethiopia’s WTO Accession* 19 (Conference Paper Presented at the 4th Executive Idea Exchange Program on the Theme Implication of WTO Accession for Ethiopian Business, 20 December 2013).

May 2007 and replied in December of the same year. In the second round about 144 questions came from US, Canada and EU in August 2008 to which Ethiopia responded in March 2009. For the third time, 134 questions were directed from same members in July 2011 and were replied to at the third working party meeting. Members that forwarded questions in the second and third rounds of questions joined by Korea forwarded 168 questions to which responses are prepared to be presented at the fourth working party meeting to be held soon. The focus of the questions were licensing and registration, telecom and finance, investment related issues, SPS and TBT, customs valuation, TRIPS, trading rights and trade facilitation, general information, tariffs and other charges, and other issues. Moreover, the first, second and third Working Party Meetings (WPM) were held on 16 May 2008, 6 May 2011, and 27 March 2012 respectively. The fourth WPM was scheduled to be held in October 2013, it was delayed for an unspecified time due in part to the failure the negotiating team to finalize documents to be submitted.¹⁵⁷

In simple mathematics, a decade has gone since Ethiopia commenced the accession process. It has yet to submit its offer in the services sector. So far, the bilateral agreements yet underway have been only with the members mentioned above. On the face of this all, no one can tell certainly when the accession ends despite the ex-Director General, Pascal Lamy, estimated that Ethiopia may join the WTO by this year.¹⁵⁸ Moreover, the delay may appear as a living disgrace to the said expedited accession procedure availed to LDCs. This however is without disregarding the time lapsed for preparatory activities, passiveness and substitution of the chief negotiator.¹⁵⁹

The guideline for accession of LDCs provides two approaches in determining import tariffs on goods trade namely overall average rate (50% for agricultural products and 35% for non-agricultural goods) or comprehensive rates on each agricultural and industrial goods. Ethiopia has chosen the first one. In the services sector, the named guideline, at least in theory, exempts Ethiopia from cumbersome commitments even if the real outcomes may differ. Ethiopia has traveled this much in the accession process while the way forward may get shorter or longer based on the challenges it would face from sitting members and the enthusiasm its negotiators will have. Sooner or later, Ethiopia will become a member of the rule based trading system.

2.4 Advantages and Challenges of Globalization

Economic integration or globalization offers advantages and poses disadvantages in pursuance to the “opportunity cost” theory. Simply, the point is that economies have to pay something to gain some other. In this section attempt is made to highlight on the perceived advantages and possible challenges of globalization in particular from the point of view of LDCs.

¹⁵⁷ Bewket Abebe, Ethiopia's Fourth Round Negotiations with the World Trade Organizations Delayed, Addis Fortune, November 3, 2013 [Vol.14, No. 705], <http://addisfortune.net/articles/ethiopias-fourth-round-negotiations-with-the-world-trade-organisation-delayed/> (last visited on January 14, 2014).

¹⁵⁸ Elias Gebreselassie, Ethiopia May Join WTO by 2014, Capital, January 14, 2014 09:19, available online at http://www.capitalethiopia.com/index.php?option=com_content&view=article&id=2303:ethiopia-may-join-wto-by-2014&catid=35:capital&Itemid=27 (last visited on January 14, 2014).

¹⁵⁹ This author learned from an extensive discussion with Mr. Lisanework Gofu (Director, Multilateral Trade Relation and Negotiation, Ministry of Trade) held on 17 January 2014 that the task of negotiation involved several individuals representing different government offices and the private sector which made it difficult to employ a system of responsibility and accountability so that it was difficult to undergo such a highly technical assignment in such conditions. It was then the Council of Ministers decided to assign the task to a focused group of persons with related background by a directive. The first chief negotiator was H.E. Mr. Girma Biru replaced by H.E. Mr. Mekonnen Manyazewal on 9 March 2011 appointed by Directive No.1/2011. According to same informant, it is since this time that a concerted work is being done.

2.4.1 Advantages

Even though there can be additions to the list of advantages integration with the global economic system may offer to developing countries, in this thesis an attempt is made to put light on some of them namely: access to capital, market access to exports, job creation, technology transfer, and strengthening of the culture of democracy.

2.4.1.1 Access to Capital

In the economic development literature, FDI, to a greater degree than any other forms of foreign investment, is one of the standard panaceas for economic underdevelopment.¹⁶⁰ FDI can be defined as “an investment made to acquire a lasting management interest (normally 10% of voting stock) in a business enterprise operating in a country other than that of the investor.”¹⁶¹ TNCs and MNCs have been the key actors in the globalization process principally through locating their production chains and/or plants in different parts of the world. Their investments count for three-fourth of the global capital flows.¹⁶² Explicitly, FDI channels exogenous capital, a complement to national savings, to foster enhanced economic growth in the host country.

Attitudes and government policies towards FDI and its characteristics considerably varied over time.¹⁶³ These days, the debate seems to be delineated to the possible host-country effects of FDI. In this regard, according to the Benign Model of FDI and Development, FDI is pro-development by supplying effective human capital, technology and marketing that would repeal low levels of productivity in the recipient developing country. The Malign Model of FDI and Development on the other hand suspects activities of MNCs and TNCs not to be within the standards of good citizens at home. They might have upset the passage of protective national standards such as environment and labour regulations or ignore the ones in place. In view of this model, they are in the host location only for the sake of enrichment of shareholders back in their home countries.¹⁶⁴

Nevertheless, there is no evidence supporting the claim that FDI *per se* accelerates economic growth; neither is anything at hand supporting the allegation that FDI naturally undermines growth potentials of host economies. Put differently, there have been research findings ranging from the ones that praise FDI for its overall pro-development results in the host countries to the ones that find no signs of relationship between FDI and growth in the host economy, and to the others that found negative effects of FDI on national economies.¹⁶⁵ Yet, it is agreeable that FDI involves both advantages and disadvantages. So, FDI is not fully in the interest of developing economies.

The positive relationship between FDI and high rate of economic growth has become explicit in the last three decades most notably in the significantly FDI assisted economic growth in the Asian Newly Industrialized Economies (NIEs).¹⁶⁶ Moreover, it is argued that such success stories, usually told to developing countries, are

¹⁶⁰ PETER NUNNENKAMP, FOREIGN DIRECT INVESTMENT IN DEVELOPING COUNTRIES: WHAT ECONOMISTS (DON'T) KNOW AND WHAT POLICYMAKERS SHOULD (NOT) DO!, 27 Centre for International Trade, Economics & Environment (2002).

¹⁶¹ Adegbite, Esther O. and Ayadi, Folorunso S., *The Role of FDI in Economic Development: A study of Nigeria*, World JOURNAL OF ENTREPRENEURSHIP, MANAGEMENT, AND SUSTAINABLE DEVELOPMENT, Vol.6, NO.1/2. 133 (2010).

¹⁶² See BENDE-NABENDE, ANTHONY, *supra* note 20, at 83.

¹⁶³ Robert E. Baldwin, *Openness and Growth: What's the Empirical Relationship?* in, CHALLENGES OF GLOBALIZATION: ANALYZING THE ECONOMICS 500 (Kimberly Ann Elliott, Debayani Kar, and J. David Richardson eds. 2004).

¹⁶⁴ MORAN, THEODORE H., FOREIGN DIRECT INVESTMENT AND DEVELOPMENT: THE NEW POLICY AGENDA FOR DEVELOPING COUNTRIES AND ECONOMIES IN TRANSITION, 19-20 Institute for International Economics (1998).

¹⁶⁵ Franco Prausselo, *Globalization and Incomplete Technology Transfer to Developing Countries*, GLOBALIZATION AND THE THIRD WORLD: A STUDY OF NEGATIVE CONSEQUENCES 201 (Ghosh, B. N. and Guven, Halil M. eds., 2006).

See also MORAN, THEODORE H., *supra* note 165, at 123-125.

¹⁶⁶ Stephen Thomsen, *Southeast Asia : The Role Of Foreign Direct Investment Policies In Development* 23 (OECD, Directorate for Financial, Fiscal and Enterprise Affairs Working Papers on International Investment, 1999).

the exceptions and not the rule. Yet, it is observed that in the economies wherein FDI worked out, the success stories are sector and time specific.¹⁶⁷ Therefore, what matters is capability of developing countries to take advantage of FDI, and not taken advantage of by it, by taking measures that maximize the positive and minimize the negative effects.

On top of that, governments in developing countries devote a lot towards attracting more FDI with a view to stimulating growth by narrowing down the gap between demand and supply of capital consequent to scarce domestic savings. The ever rising meaningful pressure exerted on TNCs to undertake social responsibility¹⁶⁸ coupled with a dynamic comparative advantage they add to a national economy also urged governments look for more FDI than ever.

Flow of FDI is determined by location advantages including but not limited to the availability of social, economic, and political stability, liberal trade regime, access to large and growing markets, proximity to rich and rapidly developing countries, and a reasonably high-quality infrastructure.¹⁶⁹ Hence, not all efforts to attract more FDI may end with success. Trends in FDI flows have got a tendency of regional concentration in response to better locational advantages the regions offer. It is the developed world that has been a focal point for activities of TNCs and it has been the source and beneficiary of most FDI. TNCs prefer developed countries than developing countries because of the relative advantages the former offer in terms of investment in research and development (R&D), large and dynamic markets and demand, investment-friendly environment and so forth.¹⁷⁰

Hence, it has been the developed world that has been offering and enjoying the lion share of FDI flows. The triad (the common name of USA, European Union (EU) and Japan) was the source of 81% of outflows and 71% of inflows of FDI in the 1980s. In 1998 in particular, 92% of outflow of FDI originated and 72% of inflow of FDI came into the triad while the developed world in general took 90% of inflow and out flow of FDI.¹⁷¹ In the same period the share of the developing world accounts only for one third of the global inflow and insignificant of the outflow.¹⁷² The trend has been changing in the recent past in that the developing world has become recipient of a considerable (above 50% in the last two years)¹⁷³ share of FDI inflows while the out flow from these economies yet lags behind. Overall FDI declined by 18% in 2012 perhaps in response to the “economic fragility and policy uncertainty in a number of major economies that gave rise to caution among investors”.¹⁷⁴ On a country basis, the US has been the biggest investor (source of FDI) and the largest recipient of FDI too.¹⁷⁵

Out of FDI flows to the developing world, the Asian and Latin American countries have been able to attract and enjoy the majority of the stylized FDI inflows.¹⁷⁶ Moreover, the share of Africa has been insignificant (only

¹⁶⁷ Id. See also Laura Alfaro, *Foreign Direct Investment and Growth: Does the Sector Matter?* 13 Harvard Business School (2003) (Can be reached via email: lalfaro@hbs.edu)

¹⁶⁸ In this regard the OECD Guidelines for Multinational Enterprises, of a unique combination of voluntary and binding elements, can be of higher credit.

¹⁶⁹ Kjetil Bjorvatn et al., *The Role of FDI in Economic Development*, 28 *Nordic Journal of Political Economy*, 109-126 (2002).

¹⁷⁰ See BENDE-NABENDE, ANTHONY, supra note 20, at 48.

¹⁷¹ Id. at 49.

¹⁷² Id. at 44.

¹⁷³ UNCTAD, <http://unctadstat.unctad.org/TableViewer/tableView.aspx?ReportId=88> (last visited on 27 March 2014)

¹⁷⁴ The developing world took 49.64% in 2011 and 52% in 2012 FDI inflows while their share of outflows were 25.12% and 30.63% in the same period respectively.

See United Nations Conference On Trade And Development (UNCTAD), *Global Value Chains: Investment and Trade for Development* xiii (World Development Report-2013).

¹⁷⁵ Id. at xiv-xv.

¹⁷⁶ Id. at xiii.

around 3% of the global inflow or one tenth of the inflow to the developing world).¹⁷⁷ This may be indicative of the marginalization of Africa in today's increasingly globalizing world. The distribution of this small fraction of FDI to Africa is uneven across countries and sectors.¹⁷⁸ Studies attribute the negligible FDI inflow and benefit out of it to Africa to problems of political legitimacy, poor infrastructure, corrupt and inefficient public sector, policy uncertainty, restrictive economic policies, low skilled human capital, poor and ineffective marketing strategy, smaller markets, and the like.¹⁷⁹

So far, the extent of FDI inflow to the developing world in general and Africa in particular is limited thus its role as a complement to domestic saving is limited too. But, in the future, so long as developing African countries can devise more liberal and comprehensive economic policies, sustain a transparent and predictable governance, improve their basic facilities and quality of the labour force, furnish a proactive and efficient bureaucracy, promote investment to the region based on advancing relations with existing investors rather than focusing exclusively on costly activities of Investment Promotion Agencies,¹⁸⁰ it is hoped that they can win the attitude of TNCs and benefit from the accruing higher FDI in flows.

Moreover, the relatively increasing cost of labour and land, and stricter regulatory compliance, in the Asian Newly Industrializing Economies (NIEs) where it pulled millions out of poverty is likely to force investors, both foreign and Asian by origin, to relocate their labour intensive productions to new sites.¹⁸¹ That may be another opportunity for African countries to become a major recipient of FDI but in fierce competition with other potential destinations elsewhere. Any region or country can become a potential destination for FDI because the trend in earlier FDI flows (FDI in the pre-1990s was clustered)¹⁸² has changed as the increased integration of the world economy and the constantly increasing cost of (nonrenewable) factors of production adds on the comparative advantage of new locations.

2.4.1.2 Transfer of Technological Knowhow

It is agreeable that any endeavor to guarantee sustainable economic growth has to make use of dynamic and high-tech because it increases total factor productivity. The unending endeavors of the developing world to end up the unbearably poor and, some other times, inhumane living standard must be restrained to remain a nightmare due to lack of this fundamental tool towards prosperity. Exclaiming on it, Joseph E. Stiglitz noted that:

... Developing countries not only lag in resources but also in technology; for achieving sustained growth, closing the knowledge gap is more vital than improving efficiency or increasing available capital. The question is: how best to learn?

¹⁷⁷ Id.

¹⁷⁸ For example, in 2001 the major recipients of flows in the region were South Africa, Morocco, Nigeria, Angola, and Algeria. Furthermore, in 2003, Morocco, Angola, Equatorial Guinea, Nigeria and Sudan accounted for half of the total inflows to the region. The primary sector remains the most important destination for FDI flows into the region, accounting for more than 50% of inflows from major investors to Africa over the period 1996-2000. Within the primary sector, oil and gas are the most important industries. Since 1999, there has been an increase in inflows into the tertiary (service) sector. In fact in 1999, the tertiary sector attracted more inflows (US\$3,108 million) than the primary sector (US\$2,726 million). In 2000 the primary and tertiary sectors attracted inflows worth US\$2,029 and US\$1,931 million respectively.

¹⁷⁹ See DAS, DILIP K., supra note 1, at 4.

¹⁸⁰ Chantal Dupasquier and Osakwe, Patrick N., *Foreign Direct Investment in Africa: Performance, Challenges and Responsibilities* 5 (African Trade Policy Centre (ATPC), Economic Commission for Africa, Work in Progress No. 21, 2005)

¹⁸¹ See Stephen Thomsen, supra note 167, at 16.

¹⁸² The US was a source to FDI inflows in Latin America while FDI outflows from EU monopolized Central and East European countries as hosts. Japanese TNCs locate in Asian countries. Asian NIEs moved capital to less advanced developing countries in Asia. Interregional investment from Latin America and others from EU went to the Caribbean while Africa was the home for TNCs from EU.

See also BENDE-NABENDE, ANTHONY, supra note 20, at 49.

*Some argue that the best way—probably the only way—to learn how to produce steel is to produce steel, as Korea did when it started a steel industry.*¹⁸³

It can be construed that the lagging state of technological advancement in the developing world has hampered development to a greater degree than any other obstacle. Developing countries are poor to purchase western technology and expand their production in terms of quality and quantity. Attempts to have their own under the theme “*to learn how to produce steel is to produce steel*” in substitute to the imported technology remained so far less fruitful. What is left for the developing countries to exhaust is to entreat the owners of it. The call may take, among others and preferably¹⁸⁴, the form of FDI.

Hence, technology transfer, as ample literature imply, is one of the supposed advantages of FDI. FDI significantly constitutes technology because the parent company should have an ownership advantage in addition to other advantages to undertake investment in a foreign location.¹⁸⁵ FDI facilitated technological spillovers in host economies are hoped to help the national economy in three ways. *First*, subject to capability of the domestic human capital, the FDI associated technology may have a spillover effect to the host economy. *Second*, linkages between the foreign company and domestic suppliers may facilitate adaptation of new technologies to advance their production. *Third*, at times when there are domestic producers in the area in which the foreign affiliate is operating, the former may try all the best to own the advanced technology to survive the competition.

Needless to say, the extent to which the developing world has been benefiting from technological spillovers accruing from FDI varies from one host country to the other. For instance, a technological spillover in Southeast Asia—the predominant FDI destination site in the developing world—was reported to be limited in the 1980s. Attempts to implant technological capabilities in Indonesia took the form of on-the-job training and in Thailand training of high level officials of foreign firms and training of local suppliers.¹⁸⁶ Nonetheless, these endeavors failed to bring about indigenous technological capabilities. The good news at the same time is the recently achieved promising spillovers through increased linkages between foreign companies and local suppliers in Southeast Asia.¹⁸⁷ Studies of good intensity to test technology effects of FDI in China, Malaysia, South Korea, Morocco and Iran revealed that there were no salient modern technology transfers.¹⁸⁸

But it does not mean that TNCs allow the leaking out of their technical knowledge to local firms willfully so that it must be their reluctance to support technology transfer that has locked developing countries in the traps of low technology conditions and poverty. Their stand seems to be valid from the view point of economics. Put in another way, commercial advantages of MNCs from shielding their technical knowledge, because it reduces costs of research and innovation and ensures monopoly and extra rents, for a possible longer period induce them to stay alert to avoid leakage of it to competitors. Yet, it is argued that even FDI may happen as a means of internalizing knowledge by diffusing it but not allowing its imitation in any form. In light of that, it is

¹⁸³ See STIGLITZ, JOSEPH E., supra note 7, at 70.

¹⁸⁴ See PETER NUNNENKAMP, supra note 161, at 27.

¹⁸⁵ Dunning's OLI framework underscores that the decision of a TNC to undertake investment in a site outside of the country of origin basically presupposes the Ownership advantage it has, Location advantage the host country offers and Internalization advantage. Accordingly, it must own a sort of unique production process, a patented good, and access to good will, trade mark and management. In addition the investor need to ascertain the business-friendliness of the environment in general and availability of some advantages like low wages, wider and dynamic market, abundant labour it can exploit in the host country style to win the possible competition it may face. The control over technology and lower transaction costs stemming from intra-company exchanges and efficient management should offer an internalization advantage.

See Kjetil Bjorvatn et al., supra note 170, at 109 & 112.

¹⁸⁶ See Stephen Thomsen, supra note 167, at 28.

¹⁸⁷ Id.

¹⁸⁸ Franco Praussello, *Globalization and Incomplete Technology Transfer to Developing Countries*, in GLOBALIZATION AND THE THIRD WORLD: A STUDY OF NEGATIVE CONSEQUENCES 211 (Ghosh, B.N. and Guven, Halil M. eds., 2006).

noted that MNCs send the second best if not outdated technology to avoid dissipation of their core technologies.¹⁸⁹ Hence, if any technology leaks, it is peripheral and to the worse the transfer may not take place in a full-fledged manner. That is what some tend to call it as “incomplete or unbalanced technology transfer”.¹⁹⁰

MNCs mercilessly employ different mechanisms to retain and legitimize their control over technological knowhow. They prefer Mergers and Acquisitions (M&As) than joint ventures to reduce the possibility of technology leakage due to the closer tie between the two partners and avoid potential rivals as the Ethiopian saying goes “two birds with a piece of stone.” Greenfield investment also become old fashioned in the eyes of MNCs and TNCs for its own reasons.¹⁹¹ Furthermore, they resorted to securing and invoking formal protection of intellectual property rights like in the Trade Related Intellectual Properties (TRIPS) system and national laws, paying higher salaries in order to hinder labour turnover, or investing in less advanced countries where local firms have lower imitation skills, and in the extreme cases to embargoes through political means.¹⁹²

In addition to TNCs’ understandable vested interest in shielding their unilateral control over such technologies to smash potential rivals out, the limited absorptive capability (due to low supply of human capital) of developing host countries to learn about and imitate high-level technologies FDI brought has been another factor for minimal technology spillovers. The apparent conflict of interest between TNCs and developing countries that hindered technology transfer may also be amplified by organizational differences like structural, cultural and bureaucratic mismatches.¹⁹³ Moreover, the anti-globalization movements argue that technologies brought to developing countries via FDI are fragile, outdated, environment-unfriendly, and pushed all the way by greed.¹⁹⁴

In view of these all, the acclaimed benefit of FDI to developing countries through technological spillovers is dodgy. So, the unending attempts by developing countries to close the gap with the advanced countries, while imitating at the same time their outdated technology, is too similar to “the labour of Sisyphus.”

Hence, despite the fact that imitation of technical knowledge would not bridge the technology gap once and for all, because the catching-up will never end, and it at the same time discourages development of an independent innovation base in the developing countries, and being cognizant of recent promising experiences, it is not wise to recommend LDCs to avoid FDI (globalization) all together.¹⁹⁵ Hence, developing countries should exert a resolute effort to attract FDI that would be of paramount importance in catalyzing sustained growth and facilitating maximum spillovers of technology.

2.4.1.3 Job Creation

According to the theory of comparative advantage,¹⁹⁶ FDI inflows to developing countries are flows of job opportunities concomitantly leading to a trend of specialization in domestic labour intensive production and an expansion in local employment. Consequently, FDI inflows to the developing world bring employment opportunities to ease the rising level of unemployment while there is a concern that FDI depress wages and employment at home by moving production abroad and depress wages in the host countries by exploiting

¹⁸⁹ Id. at 205-206.

¹⁹⁰ Id.

¹⁹¹ See Kjetil Bjorvatn et al., *supra* note 170, at 111.

¹⁹² See Franco Praussello, *supra* note 189, at 207.

¹⁹³ Id. at 210.

¹⁹⁴ Id. at 213.

¹⁹⁵ Nita Rudra, *Globalization and the Strengthening of Democracy in the Developing World*, 49 AMERICAN JOURNAL OF POLITICAL SCIENCE 709 (2005).

¹⁹⁶ According to the comparative advantage theory, it is estimated that FDI inflows to the developing world should be considerate of the abundance of labour in the host economies and geared to exploit it to secure profit as max as possible.

helpless workers.¹⁹⁷ Concomitantly, however, most FDIs, if not all, employ technology that would save labour so that FDI in such cases appear counterproductive on employment. Moreover, if FDI causes crowding out of some domestic enterprises, it would lead to some job losses. Taken as a whole, the employment impact of FDI is uncertain from a theoretical view point. Nor did empirical data provide a clear-cut answer on the question of employment effect of FDI in the host country. So, the employment effect of FDI is “country and sector-specific.”¹⁹⁸

It is also contended that even the new job opportunities FDI may offer to the host economy are discriminatory because the imported technology demands workmen to demonstrate a level of expertise and skill. That appears to the disadvantage of the unskilled or low-skilled workforce which is in abundance in the developing world. Hence, the high-paid and less-demanding occupations will be taken by the ones with the requisite skill and knowhow while the unskilled and low-skilled workforce occupy positions with little pays due to the plenty supply of such labour in the market. This would, in economic terms, mean that FDI at the minimum would perpetuate income disparities in the same way it did in Latin America.¹⁹⁹

Yet, save its limitations, globalization (export-oriented FDI) helped millions in Asia to step out of poverty. So, it may be taken as a good opportunity to the poor having chances next to nothing for survival. At this juncture again it is indispensable to underline the intolerable situation in Export Processing Zones (EPZ) in which governments in the host countries should get the commitment to outlaw at any cost.

2.4.1.4 Market Access

As noted earlier, globalization is an increased trade and capital openness. This openness provides, at least in theory, access to markets irrespective of political boundaries.²⁰⁰ Reforms towards trade and capital liberalization, and advancement in transport and communication technology make movement of goods, services, and capital easier. Nevertheless, it is more meaningful to the advanced industrialized countries than to the poor ones because the majority of tradable products join the international market from the industrialized economies as manifested by their market share.²⁰¹ But it does not mean that it is of no help to the poor countries. It could at least help them find a market to sell their produces in the areas they have a comparative advantage.

Needless to say, poor countries have been characterized by their agrarian economies so that they have a comparative advantage in the primary sector. Besides, developing countries have been accorded with more favorable trade conditions in the markets of advanced rich economies.²⁰² In response to endeavors towards trade liberalization, the share of developing economies in world market has risen to count for one-third.²⁰³ Sadly, however, their Gross Domestic Product (GDP) per capita has not risen in reply.²⁰⁴ Meaning, changes in the real life situation of the poor in the developing countries are insignificant. Low factor productivity, declining prices, stagnant markets, and less dynamic production coupled with subsidies to the agricultural sector in the

¹⁹⁷ Lipsey, Robert E., *Home- and Host-Country Effects of Foreign Direct Investment*, in CHALLENGES OF GLOBALIZATION: ANALYZING THE ECONOMICS 333 (Baldwin, Robert E. and Winters, L. Alan eds., 2004).

¹⁹⁸ Eddy Lee and Marco Vivarelli, *The Social Impact of Globalization in the Developing Countries*, 145 INTERNATIONAL LABOUR REVIEW 171 (2006).

¹⁹⁹ Franco Praussello, supra note 189, at 204.

²⁰⁰ Wolde Bulto Adugna, *Ethiopia's Accession to the WTO with Emphasis on Foreign Market Access* 62 (2006) (unpublished Master's thesis, Addis Ababa University).

²⁰¹ See BENDE-NABENDE, ANTHONY, supra note 20, at 80.

²⁰² The WTO, Everything But Arms (EBA), and the African Growth and Opportunity Act (AGOA), and the Generalized System of Preference (GSP) provide for special/preferential treatment of exports from developing countries.

²⁰³ See BENDE-NABENDE, ANTHONY, supra note 20, at 80.

²⁰⁴ Id.

richer North have made produces of the developing countries less competitive and of negligible return.²⁰⁵ That is a question of equitability of the global trade regime. Therefore, accession will be meaningful to LDCs only if their export commodities become diversified and get demand in foreign markets.

On the import side, international trade brings diversity of products to domestic markets increasing the chance of buying better qualities of products for lower prices to consumers. Moreover, predictability and transparency of the economic environment, as the WTO rules garner, will construct on confidence of foreign and national investors in general and encourage market-seeking ventures in particular because free trade “cuts the cost of doing business internationally.”

That being the full-size picture in theory, empirical evidences reveal that developing economies with export-oriented production benefit from international trade. For example, in Southeast Asian countries, export-oriented FDI has led not only to rapid growth but also expanding export performance.²⁰⁶ Not only the good performances in FDI inflows and export coincide in time (1980s and early 1990s) but also it is evident that the export items from these countries are principally the ones produced by TNCs. For instance, one third of Thai exports constituted computer parts and integrated circuits which TNCs produce. Thailand became the ninth largest computer exporting economy during the 1990s.²⁰⁷ The Thai experience repeated itself in Malaysia in that electronic goods, produces dominantly of foreign enterprises, became leading export items in the same period.²⁰⁸ Nevertheless, the sectoral specificity of FDI inflows and corresponding export growth, and the fact that such export sectors are yet foreign enclaves out rightly suggests that these economies have yet to work harder to win sustainably and considerably in the global economic order.

2.4.2 Challenges

Despite the fact that there is no agreement on the opportunities globalization offers LDCs to manipulate, it has been facing challenges debated again, though. Here in below, an attempt is made to substantiate some challenges of globalization.

2.4.2.1 Abuse of the Environment

One of the apparent downsides of economic globalization (increased production and movement of goods and persons) is its negative impact on global public goods in general and the environment in particular. If the current trend of emission of green house gases is maintained, it is estimated that it would add 2-4°C on the global temperature by the turn of this century, capable of fundamentally altering the ecosystems and threatening human existence.²⁰⁹ The worry is not only to ensure sustainable coexistence but also to be fair to the future generation too.

Moreover, what makes environmental issues special is their trans-boundary effect so that a destructive action somewhere else can reach the other corner in a short period.²¹⁰ So far, the issue of the environment has been to, a greater degree, the concern of environmentalists challenging deeds of the globalization agents. It is in the developing world the suffering has been the worst due to limited technological knowhow to avert the externalities to the extent possible. Hence, unless national governments and international organizations take

²⁰⁵ Id.

²⁰⁶ See Stephen Thomsen, *supra* note 167, at 25-27.

²⁰⁷ Id.

²⁰⁸ Id.

²⁰⁹ See BENDE-NABENDE, ANTHONY, *supra* note 20, at 70.

²¹⁰ Gernot Klepper, *Growth, the Environment, and Sustainability*, in FACETS OF GLOBALIZATION INTERNATIONAL AND LOCAL DIMENSIONS OF DEVELOPMENT 47-48 (Shahid Yusuf, Simon Evenett and Weiping Wu eds., 2001).

wholeheartedly protective and curative measures, devastation of the environment may result in ills ranging from outbreak of global epidemics to reversal of the whole thing to be history.²¹¹

2.4.2.2 Low Labour Standards

Economic globalization is not only about integration of national economies by instrumentality of cross border trade in goods and services, and investment but it is also creating a progressively more integrated global market for labor. Yet, the issue of poor labour conditions is pressing in the poor “South.” This in part is because governments of developing countries have been in competition to attract more FDI by offering lax labour and environment standards which commentators tend to name as “race to the bottom.” The poor working conditions in Export Processing Zones (EPZs) in different countries are cases in point.²¹² Furthermore, the relative skill-biased jobs FDI create in developing countries threaten the job security and wages of the unskilled labour, abundant in the developing world. The latter contributes for the within country income inequalities. The bad news is that there is little reason to believe that the situation, in particular the one pertaining to wages and job security, will change in the upcoming future.²¹³ Hence, unless noble measures at national and international levels are devised, the prevailing and supposedly sustained poor labour conditions in the developing countries may transform the unskilled workforce into a counter-globalization force.

2.4.2.3 Economic Volatility

Globalization is the increased interdependence of national economies through cross border chains of production and faster movement of factors of production. The increased interdependence could be important for efficient use of resources and the collective welfare. But the increased interdependence would make the ill of one economy of all others.²¹⁴ That means if recession hits an economy somewhere else, the rest will be infected through spillovers. The bad effects of crises of this sort are more painful in developing countries with scars surviving for long.

As noted so far, the other facet of economic globalization is liberalization of capital markets. Nonetheless, it has been advised that unregulated financial markets are dangerous for nascent economies because excessive and unregulated capital inflow may pose macroeconomic vulnerabilities such as high debt/reserve ratio, higher deficit in the current account and appreciation of the real exchange rate.²¹⁵ The financial crises in Latin America and Asia are attributed to loose financial regulations dictated by the IMF and the World Bank.²¹⁶ The lesson from this short narration is that unless healing macroeconomic policies and financial regulations are designed to discourage flow of “hot money”, economic destabilization and the consequent growth retardation would threaten the whole economic order in general and survival of emerging economies in particular.

2.4.2.4 Income Inequality between and within Countries

Even if it is a solid fact that globalization pulled millions out of poverty and somehow transformed the collective welfare, research findings reveal that the wealth divide is inequitable between countries and within

²¹¹ See BENDE-NABENDE, ANTHONY, *supra* note 20, at 70.

²¹² Eddy Lee, *Globalization and labour standards: A review of Issues*, 136 INTERNATIONAL LABOUR REVIEW 157 (1997). (Content downloaded from Hein Online (<http://heinonline.org>) on Nov. 12, 2012 02:35:50).

²¹³ THE WORLD BANK, GLOBAL ECONOMIC PROSPECTS: MANAGING THE NEXT WAVE OF GLOBALIZATION 101 (2007).

²¹⁴ Ghosh, B. N., *Globalization, Capital Inflows and Financial Crises*, in GLOBALIZATION AND THE THIRD WORLD: A STUDY OF NEGATIVE CONSEQUENCES 1981 (B.N.Ghosh and Guven, Halil M. eds. 2006). See also RICHARD PEET, *supra* note 12, at 257.

²¹⁵ *Id.* at 182.

²¹⁶ *Id.* at 198.

See also RICHARD PEET, *supra* note 12, at 257.

countries. Greater than eighty countries have percapita income lower than they had a decade or more ago.²¹⁷ To the worse, fifty five others, the majority in sub-Saharan Africa, have declining percapita incomes.²¹⁸ In 2030 it is estimated that 16.1% of world population will belong to "middle income class"; poverty will decline worldwide while the remaining poor will concentrate in sub-Saharan Africa; and growth will generate pressure toward increasing inequality within a number of developing countries.²¹⁹ Hence, unless effective corrective policy interventions at national and international levels are made, the problem of income inequality will continue to be a constant challenge of globalization and a prime problem of Africa.

2.4.2.5 Inequitable Trading System

The fact that developing countries have placed on the Doha Development Agenda a number of problems they face in implementing the present agreements tells their dissatisfaction on the existing trading system. Despite the fact that the increased proportion of trade covered by bound commitments has added security to developing country exports, they complain, *inter alia*, that they still face "tariff peaks" on textiles, clothing, and fish and fish products in important markets that continue to impede their important exports.²²⁰ It is also recalled that in the Uruguay Round, industrial countries made slightly smaller reductions in their tariffs on products which are mainly exported by developing countries (37%) than on imports from all countries (40%).²²¹ At the same time, the potential for developing countries to trade with each other is also hampered by the fact that the highest tariffs are sometimes in developing countries themselves.

It is natural that the share of government revenue collected from import tariffs will considerably decrease as a result of tariff cuts.²²² The fiscal costs of reducing import tariffs may be significant in LDCs because taxes on international transactions are major sources of government revenue. Nonetheless, this may be less of an issue in the early stages of trade liberalization when non-tariff barriers are "tariffized" and prohibitive tariffs are lowered and imports increase, both to reduce the potential revenue deficit. In the medium and long run, however, substantial reductions in average tariff rates require a broadening of government's tax bases to compensate the lose in the public earnings.²²³

The other concern of LDCs pertains to protection of their infant firms. A more liberal trade regime encouraged by WTO membership exposes companies in LDCs to stronger competition from abroad. The external vulnerability of countries may thus be aggravated if the time lag between the rate of import and export trade cannot be shortened. In any case, LDCs should strive for proliferation of local firms in diverse areas and longer adjustment periods as they accede to the WTO.

Besides, the costs of negotiation, adjustment processes and implementation should not be belittled. The role of high skilled personnel is crude to secure the most favorable terms of membership and for active participation in subsequent negotiations. Nonetheless, such minds are in short supply in LDCs so that LDCs may have to recruit them usually on onerous terms. Moreover, J. Michael Finger and Philip Schuler found out that Argentina invested over USD 80 million to achieve higher level plant and animal sanitation to gain acceptance for its meat, vegetables, and fruit export in industrial country markets. Hungary spent more than USD 40 million to upgrade the levels of its slaughter house alone. Mexico spent over USD 30 million to upgrade intellectual property laws and enforcement. They also identified 16 elements in custom reforms, each of which can cost more than USD

²¹⁷ See BENDE-NABENDE, ANTHONY, *supra* note 20, at 80.

²¹⁸ *Id.*

²¹⁹ See THE WORLD BANK, *supra* note 214, at 69.

²²⁰ THE WTO, *supra* note 137, at 98.

²²¹ *Id.*

²²² Zdenek Drabek, *supra* note 1, at 111.

²²³ *Id.*

2.5 million to implement.²²⁴ Although the amounts will vary by country, the totals involved in effective implementation of WTO agreements can exceed the annual development budget of LDCs.

On the face of these and other challenges membership to the WTO precipitates, it could be proper to ask the question that can developing countries benefit from the system. Yes, but only if their economies are absorptive enough and excel on the opportunities. That is why recent literature recommends international organizations and national governments need to revisit their policies to boost domestic capacity.²²⁵ This depends on a combination of actions ranging from improving policymaking and macroeconomic management to boosting training and investment. However, LDCs are the pits to make the adjustments because of lack of human and physical capital, poorly developed infrastructures, institutions that don't function very well, and in some cases, political instability.

2.5 Prospects of Globalization

It is out of the reach of human capacity to tell surely about the future. What is certain about the future is that surprises will occur. So, what one can tell about the future is a mere prediction based on analysis and projection of practical experiences of the past. In the same corollary, it is impossible to conclude about the future of economic globalization because history recorded that the steadily globalizing world fell apart after 1914²²⁶ for it to recuperate in the after the math of World War II. The purpose of the discussion in this section is to draw attention on some possible features of globalization in the upcoming near future.

Noting increased economic integration in terms of increased cross border trade and more integrated financial and capital markets in the last three decades, Dominique van der Mensbrugghe predicted what economic globalization would look like in 2030. The analysis bases itself on different key factors including demographic trends, savings and investment behavior, the role of technological change, and how these trends interact with globalization. By projecting experiences of the last three decades, he predicted that by 2030:²²⁷

- *The global economy will grow by more than double. The share of developing countries would jump from USD 8 trillion to USD 24.3 trillion-effectively tripling its output between 2005 and 2030 and increasing its global share of output from 23 percent to 33 percent;*
- *The level of exports will rise by more than three times from about USD 9 trillion in 2005 to over USD 27 trillion-with the world export-to-output ratio jumping to 34 percent from 25 percent currently. Exports of developing countries will increase from about USD 3 trillion to over USD 12 trillion;*
- *Some decline in savings can be expected as elderly dependency ratios increase. The short supply of surplus current account in high-income countries and the likelihood of developing countries to remain risky investment sites would lead to less to lend to developing countries. So, developing countries will need more than innovative financing techniques to deal with the coming decline in savings in high-income countries.*

By way of summary the above named writer opined that:

“... an abrupt reversal in current trends—particularly toward a global economic collapse—has a very low probability. The central scenario—and any reasonable upward or downward deviation around it—will generate mostly positive consequences, but not exclusively. Globalization and growth will have uneven impacts leading to structural change, job

²²⁴ Finger, J. Michael and Philip Schuler, *Implementation of Uruguay Round Commitments: The Development Challenge* 25 (1998) (World Bank Policy Research Working Paper, No. 2444).

²²⁵ See RICHARD PEET, *supra* note 12, at 258-9.

²²⁶ See DAS, DILIP K., *supra* note 1, at 47.

²²⁷ See THE WORLD BANK, *supra* note 214, at 29-57.

*losses in some sectors and regions, and the risk of some being left behind. And virtually any growth scenario will put stress on natural resources in the absence of corrective action.*²²⁸

The other perspective on the prospects of economic globalization pertains to changes in the international economic organizations. Even if not yet not predictable, there have been symptoms of changes in governance of the global economy. For instance, the power of the IMF has been reduced due to failed crisis management, rejection of the major policy initiatives, countries paying up as quickly as possible and distancing themselves, dwindling credibility and legitimacy, and “poor track record in forecasting recessions including those directly associated with a financial crisis”.²²⁹ Initiatives have been underway to replace it by regional banks like the attempts to establish the Bank of the South in Latin America and Asian Monetary Fund in Asia.²³⁰ The IMF has been responding through ‘streamlining’ and ‘internal reform’ including reform of the voting structure. At the 2006 Annual Meetings in Singapore, *ad hoc* increases in quotas were agreed for China, Korea, Mexico and Turkey. It also promised further reforms which will eventually increase the voting shares of two-thirds of the 185 member countries, and enhance the voice and participation of low-income countries through a tripling of basic votes.²³¹ Having this all, won’t it be possible to expect a reform towards democratization of the IMF, if not its demise and replacement in the near future?

In the same way the IMF was discredited, the World Bank has become eventually a focus of public protest and a unifying adversary for many NGOs. It has been accused for financing environment-unfriendly infrastructure projects, causing poor health and education services in countries under “structural adjustment”, for exacerbating problems of economies of developing countries due to its conviction towards unfettered liberalism, for lack of “good government practices” and democracy, for responses of “window dressing” nature, and so forth. How far would the Bank remain operational retaining the status quo?

The power of the WTO in regulation of the global economy is comparable to that of the International Financial Institutions (IFIs) in sum, if not it exceeds, because trade has become the most vibrant section of the global economy which will increase importance of the WTO. It also got power extensions over time. Nonetheless, the critics forward the argument that “trickledown economics” does not benefit all trading partners and the poor at large. Rather, they are suspicious that it would lead to accumulation of wealth to a few people in a few dominant countries. Moreover, the fact that the WTO turns deaf ears to concerns of workers’ and of environmentalists, protection and enforcement of intellectual property rights are biased to MNCs, the US has been the most influential, if not the ultimate, authority making the organization nasty, and so forth lead to resistance from developing countries in a more unified fashion. The bargaining power of certain developing countries like China, Brazil, India, and Russia has been rising to alter the power balance in the WTO system and justifying a parallel *de jure* adjustment. The deadlock the Doha Development Agenda faced for long is a manifestation of the stand of developing countries not to enter into new onerous engagements. The recent gains at Bali, Indonesia, have been described as tantamount to harvesting “the low hanging fruits” to imply that the core of the Doha Agenda is not yet settled. Thus, unless changes redressing all these concerns are introduced, critics wish the WTO to go, would the South continue under its rule? Time has the answer.

In conclusion, despite the relative increment in costs of production (for example costs of labour and land) in the globalized economies would add on comparative advantages of the less-globalized regions so that trade will become freer as a result of unilateral and/or multilateral liberalization. This would add on the importance of the “South” and its bargaining power would increase in parallel. Furthermore, even if political will and commitment

²²⁸ Id. at 58.

²²⁹ See RICHARD PEET, *supra* note 12, at 126.

²³⁰ Id. at 125.

²³¹ Id. at 126.

of the governments matters most, changes in the functioning and governance of the international economy are inevitable due to the increasing influence of the civil society and of the developing world both in producing and trading, and the rule making of the system. Joseph E. Stiglitz recommends the need of reform to make globalization work, meaning to make it work for the poor, should emphasize on poverty reduction. To that end he underscores the need to inculcate more assistance and debt relief, make trade fair by altering the unfair trade regime, protect the environment, and democratize the flawed system of global governance.²³² To him, “a change in mindset” is a requisite for the overall aspired changes to happen.

2.6 Policy Implications of Globalization and Accession to the WTO on Economies of LDCs

As noted in the previous sections of this chapter, globalization has been of a blurred picture. It is praised by its supporters for its positive returns to everyone in the world and LDCs in particular in terms of access to capital, technology transfer, job opportunities, access to foreign markets, etc. But, there are empirical evidences that stand against this outlook and it has been facing critics almost in all respects so that the issue of economic globalization has been debated over at least for half a century.

So long as economic globalization has become an unavoidable scenario irrespective of a country's location and level of development, it is wise to be optimistic and accept the situation and work for better exploitation of the opportunities and minimize costs of integration. In the first place, from the view point of LDCs, economic globalization has been praised for its facilitation of capital inflows in the form of FDI. Governments of LDCs have been competing to attract the maximum possible even by loosening their environment and labour standards in spite of the other perhaps legitimate privileges. Nevertheless, not all countries attract lots of FDIs and not all FDIs are of positive returns as theories explain and empirical evidences suggest. Hence, what matters is the capacity of the host country in identifying and attracting pro-development FDIs to the maximum possible.

Openness naturally exposes domestic firms to fierce competition from matured foreign companies. If domestic firms are seen being crowding out, which would mean to invite job losses, shifting of profits to the foreign companies, and in the long run, exclusion of citizens from the economic field of the nation. Thence, it is up to LDCs to build up competitiveness of domestic firms, as South Korea once did, to the extent of furnishing collateral for the firms earn loan from external sources.

The other usually invoked benefit of economic globalization is transfer of technology to LDCs. However, as noted earlier in this chapter, technological spillovers are not automatic to FDI. In cases where it worked out, it was attributed, *inter alia*, to facilitation of linkages between domestic firms and the foreign producer, presence of domestic suppliers to the foreign producers, availability of human resource capable of understanding, imitating, adapting, and transforming advanced technology. Besides, critics accuse technologies brought to the developing world to be fragile, outdated, environment-unfriendly, and incomplete. Although how far this holds true is debatable, the concern alarms LDCs to be considerate of the generation of the technology the FDI involves. Moreover, LDCs have to have domestic firms linked with the foreign producers, and invest on high-tech human capital.

In addition to the incentives host LDCs offer to attract FDI, it is reasonably expected that the foreign investor decides where to locate the investment being considerate of other comparative advantages available in the host territory. In the same corollary, it is hoped that foreign investments to LDCs take into account the relatively cheap labour and other natural resources. Hence, economic globalization has been considered to bring job

²³² See STIGLITZ, JOSEPH E., *supra* note 7, at 15-19.

opportunities to the host economies. Yet, critics contend that employment opportunities FDI bring together are still skill-biased widening the income inequality between the minority skilled and majority unskilled laborers. Moreover, the possibility of being occupied by foreigners of such occupations demanding a higher level of expertise is higher, pushing citizens to the ones with low payment and risky conditions. The relentless wish of the investor to minimize costs and maximize profits coupled with the reluctance of host governments to prescribe and enforce high labour standards for fear of being stigmatized by TNCs worsened poor labour conditions in LDCs. Having this all in view, LDCs should strive to attract more FDI but not at the cost of human and labour rights, and the environment. The panorama of competition among LDCs to attract FDI should be redefined to making the business environment more conducive than “race to the bottom”. Moreover, LDCs are advised to invest on education and trainings to take advantage of job opportunities FDI would create.

Furthermore, access to foreign markets to exports from LDCs is another opportunity over emphasized by the international economic organizations and pro-globalization groups. But, this opportunity will be meaningful only if LDCs get something to export. Otherwise it would remain a mere rhetoric and LDCs end up with negative trade balances which at last would make the economy paralyzed. At any rate, LDCs should emphasize on export-oriented production should they take advantage of the market access in the developed world. To that end, they should work for proliferation of export-oriented domestic firms and FDI as a complement to the domestic capacity.

Economic globalization reached today in the face of undeniable costs on the environment, infringement of human and labour rights, economic crises, cultural distortions and an inequitable wealth distribution between regions and within a country. The debate on globalization is also evocative of the need to cooperate towards the greater cause of social justice, democratic governance, workable flexibility, environmental protection and human welfare at the international level than ever. The international economic organizations have been accused for lack of democracy, serving corporate interests, determination in the “one-size-fits-all” approach of policy making, and costing the poor countries. What can be debatable in this regard is the extent and intensity of the irregularities mentioned and not their occurrence. In light of these defects in the global economic governance, LDCs should air their collective voices to bring about social justice, a democratic system, a fair room of flexibility in policy making and adequate representation in decision making in the international economic organizations. Over all, LDCs should endeavor towards driving the upcoming global order in the way that guards the interest of their people.

In summary, in the last three decades, economic integration has been the fundamental trend on the planet earth. It has been principally facilitated by unreserved efforts of the World Bank, the IMF and the WTO. Protagonists of economic globalization appreciate the role of economic openness for the growth of economies by facilitating access to capital, transfer of technology and managerial skills, job creation and market access. The antagonists claim environmental destruction, wealth inequality and human insecurities globalization has been aggravating overwhelmingly counts against the positive results. Empirical evidences also reveal that there are jurisdictions where economic liberalization pulled millions from poverty and jurisdictions where it does not help, if not worsened, the malfunctioning economic conditions. The fact that there is no evidence as to a possible reversal of the trend in the near future implies that LDCs have to persistently work to make their economies absorptive and responsive enough to take advantage of opportunities globalization offers and repeal the downsides.

CHAPTER THREE

BACKGROUND OF BUSINESS CORPORATIONS

3.1 Defining the Corporations

Epistemologically, the word 'company' is derived from the Latin word *companis* consisting of two elements: "com" which stands for being together and "panis" which means bread. Together, it was used to refer to persons sharing their meals when, if they were merchants, they took the advantage of such gatherings to discuss business matters.¹

However, in its modern legal use it stands for artificial entities having rights and duties. Blackstone, as cited by Hahlo, H.R., noted that to reverse the effect of mortality of humans and cessation of personal rights up on the death of the individual, the Romans invented artificial persons who might maintain a perpetual succession and enjoy a kind of legal immortality when it was for the advantage of the public.² These juristic persons are named as body politic, bodies corporate, *corpora corporata*, or corporation. Corporations, since time immemorial, have been formed for religious, educational or commercial purposes.³

As a matter of definition, a corporation, according to Kent, is "a franchise possessed by one or more individuals, who subsists as a body politic, under a special denomination, and are vested, by the policy of the law, with the capacity of perpetual succession, and of acting in several respects, however numerous the association may be, as a single individual."⁴

The Black's Law Dictionary defines a corporation as:

*An entity (usually a business) having authority under the law to act as a single person distinct from the shareholders who own it and having rights to issue stock and exist indefinitely; a group or succession of persons established in accordance with legal rules into a legal or juristic person that has legal personality distinct from the natural persons who make it up, exists indefinitely apart from them, and has the legal powers that its constitution gives it.*⁵

Of almost a similar content with the definition provided by the Black's Law Dictionary, a Business Law Dictionary has the following to say:

*Corporation is a legal structure authorized by [state] law that allows a business to organize as a separate legal entity from its owners—as an artificial person. As such, it can enter into contracts, sue and be sued, issue shares to raise funds, and do the other things involved in carrying on a business. A corporation's owners (i.e., shareholders) are legally shielded from personal liability for the corporation's liabilities and debts (which are limited to its assets). A business corporation is usually planned as a profit-making enterprise, but a corporation can be organized for nonprofit purposes.*⁶

It can be therefore construed from the above-mentioned definitions that a corporation is, *inter alia*, a fictitious person created by the law to overcome limitations in human nature and facilitate operation of long-lasting

¹ THE INSTITUTE OF COMPANY SECRETARIES OF INDIA, COMPANY LAW 1 (Executive Program Study Material, Module II-Paper 4).

² HAHLO, H. R., COMPANY LAW THROUGH THE CASES: A COLLECTION OF LEADING ENGLISH AND SOUTH AFRICAN CASES ON COMPANY LAW (EXCLUDING JUDICIAL MANAGEMENT AND WINDING-UP), TOGETHER WITH EXPLANATORY NOTES AND COMMENTS 1(2nd ed.,1969).

³ Id.

⁴ Id. at 2.

⁵ BLACK'S LAW DICTIONARY 341 (7th ed., 1999).

⁶ BUSINESS LAW DICTIONARY.

missions and ventures. It is also common to all corporations that their personality is distinct from the person of the owners and, unlike the case with human persons, they are of perpetual existence. Moreover, a corporation may be created for profit or non-profit purposes. Nonetheless, it is legitimate to put in black and white the fact that this thesis is interested only with **business corporations**.

Another point worth to note at this juncture is the potential confusion regarding nomenclature of incorporated and registered business organizations. In fairly many writings dealing with business organizations, the terms corporation and company are used interchangeably. Yet, company is also used to refer to a corporation or joint-stock company, association, partnership, or union that carries on a commercial or industrial enterprise.⁷ Under the commercial law of Ethiopia, all business organizations except joint ventures are legal persons in concomitance with companies while the term company is used to refer to incorporated enterprises, be it private or public, whose liabilities are limited to their assets.⁸ The term “corporation” in the US corporate law⁹ and Canadian Business Law¹⁰ represents what are identified as public companies, counterparts of AGs in the German system. So, albeit these kinds of mismatches in the use of the two terms, in this work, they are used interchangeably to correspond to incorporated companies unless expressly used to mean something different or the context implies so.

It is also proper, at this point in time, to put light on the core theme of this work-corporatization. To corporatize or corporatization, is derived from the noun corporation and refers to the state of being **subject to corporate ownership or control**.¹¹ It also means **to develop or turn into big business**.¹² In light of this and as disclosed in the introductory chapter, the purpose of this work is in particular to assess the state of business corporations in the Ethiopian economy and to recommend on desirable legal and policy reforms towards accelerating proliferation of corporations to support competitiveness and sustainability of the national economy in the face of the ever increasing influence of the integrationist forces of globalization and Ethiopia’s accession to the WTO.

3.2 Historical Account of Business Corporations and the Governing Laws

3.2.1 Business Organizations in the Ancient and Medieval Periods

Archeological evidences support that there were partnerships to undertake foreign trade as early as the time of Code of Hammurabi (2075-2025 B.C.).¹³ Associations resembling *societas* in which all the parties share the risks both as capitalists and as traders, and the other similar to the medieval *commenda*, in which one party alone undertakes the management and the commercial risk, were the two early legal forms ever identified.¹⁴ Greek commerce was also known for making use of partnerships in which a partner furnished the whole capital and the other acted as entrepreneur.¹⁵ Partnerships were also common in the Roman Empire where they were meant not only to pursuing a business activity but also non-profit purposes.¹⁶ Under the Roman law, the *socii* had to contribute in equal shares both capital and labour, and to share profit and losses equally.

⁷ BLACK’S LAW DICTIONARY, *Supra* note 5, at 274.

⁸ Commercial Code of the Empire of Ethiopia, 1960, Arts. 210(2), 296, 304(1) and 510(1).

⁹ PFEIFFER, GERO AND TIMMERBEIL, SVEN, US-AMERICAN COMPANY LAW – AN OVERVIEW 597 (2008) accessed on line at www.zjs-online.com (last visited on March 10, 2014).

¹⁰ Polten, Eric P., *German and Canadian Company Law – An Overview* 12 (2011) (available on line at www.poltenassociates.com as last visited on March 10, 2014).

¹¹ Merriam Webster Dictionary, <http://www.merriam-webster.com/dictionary/corporatize> as last visited on March 10, 2014).

¹² The Free Dictionary, <http://www.thefreedictionary.com/Corporatization> (last visited on March 10, 2014).

¹³ LEVY, ADALBERT, PRIVATE CORPORATIONS AND THEIR CONTROL, 3 (Vol.1, 1950).

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.* at 4.

In medieval-Europe too, it was partnerships between near relatives that were the leading forms in place while the backbone of the economies remained to be the individual, because associations between guild members were disfavored till the turn of the 11th century.¹⁷ In general, business life in ancient times remained mostly private and the then business associations were not recognized in corporate lines.

Following is a historical account on the evolution of the law and of business corporations in modern times. The discussion to come in particular deals with development of modern corporate law and corporate business in England, France, Germany and the USA. The selection is not arbitrary in the sense that this writer's interest in the corporate history of these nations stems from two fundamental reasons.

Firstly, the four economies have been identified as the "origin" legal systems of modern corporate law.¹⁸ Not only are these countries rich with experience in company law but also they managed to host successful corporations that remained the backbone of the respective economies and beyond. Hence, it is wise to study such rich experiences in terms of both normative standards and running successful company business to construct lessons that would enhance corporate law systems in the rest of the world including Ethiopia.

Secondly, as this work is hoped to contribute a part for the proliferation of incorporated businesses and instillation of effective system of their governance, to study the routes of these countries will be extension of and concomitant with the line of the journey corporate Ethiopia has traveled through to reach today. Put differently, the draftsmen of the Commercial Code of the Empire of Ethiopia manifestly reported that they included rules they deemed proper to redress problems corporate Ethiopia might face without sticking with a single system or family. The drafter of Book II of the Commercial Code, Professor Esccara, in particular, emphasizing on the desirability of a comparative approach¹⁹ for better results of the drafting project, acknowledged his consideration of laws of Great Britain, France, Germany, America, Italy and Switzerland.²⁰ Therefore, even if wisdom can be there everywhere, attempts to rectify challenges in the Ethiopian corporate regime do better if they draw lessons from these countries once historically attached with the development of corporate law in Ethiopia.

3.2.2 Development of Company Business and Law in the UK

The first known positive measure towards development of corporate business in England was marked by the formation of Company of Staple followed by the Company of Merchant Adventurers, established as early as the 13th century.²¹ The former was formed to procure the wool trade which was then pursued exclusively by Italian and German merchants and the latter to take on the export of cloth. Controlled to a greater degree by Londoners, the Adventurers struggled with the Staplers and succeeded to control over the country's entire export trade.²²

Moreover, up on failure of English Government's financial support for trading companies by way of loans²³ and endeavors of temporary groups that financed mercantile expeditions in order to win in the competition with the established colonial and mercantile powers of the 16th and 17th centuries,²⁴ the need create a more stable form of organization in the form of incorporated joint-stock company rose. This marked the evolution

¹⁷ Id. at 8.

¹⁸ Muchlinski, Peter, *The Development of German Corporate Law Until 1990: An Historical Reappraisal*, 14 German Law Journal 339-439 (2013).

¹⁹ WINSHIP, PETER, BACKGROUND DOCUMENTS OF THE ETHIOPIAN COMMERCIAL CODE OF 1960 61 (1974).

²⁰ Id. at 61-71.

²¹ Id. at 14-16.

²² Id. at 16.

²³ Id. at 22.

²⁴ See LEVY, ADALBERT, *supra* note 14, at 17-21.

of “regulated companies” into business companies subject to far fewer restrictions than in the former cases. But, the ‘regulated companies’ were not abolished there and then rather a hybrid of companies were retained for long.²⁵ The East Indian Company (1600) and Hudson Company were always joint-stock companies while the Russian Company, the Levant Company, the Eastland Company, and some of the African Companies were subject to regulation after formed as joint-stock companies.²⁶

True, many of the subsequently chartered companies were created for overseas trade. The Society of Mines Royal (1561) and Mineral and Battery Works (1565) in the mining sector, and the Governor and Company of the New River (1619) and the Bank of England (1694) outside the extractive industries were among the earliest known business corporations.²⁷ All of the then joint-stock companies obtained legal personality through an act of the Sovereign i.e. a royal charter. Hence, there was no a general law for corporations. Rather, each was governed by its own charter and by-laws which might be drawn in line with the charter. Yet, charters establishing different companies shared some features in common. In the latter generation of companies, the supreme authority regarding company matters resided in the “General Court” (general meeting of shareholders) while the management was entrusted to the “Court” (governors and directors) who were required to be shareholders.²⁸

The chartered joint-stock companies were corporate entities with juridical personality so that shareholders were not answerable for liabilities of the company and it could perform juridical acts like concluding contracts, suing and being sued before a court of law. Shareholders of non-chartered joint-stock companies, however, did not enjoy limited liability, meaning they were answerable jointly and severally for liabilities of the company. Moreover, the juridical personality of companies was inspired by the doctrine of perpetual succession.

At this very rudimentary level of corporate business, it was noted that the companies were almost closed-consisted of a small number of stockholders. Moreover, the need to restrict shareholding, regulate voting rights with a view to protecting “minority shareholders”, and the potential influence of boards became explicit very early.²⁹

The commonly referred Act in the history of corporate England (i.e. the Bubble Act of 1720) was necessitated by the felt speculative fever attributed principally to promotion of unincorporated companies and misuse of charters granted for quite other purposes³⁰ consequent to which the doctrine of *ultra vires* emerged from a Scot case of *Budd v. Fordyce*.³¹ The Act, formally represented as Act 6 Geo. I, c.18, overhauled the conditions of incorporation, reserved the Crown’s power to create companies and authorized the incorporation of the Royal Exchange³² and London Assurance Companies,³³ both still in business. It outlawed acting or presuming to act as a corporate body, raising or pretending to raise transferable stock, transferring or pretending to transfer such stock, and acting or pretending to act by virtue of a charter which is obsolete, or using a charter for purposes other than those for which it was granted.³⁴

²⁵ Id. at 23.

²⁶ Id.

²⁷ Id. at 24.

²⁸ Id. at 34.

²⁹ Id. at 40-41.

³⁰ Id. at 48.

³¹ Id. at 50.

³² Wikipedia: The Free Encyclopedia, http://en.wikipedia.org/wiki/Royal_Exchange_London (last visited on March 10, 2014).

³³ Wikipedia: The Free Encyclopedia, http://en.wikipedia.org/wiki/Royal_Exchange_Assurance_Corporation (last visited on March 10, 2014).

³⁴ See LEVY, ADALBERT, *supra* note 14, at 50-52

Due to the persistent reluctance of the crown and the Parliament throughout the life the Bubble Act (105 years), very few charters were issued during the whole 18th century. More than 100 companies, mainly canal and navigation undertakings were incorporated from 1759-1800 by Acts of Parliament in the form of a statutory company-a new kind of company.³⁵ Anyway, it is reported that by 1825 there were 156 joint-stock companies, the majority being canal, gas and insurance companies, with a paid up capital of £47, 936,486.³⁶ The economic revolution pushed for promotion of 624 companies with a nominal capital of £372, 173,100 between 1824 and 1826.³⁷

Under the Bubble Act, the ultimate authority of each company i.e. the general meeting of shareholders (general court) decided, *inter alia*, on issue of shares and bonds, increase of share capital of bounded debt, redemption by the company of its own shares, acquisition of real property, competing businesses, and declaration of dividends.³⁸ Moreover, voting was qualified by the requirement of minimum holding, entitlement of more than one vote for larger holdings, voting in person unless voting by proxy is allowed in the charter. There were also shares without voting right.³⁹

The Bubble Act was replaced in 1825 by the Act 6 Geo. IV, c.91.⁴⁰ Yet, incorporation of companies was retarded and further liberalization was advocated for. The Act 7 Geo. IV, c.46 liberalized banking business by empowering partnerships with members exceeding six to carry on banking business within 65 mile from London which in turn ended monopoly of the Bank of England in the sector.⁴¹ By 1836, there were 61 joint-stock banks with 472 branches operating in different areas.⁴²

Moreover, the concept of *preference shares* came to the scene as a method of procuring additional funds by the railway companies of that time. Preference shares got a legal foundation by company's special Act, Company Clauses Consolidation Act 8 & 9 Vic., c.16 as modified by section 13(5) of the Act 26 & 27 Vic., c.118 of 1863.⁴³ In the face of a strong prejudice against companies, even stronger against the principle of limited liability, and less redressed by immature Acts intended to promote incorporation, the number of companies reached 947 by 1843.⁴⁴ Out of it, 244 were water and gas, 108 railways, 51 shipping, 72 insurance, and a small number of industrial undertakings.⁴⁵

Reckless and dishonest promotions moved the Parliament to adopt the Act 7 & 8 Vic., c.110 of 1844⁴⁶ which has been identified as the first general British company law though it did not recognize the principle of limited liability. Among other things, it made possible the formation of joint-stock companies as independent legal entities by registration without a special establishing-Act of Parliament. Nonetheless, the other modalities of incorporation were not abolished altogether rather they were frequently resorted to and Parliamentary incorporation remained a necessity in railway companies.⁴⁷ In order to protect the interest of the general public, this latter Act maintained the fullest possible publicity and unlimited liability of shareholders. The principle of limited liability was introduced later by the companies Deeds of Settlement.

³⁵ Id. at 44.

³⁶ Id. at 48.

³⁷ Id. at 58.

³⁸ Id. at 51.

³⁹ Id. at 51-52.

⁴⁰ Id. at 58.

⁴¹ Id. at 59.

⁴² Id. at 60.

⁴³ Id. at 61-62.

⁴⁴ Id. at 63.

⁴⁵ Id.

⁴⁶ Id. at 64.

⁴⁷ Id. at 71.

About 956 new companies were registered from 1844 to 1856.⁴⁸ The latter Act left railway companies at liberty to choose either the scheme of registration or Royal charter for incorporation. In the same period, investment in the sector rose to the capital of £200 million based on which some tended to refer the period as “years of railway mania”.⁴⁹

A further general company law reform was envisaged by the establishment of a Royal Commission on Mercantile Law in 1854 which came up with the Bill 18 & 19 Vic., c.133.⁵⁰ The Bill maintained the Registration Act and proclaimed that companies other than banks and insurance houses could be established with limited liability on complete registration provided that the undertakings are constituted by 25 members or more, 75% of capital subscribed and 20% paid up, capital divided into shares of par value of £10 each.⁵¹ In such cases a reference to limited liability could be made in the Deeds of Settlement and the word “Limited” should form part of the name of the venture. The latter Act did not extend limited liability to directors declaring and paying dividends.

It took only a year the latter Bill to be amended by another Act 19 & 20 Vic., c.47.⁵² The amending Act, *inter alia*, abolished the compulsory appointment of auditors, made the minimum number of stockholders in a company seven and demanded partnerships with twenty or more partners to be registered as companies. It is this latter Act that introduced the concepts of Memorandum and Articles of Association in the place of Deeds of Settlement.⁵³ Content wise, a Memorandum of Association of a company was required to include, *inter alia*, name of the company, address, objects, description on its liability, capital and number of shares. Both Memo and Articles of Association were required to be registered in the Registrar which issued a Certificate of Incorporation up on their receipt.⁵⁴

Moreover, the latter Act made shares personal property of their holders and prohibited payment of dividends in case of insolvency.⁵⁵ Under this latter Act companies were duty bound to maintain register of share holders, open for inspection by all shareholders, and a summary of annual list of nominal capital, shares issued, the calls, and unpaid and forfeited shares to be filed in the Registrar so that stakeholders may inspect the current state of the company. Even if it had little to say about management, with a view to protecting interests of minority shareholders, the Act entitled 20% of shareholders in number and value to request for investigation of the company’s affairs.⁵⁶

In response to the special focus placed on banks, Act 20 & 21 Vic., c.49 of 1857 extended the Act of 1856 to apply on joint-stock banks.⁵⁷ That in effect means at least seven members each having one share holding of par value £100 could form a bank. Moreover, partnerships carrying on banking business and having more than ten members were required to register as companies. Under the latter Act one-third of shareholders could petition for investigation of affairs of the bank. Banks became of limited liability, for the first time, by the Act 21 & 22 Vic., c.91 up on adjustment of their Memo and Articles of Associations to that effect.⁵⁸

⁴⁸ Id. at 72.

⁴⁹ Id. at 73.

⁵⁰ Id. at 75.

⁵¹ Id.

⁵² Id. at 76.

⁵³ Id. at 77.

⁵⁴ Id.

⁵⁵ Id.

⁵⁶ Id. at 78.

⁵⁷ Id.

⁵⁸ Id. at 81.

In the period between 1856 and 1862, about 2,479 companies were registered as limited-liability-company out of which only 1,575 with a capital of £31 millions remained in business.⁵⁹ The share of industrial companies was also on the rise. During the same period there were 114 cotton, 3 woolen, 22 other textile, 65 iron and coal, and 207 copper, lead and other mines companies.⁶⁰ Another estimate claimed for a total of 2631 companies with a capital of £185 million were in business before 1860s.⁶¹

A project of consolidating Acts to ease the difficulty of enforcing rules scattered in different Statutes by courts and handling of company affairs by lawyers was aspired for. This happened by Act 25 & 26 Vic., c.89 which came to force on 2 November 1862 involving 212 sections and named otherwise as the “Magna Carta of Company Law”.⁶² The Act succeeded in making company law very clear and inculcating very simple method of incorporation while retaining the principle of limited liability. A peculiar contribution of this Act was introduction of a third type of company i.e. company limited by guarantee.⁶³ In the latter form of company, shareholders bound themselves to contribute to the amount fixed in the memorandum and articles of association to the assets of the company in case of its liquidation for debts contracted up to the time when they were members.⁶⁴

The consolidating Act also provided for the alteration of memorandum of association of a company, increase of capital, conversion of shares into new ones of larger par value or into stocks, and change of company name by a special resolution of the general meeting and approval of the Board of Trade.⁶⁵ Moreover, under the latter Act, companies with unlimited liability and liability limited by guarantee were required to draw memorandum and articles of association. Allowed in this latter Act was issue of preference shares and debentures subject to withholding of register of mortgages and other charges open for inspection by shareholders and creditors only, and incorporation of companies without shares where directors were required to be registered.⁶⁶ The other innovative contribution of this Act was the power given to Courts to investigate deeds of a present or past director, manager, liquidator or officer of a company up on application of a liquidator, shareholder or creditor.

In the period between 1863 and 1866, about 3503 new companies with limited liability were registered.⁶⁷ Out of these, 876 with a nominal capital of £373, 230,000 offered shares of par value £268, 136, 900 paid up was not more than 10%, though.⁶⁸ A substantial number of manufacturing companies were created with better foundations.

A legislative interference by Act 30 & 31 Vic., c.131 amending the company Act of 1862 was necessitated by the economic crisis of 1867 which slowed registration of new companies and impacted on the existing ones especially in the banking sector.⁶⁹ The amending Act introduced companies with limited liability for shareholders and unlimited liability for directors, a legal form corresponding to the French *Société par actions* and German *Kommandit Actiengesellschaft* though it remained a dead letter in that respect. It is also provided in this latter Act that capital could be reduced up on a special resolution to that effect and order of court. The other unique contribution of the Act of 1867 was its introduction of share warrants to bearer-certificates

⁵⁹ Id.

⁶⁰ Id.

⁶¹ Id.

⁶² Id. at 82.

⁶³ Id.

⁶⁴ Id.

⁶⁵ Id.

⁶⁶ Id. at 83.

⁶⁷ Id. at 84.

⁶⁸ Id.

⁶⁹ Id. at 88.

entitling the bearer to demand from the company the delivery of shares referred in it or demand payment of dividends. It also provide for protection of subscribers, shareholders and purchasers of shares, and the public.

Nevertheless, out of 7056 companies formed since 1844 only a few were in operation, the lowest rate of survival being in bank and finance.⁷⁰ Yet, record of new registrations even in virgin areas was on the rise. In 1873 alone, new companies with a capital of £152 million were formed.⁷¹

The other important company law of England, Act 40 & 41 Vic., c.76, intended to govern reduction of capital by withering the doubt in the Act of 1867.⁷² In response to the economic need to ensure sustenance of banks hit by crisis, this Act entitled companies, upon special resolution to that effect and court approval, to reduce their capital in order to avoid a mismatch between nominal capital and assets at disposal caused by losses or otherwise by making partial repayment of amounts paid up or reducing shareholders liability.

The deafening public opinion towards a more stringent law to do away with the prevailing scandals gave birth to Act 42 & 43 Vic., c.76 of 1879.⁷³ It, among others, reintroduced the compulsory auditing and extended the principle of limited liability to unlimited companies with respect to their future debts. Subsequently Act 43 Vic., c.19 of 1880 freed repayment of a company's net assets deriving from undivided profits but adding on the liability of shareholders by the amount paid.⁷⁴

The decade between 1881 and 1890 was described as 'a decade of growth of companies by number and assets'. In the time from 1888 to 1890 alone, there were new registrations with an average nominal capital of £277 million.⁷⁵

The last decade of the 20th century was a time of depression in the UK that reached the nastiest in 1893. Nonetheless, registration of new companies was on the rise especially in the aftermath of recovery. During the time from 1891 to 1895, on the average 2955 new companies with an average nominal capital of 136,691,762 every year were registered.⁷⁶

Legislative reforms were constant. Act 61 & 62 Vic., c.26 made issuance of shares for consideration other than cash possible provided that the contract was filed subsequently.⁷⁷ Act 63 & 64 Vic., c.48 of 1900 on its part made certificate of incorporation a conclusive evidence of legal personality and incorporation of a company.⁷⁸ It also prescribed rules on contents of prospectus and statutory meeting. Under this Act, 10% of shareholders were entitled to call for an extraordinary meeting on stating its purpose to directors. It also made registration of mortgages and other charges to be submitted to the Registrar.

Act 8 Edw., c.69 of 1908, meant to consolidate company law, formally recognized private companies in the corporate history of England.⁷⁹ This type of companies were companies whose ownership and control resided in members not exceeding fifty, transfer of whose shares was restricted, if not banned, and who did not appeal to the public to raise capital. It should be noted here that capital was not a factor to differentiate between public and private companies. Moreover, under the latter Act, transformation of an existing public

⁷⁰ Id.

⁷¹ Id. at 89.

⁷² Id. at 116.

⁷³ Id.

⁷⁴ Id. at 117-118.

⁷⁵ Id.

⁷⁶ Id.

⁷⁷ Id. at 119-120.

⁷⁸ Id.

⁷⁹ Id. at 125.

company into private company was almost a right while transformation of a private company into public company was a must if it wished to abolish restrictions on transfer of its shares, intended to make an issue to the public, or if shareholders exceeded fifty in number.

Then after, private companies were growing at a rate faster than public companies. For instance, among the 5024 new registrations in 1908, more than 61% were private companies.⁸⁰ In the same year 16,172 public companies were converted into limited companies while the number of conversions from private company to was public company only six.⁸¹ The time between 1908 and 1919 exhibited on the average 5,973 new registrations with an average nominal capital of £147,776,451 per annum. In general, on 30 April 1909, indicative of the place of corporate business in the economic life of the then Great Britain, there were 46,474 companies with a paid up capital of £2,163,789,000.⁸²

With a view to moderating the rapid growth of private companies, Act 3 & 4 Geo.V, c.25 of 1913 appeared being strict on private companies to the extent of annulling them for non-compliance of any of the requirements.⁸³ It tolerated membership in excess of the standard only when such addition was consequent to purchase of shares by former or present workers of the company. A subsequent Act 7 & 8 Geo.V, c.28 of 1917 introduced the requirement of disclosure of nationality of non-British directors of companies as part of measures in connection with Trading with the Enemy legislation.⁸⁴ This rule remained valid permanently.

The long depression after the economic boom of 1920 had a negative impact on the rate of new corporate establishments till recovery was achieved in 1925 while increase in the number of new of companies was the constant trend all the time. On the average, there were about 7,655 new registrations with an average nominal capital of £207,283,081 in each year from 1920 to 1929.⁸⁵

Act 19 & 20 Geo.V, c.23 of 1929, *inter alia*, prescribed rules on the transfer of the whole undertaking or amalgamation with another venture, and prohibited giving of financial assistance for the purchase of a company's own shares.⁸⁶ It also entitled 15% of shareholders of any class to apply to a court for relief against resolutions impeding their rights. Moreover, it set rules on books of account, form and content of balance sheet of a company, disclosure of loans and remuneration of directors, and subsidiary companies. It also empowered auditors by allowing them to attend general meetings at which accounts of the company were to be considered. Nonetheless, private companies were not subject to these special rules.

The collapse on the New York Stock Exchange in 1930 was felt in London too. Consequently, new registrations were slowed in 1930 and 1931 and half of assets of 284 companies were lost and of these 284 companies 70 were liquidated in the next three years time.⁸⁷ Recovery was achieved in 1932 and there were 13,192 new registrations annually with an average nominal capital of £124,378,342 in the period 1933-1938.⁸⁸ During this time, capital invested in private companies rose not only in absolute terms but also in comparison with public companies. By the end of 1938 there existed 14,355 public companies with a paid-up capital of £1,893,738,013.⁸⁹ After a year, the number of public companies decline to 13,920 while their paid-up capital rose to £4, 117,000,000 and the number of private companies reached 146,735 with a capital of

⁸⁰

⁸¹ Id. at 159.

⁸² Id.

⁸³ Id. at 160.

⁸⁴ Id.

⁸⁵ Id. at 161.

⁸⁶ Id.

⁸⁷ Id. at 164.

⁸⁸ Id. at 165.

⁸⁹ Id.

£1,923,000,000.⁹⁰ In 1944 public companies showed a slight reduction in number and capital while private companies kept on rising both in number and size.

Act 11 & 12 Geo.VI, c.38, consolidating Acts proclaimed after 1927 was enacted on 30 June 1947 and partly entered into force on 1 December 1947 and as a whole starting on 1 July 1948.⁹¹ Among others, this Act included rules on investigation of affairs of companies, share ownership, company name and alteration of company's objects and memorandum of association.

Leaving aside the frequent minor changes made to it year by year, the Companies Act of 1948 was subsequently amended in 1967, 1976, 1980, 1985 and 1989, all meant to introduce new things or otherwise redefine a pre-existing rule. Moreover, the reforms in the sector have been justified by the legal duty the UK government has shouldered, as is the case in France and Germany, to enforce directives of the European Economic Community (EEC), now European Union (EU).⁹² The UK also has got, after a lengthy development period, a comprehensive Company Act in 2006. It entered into force part by part through commencement orders. It is therefore this Act augmented by regulations and orders issued as statutory instruments under it that forms the current fundamental and active company law of the nation.

Numerical data suggests that the number of companies has been on a constant increase over the years. It rose from 2.7 million in 1994⁹³ to, based on the UK Companies House report, 3,201,983 by January 2014 of which 91.5% have been active.⁹⁴ Besides, public companies as percentage of effective register of total companies have been insignificant and declining over time, for instance from 0.7% in 2002/03 to 0.3% in 2012/13.⁹⁵

3.2.3 Development of Companies and Company Law in France

By the end of the 17th century, the common business organizations in France were partnerships, properly named as the *commandite* or *participation*.⁹⁶ There were also companies created by royal letters with far-reaching monopolies, substantially held by the crown, regarded as instruments of public policy, and mainly destined for foreign trade.⁹⁷

A note worthy icebreaking happening in the history of corporate France i.e. the establishment of *Banque Générale*, modeled on the Bank of England, with a capital of 6,000,000 francs divided into 1,200 shares of 500 francs each took place in 1716.⁹⁸ The establishment of the *Compagnie de Louisiana ou d'Occident* to takeover tobacco monopoly from Canada and Mississippi companies was another remarkable step in development of corporate France.⁹⁹ Its obligations guaranteed by the king, *Banque Générale* was transformed into *Banque Royale* in 1718. Widening its influence, the *Compagnie de Louisiana ou d'Occident* was also made to absorb the *Compagnie des Indes Orientales et de Chines* i.e. the French East India Company.¹⁰⁰

⁹⁰ Id. at 166.

⁹¹ Id. at 168.

⁹² M. Freeman Durham, *The Companies Act, 1980: Its Effects on British Corporate Law*, 4 Nw. J. INT'L L. & BUS. 551 (1982).

⁹³ Advantages and Disadvantages of Running a Business as a Company, http://www.companylawclub.co.uk/topics/advantages_and_disadvantages_of_running_a_business_as_a_company.shtml (last visited on March 10, 214).

⁹⁴ <http://www.companieshouse.gov.uk/about/statisticsAndSurveys.shtml> (last visited on March 10, 214).

⁹⁵ Companies House, *Statistical Tables on Companies Registration Activities 3* (2006/07) (available online at http://www.companieshouse.gov.uk/about/pdf/companiesRegActivities2006_2007.pdf and 2012/13 available at http://www.companieshouse.gov.uk/about/pdf/companiesRegActivities2012_2013.pdf as both last visited on March 10, 214).

⁹⁶ See LEVY, ADALBERT, *supra* note 14, at 53.

⁹⁷ Id.

⁹⁸ Id.

⁹⁹ Id. at 54.

¹⁰⁰ Id.

By the middle of the 18th century, a fairly large number of joint-stock companies were formed. The majority specialized in canal works, mines, iron works and foundries, glass and other manufacturing undertakings. In those days a royal charter was not required for formation unless the company aimed at monopoly or some other franchise. That time, government regulation was such loose once a charter was granted to companies.¹⁰¹

Evidence as to existence of joint-stock company proper (*Société Anonyme*) and partnerships by shares (*Commandite par actions*)¹⁰² in the same period was found. Different classes of shares were also envisaged at this preliminary stage though in wider use were shares registered in the name of owners in which case transfer was made by formal declaration (*declaration de transfert*) to that effect. With respect to transfer of bearer shares the declaration was required to be registered so that the distinction between bearer and registered shares was negligible. Although General meetings were known but not held on a yearly basis, management of companies was mainly in the hands of directors.¹⁰³ Overall, the French revolution met the largely privileged chartered companies, a number of fair-sized joint-stock companies, and *commandite par actions* occupying a substantial part in the economic life of the then France.¹⁰⁴

Adoption of the principle of “free association” by the National Assembly contributed a part for the proliferation of companies in the post-revolution France. Nonetheless, reckless speculation that developed in the past necessitated the revolutionary law of the Year II in 1793 which mercilessly prohibited formation of new companies and ordered the dissolution of the existing ones.¹⁰⁵ However, the latter law, counting against development of corporate enterprises, was reversed by the law of the Year IV (1795) which freed again formation of companies in any form.¹⁰⁶

Consolidation of company law was part of Napoleons’ project of codification. A short statement of general corporation law, considered as the first codified French company law, came to the scene as part of *Code de Commerce* in 1807.¹⁰⁷ This law made the need of securing a charter mandatory only for joint-stock companies proper while *commandites par actions* could be created freely and without restriction. The Code named joint-stock companies as *Société Anonyme* (SAs) which literally means “Nameless Company” because the name of any of the partners was not required to form part of the name of the company. The Code recognized the principle of limited liability.¹⁰⁸ Moreover, company capital was required to be divided into shares of equal value. Bearer shares, transferable by mere delivery of the certificate, were also envisaged by the code.

Regarding management of a company, the code provided it to be carried out by agents appointed for a fixed period by shareholders for remuneration or otherwise as provided in the articles of association.¹⁰⁹ With a view to making newly formed companies known to the public, the constituent act was required to be filed with the court along the decree evidencing assent of government attached to it.

The strict regulation of the formation of joint-stock companies provoked a relatively faster evolution of *commandites par actions*, even if the majority were lost in the recurrent crises than companies proper. At the same time all dubious promotions took the form of *commandites par actions*. In the face of these all, reform of

¹⁰¹ Id.

¹⁰² Partnerships by shares (*Commandite par actions*) were of characteristics of both *commandites* and joint-stock companies in the sense that one or several partners (i.e. *gérants* meaning managing partners) assumed personal and unlimited liability for the company’s debts and obligations, resembling partnerships, while the remaining partners limited their liability to the extent of their interest.

¹⁰³ Id. at 55.

¹⁰⁴ Id.

¹⁰⁵ Id.

¹⁰⁶ Id. at 55-56.

¹⁰⁷ Id.

¹⁰⁸ Id.

¹⁰⁹ Id.

company law was highly urged which became a reality only in 1856 when the law dealing with *commandites* was amended.¹¹⁰

The amending law, *inter alia*, required par value of shares of a *commandites par actions* with a capital less than 200,000 francs to be not less than 100 francs and for those whose capital exceeded 200,000 to be 500 francs and more.¹¹¹ Issue of shares was prohibited up until capital fully subscribed and 25% paid in cash. Companies were also prohibited to issue bearer shares before full payment of capital and not negotiated till 40% was paid.¹¹² Moreover, contributions in forms other than cash (*apports*) were subject to approval by resolution of the general meeting to be held before the undertaking commences operation. The decision in this regard was required to be done by majority in number and holdings of shareholders who contributed in cash.¹¹³

The new law also introduced a board of supervisors of not less than five members elected at each *commandite's* general meeting for a period of not more than five years. The board was authorized to examine books, cash and security of the company and report to shareholders before declaration and payment of dividends. The board also might convene a general meeting and propose dissolution of the company.¹¹⁴

Under the latter law, an action for nullity could be brought by managers (*gérants*), supervisors, or members who contributed non-cash assets. To ensure observance of the law and legitimize responsibility of *gérants* and supervisors, this law required them to file a declaration with notary public certifying that the requirements as to subscription and payment had been carried out.

In effect, the law of 1856 was successful in retarding the formation of *commandites par actions* and somehow prevented the issue of false shares.¹¹⁵ The slower formation of companies coupled with the fear of being swallowed by English companies in consequent to the commercial treaty of 1862 with the UK¹¹⁶ forced the Imperial Government of France to introduce an amendment law that relaxed the conditions of formation of *Société anonymes*. The new law removed the need to securing an Imperial permit provided their capital did not exceed 20 million francs and involve seven or more members.¹¹⁷ Such companies, equivalent to the British Private Limited Companies, have been named as "*Société à responsabilité limitée*".¹¹⁸ Those with a capital of less than 200,000 francs were directed to make their shares of par value of 100 francs and those having more than 200,000 francs were directed to make their shares of par value of 500 francs.¹¹⁹

By virtue of the latter law, management of *Société à responsabilité limitée* was entrusted to a board of directors (*council d'administration*) elected by shareholders for a period to be determined by the articles and not exceeding six years in any case.¹²⁰ Directors were required to deposit with the company at least 5% of total share capital in shares issued in their names. *Commissaires* with a term of office of one year were elected to control the management of the company. Moreover, with respect to accounting of these companies, the directors were required to prepare quarterly statement of assets and liabilities, and detailed inventory and summary balance

¹¹⁰ Id. at 90.

¹¹¹ Id.

¹¹² Id.

¹¹³ Id.

¹¹⁴ Id.

¹¹⁵ Id. at 91.

¹¹⁶ Id. at 92.

¹¹⁷ Id.

¹¹⁸ Id.

¹¹⁹ Id.

¹²⁰ Id.

sheet at the end of each financial year. Besides, 20% of the annual profit was required to be deposited in a reserve fund until it reached 10% of the company's grand capital.¹²¹

Till this point in time, corporate France exhibited three kinds of companies: the strictly regulated *commandite par actions*, limited companies envisaged under the law of 1863, and *société anonymes* governed by the *Code de Commerce* and in whose respect government approval is mandatory for formation. Previously, the company law of France was not comprehensive and clear-enough to regulate the situation on the ground so that a codification project of company law was sought to for long, but became a reality only in 1867.¹²²

The new law somehow relaxed the regulation of *commandites par actions*, *inter alia*, by making nominative shares negotiable after payment of 25% of the capital, authorizing conversion of nominative shares into bearer shares after such payment but retaining liability of the original subscriber for two subsequent years after the transfer, providing for the constitution of a board of supervision of not exceeding three persons for a period to be fixed in the articles, and limiting liability of board members only to their holdings.¹²³ Regarding *société anonyme*, the new law abolished the requirement of government authorization for effective incorporation so long as the legal requirements were complied with. It also provided for issue of bearer or nominative shares which might be transferred in similar ways as in *commandite par actions*. Board of directors, members required to be shareholders and of a qualification determined by the articles, might be appointed by shareholders for a period not more than six years. Moreover, *commissaries* with the power of examining books, records, transactions of the company might be elected. Inventory, balance sheet, and profit and loss accounts were required to be drawn. It also indicated that a general meeting should be held at least once a year and subject to quorum and voting rights prescribed by the articles.¹²⁴

Under the latter law, a company was required to file the constituent act with the office of the *judge de paix* and with the competent commercial tribunal to obtain license, and extract should be published in one of the news papers authorized to receive official advertisements. The documents filed were open for public inspection and required to be displayed in the premises of the company.¹²⁵

In the mean time, company law reform was highly sought to and drafts of amendments were drawn up repeatedly though came to being only in 1893.¹²⁶ Of the most important changes the latter amendment brought, the rule that made all companies merchants whether they engaged in mercantile business or not is worth of mention.¹²⁷ The difference between mercantile and non-mercantile (civil) companies lied on the fact that unlike the mercantile ones, civil companies were not subject to bankruptcy procedure in case of insolvency.

It also prohibited the issue of bearer shares before full payment of the capital and restrained transferability of shares issued for *apports* (stockholders who contributed to the capital of the company not in cash) during the first two years and extended liability of the transferor of nominated shares for two years of the transfer.¹²⁸ It empowered members with smaller holdings to unite to vote through a representative (*Droit de groupment*). This law also qualified the characteristic feature of French company law i.e. "action for nullity" by barring it should

¹²¹ Id. at 92-93.

¹²² Id.

¹²³ Id. at 94.

¹²⁴ Id.

¹²⁵ Id.

¹²⁶ Id.

¹²⁷ Id. at 155.

¹²⁸ Id.

the irregularity was amended subsequently or a resolution of the general meeting was passed in cases demanding such a resolution. It totally bared such actions after ten years of establishment of the venture.

The subsequent company law reform of 1902¹²⁹ allowed *société anonymes* to issue preferred shares entitling priority rights as to dividends and distribution of assets during liquidation, or special voting rights if provided so in the articles. It also provided for a right to hold a special meeting of affected shareholders should a general meeting was convened to decide on an alteration in the rights of different categories of shares.¹³⁰ It also extended the right to issue preference shares to *commandites par actions* and companies existing before 1902 unless their articles prohibits.¹³¹ Besides, it repealed the restriction on transfer of *apport* shares.

Even if the parliamentary machine was unable to satisfy the deserved substantial company law reform, it undergone frequent amendments in response to the need to advance the economic conditions. In 1913 the power of general meetings was extended by law to include any alteration of articles less nationality of the company. The new law also envisaged the procedures and quorum of a second and third general meetings should the first was not held for inadequate participants to reach the $\frac{3}{4}$ quorum but retaining the $\frac{2}{3}$ majority to pass valid resolutions. It also regulated powers and procedures of extraordinary meetings anew.¹³²

Regarding institutional reforms, the law of 1919 introduced the institution of Commercial Register and applied to companies.¹³³ A law of 1925 is also noted for importing a new type of company with limited liability i.e. *société à responsabilité limitée* as a private company.¹³⁴ An Order of 1929 on the other hand made Founders' shares i.e. profit sharing certificates issued in favour of incorporators not an evidence for the holder a legal position of a shareholder. Another amending Order of 1930 amended provisions of the law of 1913 pertaining to balance sheet, and profit and loss accounts.¹³⁵ An Order of 1933, itself amended by Orders of 1935, amended the law of 1867 by altering rules of voting at general meetings.¹³⁶

The Vichy regime of France also underwent frequent reforms of the French company law. It, by law of 28 February 1941, prohibited negotiation of bearer shares unless deposited with a French bank or a company of brokers authorized by the government.¹³⁷ To do away with the requirement of dispossession, it advised conversion of bearer shares into registered ones. Moreover, the law of 3 February 1943 required the total conversion of bearer shares into registered shares or deposition with a central institution for such deposit and transfer of securities upon issue of a nominative certificate to depositors by the depositing institution in replacement.¹³⁸

A law of 4 March 1943 allowed companies not to call up the unpaid remainder of their capital shares before a five years time.¹³⁹ It also directed, for the sake of reducing interlocking shareholdings, a company to report to the other of its holding if such holding exceeded 10% of the capital of the latter, and the informed company was prohibited from acquiring any holding in the former company.¹⁴⁰ If it acquired any, it was required to reduce its holdings to less than 10% by sale on the market or by surrendering the excess to the other

¹²⁹ Id.

¹³⁰ Id.

¹³¹ Id. at 157.

¹³² Id.

¹³³ Id. at 163.

¹³⁴ Id.

¹³⁵ Id.

¹³⁶ Id.

¹³⁷ Id. at 218.

¹³⁸ Id.

¹³⁹ Id.

¹⁴⁰ Id.

company in reduction of its capital and of course against payment.¹⁴¹ Under this law, in response to the escalating criticism against the number and payments due to directors, the number of directors was fixed not to exceed 12 and a person could not be a director in more than eight companies at a time.¹⁴²

In the post-WW II France, the governing rules of *société anonyme* were transformed by the law of 24 July 1966 and the implementing decree of 23 March 1967 as amended subsequently by different acts.¹⁴³ According to the law currently in force, minimum capital of SAs is fixed to be 250,000 francs and 1,500,000 francs if they offer shares to the public.¹⁴⁴ For valid incorporation, SAs should involve at least seven shareholders with expressed agreements contained in the articles and memorandum of association.

To date, corporations may have a unitary or two-tier board.¹⁴⁵ The unitary board structure may have members ranging from three to twelve for a six years term of office. The maximum number of members in listed companies may reach fifteen. Whereas, the two-tier board structure consisting of a supervisory board and a managing board, imported from Germany by the law of 1966, should be envisaged in the constitution of the company for its subsequent existence. Nonetheless, companies that adopted the two-tier board structure do not exceed 10% of registered public companies¹⁴⁶ so that it is not yet well known by the majority of French companies. The other notable feature of French company law is its exploitation of criminal law as a tool to regulate company matters.¹⁴⁷

With respect to regulation of *Société à responsabilité limitée* (SARL), there has been a separate regime-the Law of 24 July 1966 as enriched by the Decree of 23 March 1967.¹⁴⁸ Under this law, *inter alia*, SARLs are formed for a fixed time scale of 99 years with a maximum number of fifty members and the minimum share capital of 50,000 francs with non-par value shares since 1994.¹⁴⁹ Starting from 1985, an individual person has been authorized to form a single member private company-the EURL.¹⁵⁰ They involved a unitary board with a general supervisory role while the day-to-day activities of the company are run by managers (*gerants*). A derivative action can be initiated by 10% of shareholders while holders of 25% of the capital can request extraordinary general meeting (EGM).¹⁵¹ Amendment of the constitution of the company is possible if it is in the interest of 75% of the holders.

The other issue of modern company law in general pertains to conversion of a business establishment from one form to the other. Under French company law, a private company can be converted into a public company provided that it owns assets worth of not less than 5 million francs. A private company also can be transformed into an unlimited company or a limited partnership upon adoption of a unanimous resolution to that effect.¹⁵²

A further continuum of legal reforms affecting company businesses continued in the late 1960s. *Inter alia*, the law of 1967, an instrument dealing with insider dealings, was enacted making France the first European

¹⁴¹ Id.

¹⁴² Id. at 219.

¹⁴³ Id.

¹⁴⁴ Centre for Law and Business, Faculty of Law, University of Manchester, *Company Law in Europe: Recent Developments, A Survey of Recent Developments in Core Principles of Companies Regulation in Selected National Systems* 22 (1999).

¹⁴⁵ Id.

¹⁴⁶ Id.

¹⁴⁷ Id. at 23.

¹⁴⁸ Id.

¹⁴⁹ Id.

¹⁵⁰ Id.

¹⁵¹ Id. at 24.

¹⁵² Id.

jurisdiction to own such a regulation.¹⁵³ The European Refinement of 1985 and the company formation decree of 1991 that governs the administrative aspects of company registration constitute additional segments of evolution of French company law.¹⁵⁴

More recently, the Commercial Companies Accounting Obligation Decree of 1994 designed to implement EU directives, Business (Prevention of Hardship) Act of 1994, and Companies Simplified (Public Company Amendment) Act of 1994 which introduced *Société par Actions Simplifiée* (SAS), a new legal form of company, meant to facilitating joint venture among two or more company-shareholders, are among significant developments in French company law. Shareholders of SAS have to be companies with a minimum capital of 1,500,000 francs and the minimum capital for SAS is fixed to be 250,000 francs divided among founders.¹⁵⁵

In the late 1990s, a much more flexibility was advocated for to promote competitiveness of French companies in the international business arena. Reforms towards better protection of investors, a system of more flexible conversion, increasing minimum capitals, replacement of criminal sanctions by civil ones and a favorable tax regime were identified as of particular importance.¹⁵⁶ The Law of 2 July 1998 altered the law relating to listed SAs by conferring them the right to buy back up to 10% of their own shares and availing them non-par value shares.¹⁵⁷

Overall, in spite of the more imperative company governance tradition than the Anglo-Saxon approach, France managed to have more than 170,000 registered joint-stock companies in 1999, by far a greater number compared with its counterparts in other jurisdictions.¹⁵⁸

In the last one and half decade too, amendments on the French company law have succeeded one after the other on a yearly basis.¹⁵⁹ One of the last important reforms was introduced by the New Economic Regulation (NRE) Law of 15 May 2001 which aspires for higher standards of transparency in the commercial world by requiring companies to draw detailed annual reports. The recent reforms have been designed to marshal on the application of EU regulations and directives including the Regulation on the Statute for a European Company (*Societas Europaea*) which entered into force on 8 October 2004, and transposed into national laws of all EU countries by mid-2007.¹⁶⁰

3.2.4 Development of Companies and Company Law in Germany

The overall public opinion and government stand in the 18th C. was prejudiced against corporate enterprises. For instance, the Hansa Federation declared that “creation of companies was not a proper method for mercantile undertakings instead the individual merchant or at most partnerships were adequate channels for trade.”¹⁶¹ In Hamburg, in 1720 it was prohibited to form insurance companies in joint-stock lines.¹⁶² At times when a joint-stock company was created, the state took a large portion of the capital like the case in the

¹⁵³ Id.

¹⁵⁴ Id.

¹⁵⁵ Id.

¹⁵⁶ Id. at 25.

¹⁵⁷ Id. at 26.

¹⁵⁸ Id. at 22.

¹⁵⁹ Cremers, Jan and Wolters, Elwin, *EU and National Company Law-Fixation on Attractiveness* 16 (European Trade Union Institute, Report 120, 2011).

¹⁶⁰ Id. at 1.

¹⁶¹ See LEVY, ADALBERT, *supra* note 14, at 96.

¹⁶² Id.

Königliche Seehandlung, a company created by Frederick the Great in 1765 to engage in overseas trade where the state took 97.5% of its capital.¹⁶³

Therefore, until the revolutionary wars, there were few companies in German States all created by a special charter providing for the regulation of the company because there was no general company law. The first experience from the view point of a comprehensive company law came into being in Germany only when the Rhine Confederation imported Napoleon's *Code de Commerce* involving provisions *vis-à-vis* joint-stock companies and *commandites par actions* of France.¹⁶⁴ Annexation of territories within the Rhine Confederation and Westphalia by Prussia in 1815 extended the application of the Code to a wider geographic coverage.¹⁶⁵ Under it, chartered companies started to evolve and the Prussian government did all it can to get merchants and capitalists united to carry on bigger undertakings.

Nonetheless, the positive attitude towards corporatization did not last long; royal assent was given with greater reluctance in the mid of the 19th century. In 1860, capitalist interest in the existing Rhenish companies was limited only to 19.4% of total assets of companies.¹⁶⁶ In the contrary, in response to the economic need in the sector, a positive attitude was in place towards railway undertakings and special law for their regulation was passed in 1838.¹⁶⁷ The first general company law of the jurisdiction was enacted in 1843 in Prussia.¹⁶⁸

The new law of Prussia was modeled on the *Code de Commerce* except it supplied detailed rules for *société anonyme* only. It maintained the concession system, meaning in addition to contract of association, government assent was needed for a company to get legal personality. The certificate of incorporation was required to be published in the *Bulletin of Statutes* and an extract from articles published in the provincial *Gazette*. Under this law the government reserved the power to repeal any charter at any time against payment of compensation covering actual damages. As a matter of principle the Prussian law recognized nominative shares though it did not prohibit issue of bearer shares but upon full payment of capital. Transfer of both registered and bearer shares was restrained till payment of 40% of par value.¹⁶⁹

Innovative of the Prussian law was that it empowered companies to prescribe penalty clauses in their articles to penalize subscribers who did not pay the call.¹⁷⁰ Companies incorporated under this law were accorded with legal personality that culminated earlier disputes on the juristic personality of corporations. It also accepted the principle of limited liability. In so far as management of companies is concerned, it provided for appointment of one or more managers (*Vorstand*). It however failed to expressly envisage a board of supervisors though the practice revealed that companies often elected supervisors. It also made the general meeting of a company the supreme authority of the company.¹⁷¹ It left articles of each company to prescribe rules on voting rights, quorum, and requirements as to rule of majority. Companies were duty bound to keep the government informed about their status regularly.

Statistically, only sixteen companies with a total capital of 11.5 million thalers (equivalent to £1,600,000) were formed between 1800 and 1825 which increased to 112 by the end 1850 with a total share capital of

¹⁶³ Id.

¹⁶⁴ Id.

¹⁶⁵ Id. at 97.

¹⁶⁶ Id.

¹⁶⁷ Id. at 98.

¹⁶⁸ Id.

¹⁶⁹ Id.

¹⁷⁰ Id.

¹⁷¹ It could resolve upon dissolution of the company though government assent was required for the validity of the decision.

160,631,428 thalers in Prussia.¹⁷² Of these, railway companies accounted for the lion share both in number and capital followed by insurance, mining, banking, and industrial companies respectively.¹⁷³

In a project towards legal unification in the German Confederation, a uniform Bill of Exchange Law was adopted in 1840s followed by a general German Commercial Code drafted by a committee of delegates of member states of the Federation.¹⁷⁴ It became an independent law for each of the members after promulgated by their respective law makers in the time between 1861 and 1863.¹⁷⁵ The code involved a full codification of company legislations governing both joint-stock companies proper and *Kommanditaktiengesellschaft* equivalent to the French *commandites par action*.

The issue of free or chartered formation of companies was left for each member state to decide on. Accordingly, Prussia retained the concession system while Saxony, the Hansa Towns, Baden and Wurttemberg made company formation generally free.¹⁷⁶ With respect to *commandites par actions*, a large number of states shared the rule of free formation as the French system did.¹⁷⁷

The new general company law fixed par value of shares of both classes to be not less than 200 thares.¹⁷⁸ *Commandites* were prohibited to issue bearer shares. It also envisaged the holding of general meetings, compulsory appointment of board of supervisors (*Aufsichtsrat*), and managers' absolute power of representation of the company as against third parties.¹⁷⁹

The North Federation, as reconstituted in 1866 and from which Austria was excluded, enacted an amendment in 1870 to the part of the general code dealing with company matters.¹⁸⁰ The amendment freed formation of both *commandites* and companies and reduced par value of shares of both types of companies to 50 thares.¹⁸¹ Issue of bearer shares with a par value of more than 100 thares was made unconditional to joint-stock companies and it lowered the requisite payment for formation of a company to 10%.¹⁸² It prohibited the payment of dividends before the full payment of the capital of the company and outlawed solicitation of resources from a company for acquisition of its own shares. Generally speaking, *laissez faire* became a fairly complete ideology in Germany in company matters by the turn of the 19th century.

The law of 1884 of Prussia focused on *commandites par actions* (K.A.G.s) while it made only certain amendments on rules pertaining to companies proper (A.G.s).¹⁸³ The main reform the law of 1884 inculcated pertains to company formation. Among others, it required the whole capital to be paid for issue of shares before registration of a company. It also made the minimum number of founders five and ordered immediate registration of a company if the founders took all the shares. The latter law also provided for examination by managers and board of supervision of valuation of contributions in kind. Such examination with respect to valuation of contributions of managers and board members was to be undertaken by auditors to avoid the

¹⁷² See LEVY, ADALBERT, supra note 14, at 99.

¹⁷³ Id.

¹⁷⁴ Id.

¹⁷⁵ Id.

¹⁷⁶ Id.

¹⁷⁷ Id.

¹⁷⁸ Id.

¹⁷⁹ Id.

¹⁸⁰ Id. at 102.

¹⁸¹ Id.

¹⁸² Id. at 103.

¹⁸³ Id.

potential conflict of interests. This law contained provisions that strengthened rules pertaining to accounts of the company.¹⁸⁴

It was also by this law that the concept of legal reserve was introduced into German company legislation. In this respect the law ordered accumulation of premiums obtained from subscribers of shares issued subsequently in the legal reserve. Moreover, 5% of annual profit was put into this reserve until this reached 10% of the capital of the company.¹⁸⁵ The accumulated amount was to be expended exclusively to cover losses in any subsequent year. Retained the management (*Vorstand*) as the company's executive and legalized the practice by making the constitution of a board of supervision of three or more members in both companies and *commandites* mandatory. The board of supervision was empowered to the control and check the management at any time though not lived up to this expectation.¹⁸⁶ It also prohibited the purchase by a company of its own shares.

Moreover, the protection this law accorded minority shareholders is worth of a special mention. *Inter alia*, under this law every share was made to entitle voting rights, shareholders representing 10% of the capital were empowered to request for investigation of company's affairs upon production of prima facie evidence on dishonest or gross violation of the law or articles of association.¹⁸⁷ Moreover, shareholders having 20% of the capital of the company were entitled the right to bring action against management, members of the board of supervision, promoters, other persons who caused damage to the company in connection with its incorporation or management.¹⁸⁸ Shareholders representing 5% of capital could call for a general meeting to discuss any matter they put on the agenda. Shareholders whose objections had been recorded in the minutes were also empowered to bring a legal action to invalidate resolutions of the general meeting within a month time for violation of law or articles of association irrespective of its significance to the company.

The subsequent company legislation in Germany, the law of 1892, pertains to private companies with limited liability (*Gesellschaft mit beschränkter Haftung* or G.m.b.H.s).¹⁸⁹ It was fundamentally destined to ease their formation in order to encourage proliferation of small and medium sized enterprises. *Inter alia*, it relieved G.m.b.H.s from the stringent requirement of publicity of their accounts. Yet, companies of this kind were required to attach the letters G.m.b.H. to their names to avoid confusion with other forms of companies. They might not issue share certificates so that transfer of shares took place only by notarial declaration recorded by the company and to which the company or managers gave consent. Board of supervisors was not compulsory in G.m.b.H.s but not prohibited either so that it could be set up if agreed in the contract of association. Consequently, a considerable number of pools, cartel and business combine flourished in the form of G.m.b.H.¹⁹⁰

Enactment of the German civil code in 1896 increased the appetite for having a codified commercial law. The desire became true in 1897 as signified by the passing of a new commercial code which came binding as of 1 January 1900.¹⁹¹ The new code included the laws of AG.s and K.A.G.s but not of G.m.b.H.s. Nonetheless, alterations to the pre-existing law were limited to minor technical improvements, clearing up obscurities and settling doubts. The new law allowed A.G.s and K.A.G.s to provide in their articles for recurrent contributions in goods. This was of particular help for the development of the German beet sugar industry

¹⁸⁴ Id.

¹⁸⁵ Id. at 128.

¹⁸⁶ Id.

¹⁸⁷ Id. at 130.

¹⁸⁸ Id.

¹⁸⁹ Id. at 132.

¹⁹⁰ Id.

¹⁹¹ Id.

which was carried on by companies whose shareholders were landowners who undertook to deliver the sugar beet they produce to the factory.¹⁹² It also extended protections given to the minority shareholders by entitling shareholders representing 10% of capital to bring a representative action against persons liable to the company.¹⁹³

Schmoller estimated that by the end of 1883 there were a total of about 1,300 companies (A.G.s and K.A.G.s) with a capital of 4 billion DM (equivalent to £200 millions) though much lower than its counterpart in England in the same period (£475 million).¹⁹⁴ The number of companies increased to 3,000 with a corresponding capital of 5 billion DM (£250 million) in 1890 and to about 4,000 with a capital of 8-10 billion DM (£400-500 million) in 1900.¹⁹⁵

The first official statistics of companies for the whole of Germany was published in the *Statistical Yearbook* of 1908 and it reported that on 31 December 1906, there were 5060 A.G.s and 108 K.A.G.s with an aggregate capital of 13,848,600,000 DM and a total reserve of 2,737,000,000 DM. It was also detailed that of these companies, 523 were banks with a corresponding capital of 3,738,800,000 DM and 65 were railway companies with a total capital of 303,003,000 DM.¹⁹⁶ The time between 1908 and 1914 added at average 166 companies a year with an average capital of 1,426.3 million DM each.¹⁹⁷ Hence, before the advent of WW I, corporate business was quite successful in Germany.

Despite in the aftermath of WW I, Germany not only lost territory but also value of its currency declined by 40% of its value before the war,¹⁹⁸ it showed a drastic increase in the number and capital of companies. In 1921 alone about 979 new companies were created with a capital of 3,930,000,000 DM and in 1922 about 2922 with a capital of 13,854,000,000 DM.¹⁹⁹ In effect the total number of A.G.s and K.A.G.s reached 9558 with a corresponding capital of 103,739,000,000 DM in the same time.²⁰⁰

To lower adverse effect of the war-induced inflation and protect corporations from collapse, the government issued an order in December of 1923 which provided for the readjustment of company balance sheets based on a new valuation of assets and liabilities on the basis of gold mark, equivalent to 10/42 of USD in three years time.²⁰¹ In response, most companies reported diminishing capital. The government then issued an order that tolerated reduction of capitals of A.G. and K.A.G.s to 5,000 gold marks (M) with corresponding par value of shares not less than 100 DM and 20 DM for those with former value of 1,000 DM and 500 DM respectively. Capital of G.m.b.H.s was reduced to M500 or less and value of shares to less than M50.²⁰²

Yet, a considerable number of companies survived the collapse and there were a total of 13,010 companies with a readjusted capital of M 19,121,000,000.²⁰³ Of these, 3,347 companies were the ones in operation before 1914. The reversal of the collapse was mostly attributed to the financial reforms of the government. By the end of 1929 there were about 11,344 A.G.s and K.A.G.s with a readjusted capital of M 23,728,029,000 and of

¹⁹² Id. at 133.

¹⁹³ Id.

¹⁹⁴ Id. at 135.

¹⁹⁵ Id.

¹⁹⁶ Id.

¹⁹⁷ Id.

¹⁹⁸ Id. at 168.

¹⁹⁹ Id. at 173.

²⁰⁰ Id.

²⁰¹ Id.

²⁰² Id. at 174.

²⁰³ Id. at 176.

30% foreign holdings.²⁰⁴ Throughout this period, it is noted that, there was no substantial company law reform despite louder calls for it. The tendency was in the direction of bringing German closer to the American law and finding new ways and means of attracting capital.²⁰⁵

To mitigate consequences of the New York stock market collapse that stunned Germany's economic life to its foundations, the Reich government reacted by passing an Emergency Order of 19 September 1931.²⁰⁶ The Order was primarily meant to regulate issues not addressed properly by the preexisting company law regime. The toughest of all the problems of the time was the question of purchase by a company of its own shares despite the law of 1884 and the Commercial Code of 1897 prohibited it.²⁰⁷ The business community went through loopholes in those laws in particular by forming syndicates and making use of subsidiaries and associate companies to purchase shares of a principal company. The Order of 1931 allowed companies to buy their own shares only when it was meant to prevent serious impairment or grave damage, and such a purchase could not exceed 10% of their respective capitals.²⁰⁸

It also made granting of credits to management subject to approval of the board of supervision. The Order fixed the maximum number of members of the board of supervision to be 30 for a period up to the general meeting next to their appointment.²⁰⁹ It also introduced detailed rules on contents of reports to the general meeting, balance sheet, and profit and loss accounts. Moreover, it made financial and legal audits by qualified accountants compulsory and entitled shareholders representing 10% of share capital to request for investigation of promotion and/or management of the company.²¹⁰

In January 1933, the Nazi government assumed political power and followed the line of the Order of 1931 for a short while. On 4 December 1934, it issued a new law dealing with certain new issues.²¹¹ *Inter alia*, it limited payment of dividends not to exceed 6% (or 8% if the company was paying higher dividends in the previous years) of the share capital of the company.²¹² It contracted property rights of owners by ordering the payment of the balance of the profits into a loan fund (Reich Bonds) established by law of 29 March 1934 with a view to securing additional funds for the Reich government and other public bodies.²¹³

The Nazi government expressed its adore to larger enterprises through helps it gave to banks and industrial undertakings through the Reichs' bank and other public bodies while the racial laws that eliminated leading figures in corporate enterprises and dispossession of the investing public caused an observable decline in the number and capital of companies.²¹⁴ It was reported that corporate business tapered from about 10,437 companies with aggregate capital of M 24,653,443,000 in 1931 to 6,094 with a capital of M 18,704,506,000.²¹⁵

The Nazi government was determined to inculcate its ideology in all the reforms that came after 1933. It was the case in the company law promulgated on the sixth anniversary of its accession to power, 30 January 1937. Among others, the latter law dispossessed the power of general meeting to give instructions regarding future business policy unless the management or the board of supervision requested, reserved the power of

²⁰⁴ Id. at 178.

²⁰⁵ Id. at 185.

²⁰⁶ Id. at 206.

²⁰⁷ Id.

²⁰⁸ Id. at 207.

²⁰⁹ Id.

²¹⁰ Id. at 208-9.

²¹¹ Id.

²¹² Id.

²¹³ Id.

²¹⁴ Id. at 210.

²¹⁵ Id.

investigating accounts for the board of supervision and the general meeting could not question once the board accepted it. Under this law reserved for the general meeting, suspended altogether by the Order of the Reich Ministry of Justice of 1944, was to resolve upon payment of a smaller dividend than is proposed. The power of removing a member of management was give exclusively to the board of supervision. The laws also dictated for the abolition of shares with plural votes.

On the eve of WW II, Austria was overtaken by the Nazi regime and German company law was introduced there in. WW II left German economy devastated. Companies and G.m.b.H.s disappeared in a considerable number to reach 4,000 and 17,000 respectively.²¹⁶ By the end of 1941 the total number of companies and G.m.b.H.s was 28,869 with an aggregate capital of 26,000,000,000 DM. Revaluation of assets of companies was undertaken to cop up with the resultant inflation so that the revaluated capital of companies and G.m.b.H.s existing in 1941 was 28,700,000,000 DM which rose slightly to 30,000,000,000 marks in 1944.²¹⁷

Restriction on payment of dividends was somehow readjusted but only on the face of special surtaxes for dividends of more than 7% making the increase of actual dividends practically band. Overall, all the reforms under Nazi government were against shareholders and succeeded in some respects. In 1944, the holdings of the general public in the share of existing companies did not exceed 25%²¹⁸ because individuals were prevented from taking part in the formation of new companies and secluded from obtaining shares in the existing companies as the majority of such investments were made by companies, capitalists and public bodies. Moreover, the Nazi legislation introduced family companies like the Krupp A.G. which were exempted, *inter alia*, from the requirement of publicity.²¹⁹ Consequently, the role of company as a means of accumulation of collective resources was made aside and companies remained tools of securing the privilege of limited liability for a class of favoured individuals.

GmbHs have been governed by the Act of 1892 as amended subsequently. To date, a GmbH can be formed with a minimum capital of 50,000 DM each shareholder having a minimum capital participation of 500 DM. Since 1980 however, a single-member can from a GmbH.²²⁰ GmbHs are set up with a relative ease of incorporation and legal personality of the company is obtained up on registration in the commercial register. In such kinds of business establishments, minority rights are less explicit, but yet holders of 10% of shares can oblige an EGM.²²¹

Public companies (A.Gs) on the other hand have been governed by the Stock Corporation Act of 1965 as amended then after. *Inter alia*, A.Gs are required to have a minimum capital of 100,000 marks divided into shares of nominal value of 5 DM, intended to reach small investors, and to put a portion of its profits in a legal reserve until it reaches 10% of its capital.²²² Since 1994, an A.G. can be formed by an individual investor.²²³ Transfer of hares has been subject to approval of the board of management and bearer shares have been in common use.

A two-tier board structure consisting of the board of management (*vorstand*) and a supervisory board (*aufsichtsrat*) that represents interests of shareholders and employees has been introduced.²²⁴ While the board

²¹⁶ Id. at 216.

²¹⁷ Id.

²¹⁸ Id.

²¹⁹ Id. at 217.

²²⁰ See Centre for Law and Business, Faculty of Law, University of Manchester, *supra* note 148, at 28.

²²¹ Id.

²²² Id.

²²³ Id.

²²⁴ Id. at 29.

of management is appointed by the board of supervisors for up to five years term of office, the board of supervisors is appointed by the general meeting of shareholders.

To date, repurchase by a company of its own shares is permitted in only very limited circumstances, directors have the discretion of withholding up to 50% of the net profits provided it is to be used for reinvestment. Up on loss of 50% of capital of an A.G., the managing directors must notify the same to shareholders.²²⁵

Under current German company law, 10% of shareholders can compel the company bring a legal action against debtors or seek removal of the supervisory board which demands a three-quarter majority in the general meeting unless such a lower majority is contracted in the articles.²²⁶ Moreover, the support of 5% shareholders suffices to require an EGM where as 10% of shareholders may seek a special audit.²²⁷

From the view point of recent developments in German company law, it is important to take note of the following. The Companies (Time Limits for Liability of Owners and Partners) Act of 1994, limited the ongoing liability of former owners of a business after expiration of a five years from the time of transfer.²²⁸ Another Act of 1994, allowed a single-member A.G., relaxed rules governing company meetings, and improved shareholders' right to seek dividends by limiting the power of directors to hold back funds for reinvestment purposes²²⁹ where as A.G. Act of 1994, effective from 2 July 1994, lowered the right of preemption for shareholders.²³⁰

The Securities Regulation Act of 1995 outlawed insider dealing and enhanced disclosure rules on acquisition of shares.²³¹ A Transformation Act, company-law-associated tax legislation, eased conversion of legal status, and procedures of mergers and divisions since 1995.²³² The Corporate Control and Transparency Act of 1998 coupled with the Raising of Capital Act promote more transparency through accounting rules and facilitating share transactions through tax changes and clarified the demarcation between roles of auditors and the supervisory board. The German Insolvency Law of 1999 codified new procedures and remodeled creditor rights.²³³

The additional developments in German company law have been geared to facilitating enforcement of EU directives intended to harmonizing national company laws. For instance, the Euro Introductory Law fixed the minimum capita of an AG to be €50,000 divided into shares with a minimum par value of €1, whereas the minimum capital of a GmbH is directed to be €25,000, each shareholder contributing a minimum of €100.²³⁴

More recently, the issue of corporate governance in Germany, seen through the lens of shareholder empowerment, has been considered by policy makers and a Commission on corporate governance worked on a reform agenda.²³⁵ The endeavor resulted in the promulgation of the Transparency and Public Disclosure Act of 2002 which introduced further reforms by strengthening the information functions of the supervisory board and rights of members and the German Corporate Governance Code of 2002.²³⁶ Moreover, the Act listed essential corporate decisions which the management cannot implement before securing approval of the

²²⁵ Id.

²²⁶ Id.

²²⁷ Id.

²²⁸ Id. at 30.

²²⁹ Id.

²³⁰ Id.

²³¹ Id.

²³² Id.

²³³ Id.

²³⁴ Id. at 31.

²³⁵ Leyens, Patrick C., *German Company Law: Recent Developments and Future Challenges*, 06 German Law Journal, 1412 (2005).

²³⁶ Id.

supervisory board.²³⁷ Yet, the question of corporate governance towards increasingly market driven governance systems²³⁸ has been identified to be one of the core challenges not only for Germany but also for Europe in general with its present 28 Member States and its view to further accessions.²³⁹

3.2.5 Development of Corporations and Corporate Law in the USA

When America was under colonial rule, the power monopoly of the English Crown was extended to creation of corporations in America. States like Virginia and Maryland were themselves 'corporations' created by Royal charters.²⁴⁰ Moreover, the common law dictum which goes "a corporation cannot create another corporation" prevented colonies to create domestic corporations. It was only in the 18th century that colonies were entitled to create companies, sometimes subject to royal assent.²⁴¹ It was the Bubble Act, extended to the American colonies in 1714 by Act 14 Geo.II, c.37,²⁴² that became the first general company legislation in America.

Among the early corporations are, the first insurance company incorporated in 1768 in Philadelphia, water companies formed in 1652 in Boston and Rhode Island in 1772 and 1773, and the New London Society for Trade and Commerce in Connecticut.²⁴³ There were also unincorporated companies for trade, fishing, whaling, drainage, mining and manufacturing.

Following the War of Independence, colonies started to claim their right to exercise economic sovereignty as manifested in constitutions of Pennsylvania and Vermont.²⁴⁴ The State of North Carolina adopted an Act to free the formation of canal companies in 1795 but with only the power of suing or being sued.²⁴⁵ The Act of Massachusetts of 1799 also freed formation of corporations with a complete corporate character for aqueducts. Later, the freedom of incorporation was extended to any company irrespective of the purpose. The Congress also chartered the first commercial bank—the Bank of North America in 1781 with a capital of USD 800,000 and Bank of the United States of America in 1816 with a capital of USD 10,000,000²⁴⁶ exercising its power to grant corporate charters if they could serve as tools of federal policy.

Consequently, there were more than 300 business corporations by the end of the 18th century of which highway companies, banking, and insurance, and local public service companies in sum count for 90%.²⁴⁷ In these early corporate ventures, the majority of shareholders were merchant classes while the holdings of small savers were insignificant. Values of shares of companies ranged between USD 20-100.²⁴⁸ In response to the prejudice against incorporation and concentration of holdings in a class of merchants, charters establishing

²³⁷ Cremers, Jan and Wolters, Elwin, *supra* note 163, at 16.

²³⁸ Leyens, Patrick C., *Supra* Note 253, at 1417

²³⁹ Wikipedia The Free Encyclopedia, http://en.wikipedia.org/wiki/Member_state_of_the_European_Union (last visited on March 10, 2014).

²⁴⁰ *See* LEVY, ADALBERT, *supra* note 14, at 103.

²⁴¹ *Id.* at 104.

²⁴² *Id.*

²⁴³ *Id.*

²⁴⁴ *Id.* at 105.

²⁴⁵ *Id.*

²⁴⁶ *Id.* at 106.

²⁴⁷ *Id.*

²⁴⁸ *Id.* at 107.

companies tended to limit subscriptions and import regressive voting system. In those days, charters were given for a fixed and relatively shorter periods.²⁴⁹

As is expected, in the absence of general corporation law, company regulation was provided by English common law adopted by each State and provisions contained in each charter. Yet, it was at this preliminary stage that limited liability was granted expressly or acknowledged by implication. Companies were usually formed for a single purpose and no monopolies were granted except to the Bank of the United States America which for twenty years had a charter to exclude any similar bank.²⁵⁰ Profits were divided in full and there was no attempt to form reserves of any kind.

At this stage of corporate America, the evolution of companies and the governmental attitude to them a bit differed from state to state and over time within a state. For instance, the State Legislature of Massachusetts persisted on the unlimited liability of shareholders at least for judgment debts not covered by the assets of the company except for banks and insurances.²⁵¹ It also discriminated in particular between manufacturing and banking and insurance companies in that the former were chartered for an indefinite period while the latter were not given for a term more than twenty years.²⁵² The state legislatures of New Jersey, New York and Pennsylvania were very positive for incorporation. For example, the state legislature of New Jersey not only gave assent to the formation of the Society of Useful Manufacturers (Association of New Jersey Company) with a capital of USD 1,000,000 in 1791 but it also gave a bonus of 36 square miles land and a contribution amounting USD 100,000 in its capital.²⁵³

To the worst, some states became hostile to corporate business later. For instance, Pennsylvania proposed in 1837 the prohibition of the grant of a charter for a work which individual activity could accomplish while Ohio moved to replace partnerships for corporations.²⁵⁴ Moreover, Massachusetts and Maine showed reluctance on the principle of limited liability in 1822 and 1821 respectively.²⁵⁵ Overall, however, corporations were rising in number and size in different sectors of the economy in the 19th century.

The path of reforms in company regulation flowed towards a system of general corporation law, initially introduced for a certain class of corporations. In light of this trend, New York freed formation of corporations for certain manufacturing purposes in 1811 which the constitution of 1846 extended to all sectors of industry except in cases where the corporation could not be achieved by the general law.²⁵⁶ Under the umbrella of this constitution several special laws were passed for various classes of companies. Massachusetts also passed an Act in 1809 to regulate manufacturing corporations but retaining the prerogative of granting a charter. It adopted a general Statute for the regulation of manufacturing corporations in 1851.²⁵⁷ Connecticut, in its part, permitted incorporation by filing the required documents with the Secretary of the State in 1836.²⁵⁸

In the same fashion, New Jersey proclaimed for incorporation of companies for manufacturing, mining, mechanical and agricultural purposes by filing a declaration of four incorporators with the Sate Secretary.²⁵⁹

²⁴⁹ Id.

²⁵⁰ Id. at 108-9.

²⁵¹ Id.

²⁵² Id.

²⁵³ Id.

²⁵⁴ Id, p.111.

²⁵⁵ Id.

²⁵⁶ Id.

²⁵⁷ Id, p.112.

²⁵⁸ Id.

²⁵⁹ Id, p.113.

Mary Land regulated manufacturing companies since 1839 and entitled freedom of incorporation by the constitution of 1851. Under the spirit of this constitution, general Acts for mining, manufacturing, and other classes of companies were adopted. Louisiana adopted the principle of free incorporation by an amendment to its constitution in 1845.²⁶⁰ On the whole, it is evident that a consensus was reached across the States on the centrality of the *laissez faire* economic thinking.

At this rudimentary level, there were attempts to regulate capitals of companies. The Act of 1811 of New York fixed the maximum capital of a company to be USD 100,000 and Connecticut fixed the minimum and maximum of capitals of a company to be USD 2,000 and 200,000 respectively.²⁶¹ Management of companies was given to directors even with a power to issue by-laws of the company. In New Jersey, directors were required to be residents of the state.²⁶²

In those old days, the sectoral distribution of companies was not even; railway companies accounted for the lion share while industrial companies were lagging behind.²⁶³ The fact that the number of shareholders was considerably high necessitated the system of "voting by proxy". The Western Railroad of Massachusetts had 2331 stockholders in 1838 and 2445 stockholders constituted the New York Central in 1853.²⁶⁴ After the Civil War the industrial field showed a distinct stage of growth. The capital of manufacturing corporations rose from USD 1,886,000,000 in 1858 to USD 9,372,000,000 in parallel with the constant increase in the number of undertakings.²⁶⁵ By the turn of the 19th century, there were 512,254 producing units of which 40,743 were corporations contributing 59.5% of total product.²⁶⁶

Competition among companies in the manufacturing and railway sectors was tight. To avert the resultant crowding out of ventures because it is natural that all cannot win a race, many of them started to consolidate. Later the consolidation took place through trusts like what the Standard Oil Trust, the American Cotton Oil Trust, the Linseed Oil Trust, Trusts of distillers, Trusts of Cattle-feed Producers and Sugar Trust did.²⁶⁷ Nevertheless, the amalgamations were disfavored by the public so that the *Sherman Act* was brought to uphold public opinion. In response, the business community resorted to establishing a system of holding and subsidiary company,²⁶⁸ one buying stocks of the other and appropriating new shares to shareholders or holders of trust certificates, to undergo the disfavored business collaboration. As a result in 1904, about 183 industrial combinations were registered with a capital of USD 3,200,000,000.²⁶⁹

The fact that business matters fall within State jurisdiction placed States on a fierce competition to attract incorporation as high as they could. The view that strict regulations means flight of corporations and keeping away new incorporations was shared across all the States and they were convinced to levy moderate taxes, adopt liberal corporation laws and employ effective propaganda. To that end New Jersey levied low tax duties for railway companies. Consequently, it managed in 1900 to home 61 of 121 corporations with capitals exceeding USD 10 millions.²⁷⁰ Delaware was the other corporation-friendly State and it homed 209 of the 606

²⁶⁰ Id.

²⁶¹ Id.

²⁶² Id, p.114 .

²⁶³ Id, p.115.

²⁶⁴ Id.

²⁶⁵ Id, p.147.

²⁶⁶ Id, p.148.

²⁶⁷ Id. at 149.

²⁶⁸ Id. In definition, a holding company is a company which controls more than 10% of the securities with voting power of another while the latter is named as a subsidiary company.

²⁶⁹ Id. at 150.

²⁷⁰ Id. at 153.

companies whose stocks were listed on the New York Stock Exchange during the same time.²⁷¹ In 1912 New York adopted a new form of corporate structure—a corporation with shares of no par value²⁷² which was duplicated in different states.

In the aftermath of WW I, America became a creditor nation. In addition to corporations in the private hands, a number of corporations created by public funds as agencies of the Federal Government to further the war efforts were the other impetus for the reversal of the global economic order in favour of America. The amassed liquid asset therefore facilitated the formation of new enterprises in the post-War times. Mass participation became a new trend in many ventures. In 1922, although the majority lacked voting rights, there were in sum 14,400,000 individual stockholdings of which 3,400,000 were acquired in the last three years.²⁷³ In particular Pacific Gas and Electric Company in 1914 and Southern California Edison in 1926 had 4,128 and 26,294 shareholders respectively.²⁷⁴ The number of shareholders of Southern California Edison rose from 2,000 in 1917 to 65,636 in 1923.²⁷⁵ There were also one million holders in railway bonds.²⁷⁶

The unfettered and full company autonomy however caused interlocking holdings of corporations even in the same field of work which in turn exposed corporations to reckless managers and promoters.²⁷⁷ The inevitable collapse took only a short period to ensue in September of 1929. To the saddest the deserved legislative intervention came to the scene only lately in 1933 by the Federal Securities Act as amended subsequently in 1934 and 1940 to deal with the primary market of securities.²⁷⁸ The latter Act demanded, *inter alia*, registration of issue of shares in the Federal Trade Commission. It also empowered the Commission to require further information and documents, have access to books and accounts of corporations. It also established a system of liability for untrue statements or omission of material facts in the forwarded information.

The Securities Exchange Act of 6 June 1934 destined to regulate the secondary trading of those securities between persons often unrelated to the issuer, frequently through brokers or dealers, established the Securities Exchange Commission (SEC) to take-over the power of the Federal Trade Commission.²⁷⁹ Composed of five members appointed by the president with the advice and consent of the Senate, the SEC was entrusted with wide ranging power, *inter alia*, to require corporations submit annual returns, regulate solicitation of proxies, require information and order investigation, decide on request of corporations to issue securities.²⁸⁰

As noted earlier, contemporary corporate law in the USA is a collection of over 50 different systems of corporate law, which means one law for each state. Hence, evolved over time, state corporate laws have been of primary importance in corporate America. Nonetheless, due to variations in how states defined corporations, the Model Business Corporation Act (MBCA), drafted by the American Bar Association, came into the scene in 1950. The MBCA has been influential and adopted by half of members of

²⁷¹ Id. at 154.

²⁷² Id. at 155.

²⁷³ Id. at 186.

²⁷⁴ Id. at 187.

²⁷⁵ Id.

²⁷⁶ Id.

²⁷⁷ Id. at 189.

²⁷⁸ Id.

²⁷⁹ Id.

²⁸⁰ Id. at 190.

the federation.²⁸¹ The Revised Model Business Corporation Act (RMBCA), the MBCA as revised through in 2002, has been model to most state corporate laws.²⁸²

Under the US Constitution, companies are free to incorporate in any state regardless of whether they are doing business or are headquartered there. It is therefore natural to search for a state with lax corporate regulations and offers other privileges on the side of corporations, and competition in that respect among states. In light of the inevitable race to the better, many corporations have found Delaware's laws and specialized courts attractive so that more than half of US public and 60% of the Fortune 500²⁸³ companies are incorporated under the Delaware General Corporation Law (DGCL).²⁸⁴ Consequently, Delaware corporate law is particularly influential on practical terms.

Yet, many federal laws form part of the US corporate law regime. *Inter alia*, the Securities Act of 1933 and Securities Exchange Act of 1934 have continued to the present to bind publicly traded corporations irrespective of the state of registration and operation. The Sarbanes-Oxley Act of 2002 (SOXA), also known as the 'Public Company Accounting Reform and Investor Protection Act' in the Senate and 'Corporate and Auditing Accountability and Responsibility Act' in the House, forms part of the recent developments in the US corporate law. The latter bill was enacted as a reaction to a number of major corporate and accounting scandals that led to loses of millions of dollars to investors. The Act imposed many new rules on public corporations ranging from additional corporate board responsibilities to criminal penalties. In response to the prevailing perception that stricter financial governance laws are needed, laws modeled on the SOXA have been subsequently enacted in Japan, Germany, France, Italy, Australia, Israel, India, South Africa, and Turkey.²⁸⁵ Corporations must also comply with a wide variety of federal laws governing employment, environmental protection, food and drug regulation, intellectual property and other areas.

Having said this much on the evolution of business corporations and the law governing such establishments in the English, French, German, and US systems, we will cite in the fourth chapter relevant sections of the active laws in these systems, need be of others too, from the view point of substantiating the position of Ethiopia's company law on different issues of interest which, in view of this writer, are fundamental and boldly backward and/or insufficiently provided in it. Hence, that part of the discussion may add on insights on the existing laws of the systems considered in this section and beyond.

3.3 Common Features of Business Corporations

Notwithstanding the fact that national company laws differ in several dimensions, there are universally shared values and characteristics of business corporations. In a few of subsequent paragraphs, attempt is made to highlight on the defining features of business corporations namely: separate legal personality, limited liability, transferable shares, delegated management under a board structure, and investor ownership.

²⁸¹ Wikipedia The Free Encyclopedia, http://en.wikipedia.org/wiki/Corporate_law_in_the_United_States (last visited on March 10, 2014).

²⁸² Wikipedia The Free Encyclopedia, http://en.wikipedia.org/wiki/Corporate_law_in_the_United_States (last visited on March 10, 2014).

²⁸³ The **Fortune 500** is an annual list compiled and published by *Fortune* magazine that ranks the top 500 U.S. closely held and public corporations as ranked by their gross revenue after adjustments made by *Fortune* to exclude the impact of excise taxes companies incur. The list includes publicly and privately held companies for which revenues are publicly available. The first Fortune 500 list was published in 1955.

²⁸⁴ Wikipedia The Free Encyclopedia, http://en.wikipedia.org/wiki/Delaware_General_Corporation_Law (last visited on March 10, 2014).

²⁸⁵ Wikipedia The Free Encyclopedia, http://en.wikipedia.org/wiki/Sarbanes%E2%80%93Oxley_Act (last visited on March 10, 2014).

3.3.1 Separate Legal Personality

Corporations in all jurisdictions have been ascribed with artificial personality which avails them most of the rights and duties human persons are accorded, and some not available to humans in the economic field. This holding of such human-equivalent standing before the law is called “corporate personhood” or as some writers rather charmingly have it “corporate personality”. The principle of independent personality of a corporation in the UK has its roots in the widely known precedent of *Salomon v A. Salomon and Co. Ltd* which dates from 1897.²⁸⁶ Descending from the premise that the company is itself a person in the eyes of the law, it is straightforward to figure out that it should be capable of entering into contracts and owning its own property, capable of delegating authority to agents, and capable of suing or being sued in its own name.

But the firm, to exercise its rights, discharge its duties and perform any kind of juridical acts, should be represented by human agents. Whilst, of course, participants in a firm are free to specify the delegation of authority by contract amongst themselves, it is not uncommon to prescribe background rules dealing with ‘delegated management’ forming a separate core characteristic of the corporation. Usually, a board of directors, as opposed to individual owners, has power to bind the company in contract.

Description of the firm as “a nexus of contracts” or “a nexus for contracts,”²⁸⁷ meaning most of the important relationships including those among the firm’s owners, managers, employees, suppliers, distributors, etc. are contract-based despite it does not distinguish corporations from other networks of contractual relationships, this very understanding presupposes the capacity of the firm to act as a contracting party-juristic personality.

The other trait of corporate personality is what civil law describes as “separate patrimony”.²⁸⁸ This involves the demarcation between a pool of assets that are distinct from other assets owned, singly or jointly, by the firm’s owners, and of which the firm in itself, acting through its designated managers, is viewed in law as being the owner. The firm’s rights of ownership over its designated assets include the rights to use the assets, to sell them, and to make them available for attachment by its creditors. Conversely, because these assets are conceived as belonging to the firm rather than the firm’s owners, they are unavailable for attachment by the personal creditors of stockholders. The core function of separate patrimony is “entity shielding” i.e. shielding of the assets of the corporation from the creditors of the entity’s owners.

With respect to corporations, entity shielding involves two relatively distinct rules of law namely “the priority rule” that grants to creditors of the firm, as security for the firm’s debts, a claim on the firm’s assets in priority to the claims of the personal creditors of the shareholders, and “liquidation protection” which provides that shareholders of the corporation cannot withdraw their share of firm assets at will, thus a shareholder cannot force partial or complete liquidation of the firm, nor can the personal creditors of an individual owner foreclose on the owner’s share of firm assets.²⁸⁹ The “liquidation protection” rule intended to protect the perpetual succession of the firm against destruction either by individual shareholders or their creditors. In contrast to the “priority rule” mentioned above, it is not found in some other standard legal forms for enterprise organization such as the partnership.

²⁸⁶ HAHLO, H. R., *supra* note 2, at 33.

²⁸⁷ John Armour, Henry Hansmann, and Reinier Kraakman, *The Essential Elements of Corporate Law: What Is Corporate Law?* 6 (Harvard John M. Olin Center for Law, Economics, and Business, Discussion Paper No. 643, 2009) (available online at http://www.law.harvard.edu/programs/olin_center/ as last visited on March 10, 2014).

²⁸⁸ *Id.*

²⁸⁹ *Id.* at 7.

3.3.2 Limited liability

The corporate form effectively imposes a default term in contracts between a firm and its creditors whereby the creditors²⁹⁰ are limited to making claims against assets that are held in the name of or owned by the firm itself, and not against assets that the firm's shareholders hold in their own names. In spite of the fact that the rule of 'limited liability' has not always been associated with the corporate form, some corporate jurisdictions persisted for long on unlimited shareholder liability for corporate debts, and there are jurisdictions in which corporations with unlimited liability are still formally recognized,²⁹¹ limited liability has become a nearly universal feature of the corporate form. This evolution indicates strongly the value of 'limited liability' as a contracting tool and financing device. Limited liability is a strong form of "owner shielding" that is the converse of the 'entity shielding' described above as a consequence of corporate personality.

Entity shielding protects the assets of the firm from the creditors of the firm's owners, while limited liability protects the assets of shareholders from the claims of the firm's creditors. Together, they set up a regime of "asset partitioning" whereby business assets are pledged as security to business creditors, while the personal assets of the stockholders are reserved for the owners' personal creditors. This partitioning can increase the value of both types of assets as security for debt. Creditors of the firm commonly have a comparative advantage in evaluating and monitoring the value of the firm's assets, while an owner's personal creditors are likely to have a comparative advantage in evaluating and monitoring the individual's personal assets. As a result, corporate-type asset partitioning can reduce the overall cost of capital to the firm and its owners.

By virtue of the asset partitioning effect of incorporation, the formation of corporations and subsidiary corporations can also be used as a means of sharing the risks of transactions with the firm's creditors, at times when the latter are in a better position to identify or bear those risks in relation to the assets shielded by the corporate form. Thus, use of the corporate form can assist in raising debt finance even in situations where there is no need to raise additional equity capital, as in the case of the parent company of a wholly owned subsidiary.

Finally, it should be emphasized that when we refer to limited liability, we mean specifically limited liability in contract i.e. limited liability to creditors who have contractual claims against the corporation. To extend the rule of limited liability in tort like to third parties who have been injured as a consequence of the corporation's negligent behavior is "arguably not a necessary feature of the corporate form and perhaps not even a socially valuable one."²⁹²

3.3.3 Transferable Shares

Fully transferable shares in ownership form the third basic characteristic of the business corporation that distinguishes a corporation from partnership and various other standard-form legal entities. Transferability permits the firm to conduct business uninterrupted notwithstanding changes in the identity of its owners, thus avoiding the complications of member withdrawal that are common among, for example, partnerships and cooperatives.²⁹³ This in turn enhances the liquidity of shareholders' interests and makes it easier for shareholders to construct and maintain diversified investment portfolios.

²⁹⁰ By 'creditors' we mean here, broadly, all persons who have a contractual claim on the firm, including employees, suppliers, and customers.

²⁹¹ British Companies Act 2006, §3

²⁹² John Armour, Henry Hansmann, and Reinier Kraakman, *supra* note 308, at 10.

²⁹³ *Id.* at 12.

Fully transferable shares do not necessarily mean freely tradable shares. Even if shares are transferable, it may mean transferable among limited groups of individuals exercising a preemption right or with the approval of the current shareholders or of the corporation. It also gives the firm maximal flexibility in raising capital. For these reasons, all jurisdictions provide for free tradability of at least shares of public corporations.

However, free tradability can also make it difficult to maintain negotiated arrangements for sharing control and participating in management. Consequently, all jurisdictions also provide mechanisms for restricting transferability. Sometimes this is done by way of a separate statute, while other jurisdictions simply provide for restraints on transferability as an option under a general corporation law.

To imply the relative differences in terms of transferability of securities issued by corporations, those with freely tradable shares have been referred to as 'open' or 'public' corporations while the terms 'closed' or 'private' are used to refer to corporations that have restrictions on the tradability of their shares.²⁹⁴ To add more on the transferability of shares of a corporation, the shares of open corporations may be listed for trading on an organized securities exchange, in which case we will refer to the firm as a 'listed' or 'publicly-traded' corporation, in contrast to an 'unlisted' corporation. Moreover, a company's shares may be held by a small number of individuals whose interpersonal relationships are important to the management of the firm, in which case we refer to it as 'closely held', as opposed to 'widely held'. Nonetheless, not all companies with freely-tradable shares in fact have widely-held share ownership, or are listed on securities exchanges. Conversely, it is common in some jurisdictions to find corporations whose shares are not freely tradable but that nonetheless have hundreds or thousands of shareholders and that consequently have little in common with a typical closely-held corporation having only a handful of shareholders, some or all of whom are from the same family.

Transferability of shares, as we have already suggested, is closely connected both with the liquidation protection and with limited liability. Absent either of these rules, the creditworthiness of the firm as a whole could change, perhaps fundamentally, as the identity of its shareholders changed. Consequently, the value of shares would be difficult for potential purchasers to judge.

Perhaps more importantly, a seller of shares could impose negative or positive externalities on his fellow shareholders depending on the wealth of the person to whom he chose to sell had it not been for the rule of limited liability. It is therefore not surprising that strong form legal personality, limited liability, and transferable shares tend to go together, and are all features of the standard corporate form everywhere. This is in contrast to the conventional general partnership, which lacks all of these features.

3.3.4 Delegated Management with a Board Structure

Standard legal forms for enterprise organization differ in their allocation of control rights, including the authority to bind the firm in contracts, the authority to exercise the powers granted to the firm by its contracts, and the authority to direct the uses made of assets owned by the firm. For instance, in general partnerships, management of the firm, in the ordinary course of business, resides in the majority of partners and more fundamental decisions require unanimity. Both aspects of partnership management are unworkable for business corporations with numerous and constantly changing owners.

Consequently, corporate law typically vests principal authority over corporate affairs in a board of directors or a similar committee organ that is periodically elected, exclusively or primarily, by the firm's shareholders.

²⁹⁴ Id.

More specifically, business corporations are distinguished by a governance structure in which all but the most fundamental decisions are delegated to a board of directors that has four basic features.

First, the board is, as a matter of formality, separate from the operational managers of the corporation. The nature of this separation varies according to whether the board has one or two-tiers. In two-tier boards, top corporate officers occupy the board's second (managing) tier, but are generally absent from the first (supervisory) tier, which is at least nominally independent from the firm's hired officers (i.e. from the firm's senior managerial employees). In single-tier boards, in contrast, hired officers may be members of, and even dominate, the board itself. Regardless of the actual allocation of power between a firm's directors and officers, the legal distinction between them formally divides all corporate decisions that do not require shareholder approval into those requiring approval by the board of directors and those that can be made by the firm's hired officers on their own authority. This formal distinction between the board and hired officers facilitates a separation between, on the one hand, initiation and execution of business decisions, which is the province of hired officers, and on the other hand the monitoring and ratification of decisions, and the hiring of the officers themselves, which are the province of the board. That separation serves as a useful check on the quality of decision-making by hired officers. It also performs the key function of permitting third parties to rely on a well-defined institution to formally bind the firm in its transactions with outsiders.

Second, the board of a corporation is elected, at least in substantial part, by the firm's shareholders. The obvious utility of this approach is to help assure that the board remains responsive to the interests of the firm's owners, who bear the costs and benefits of the firm's decisions and whose interests, unlike those of other corporate constituencies, are not strongly protected by contract. This requirement of an elected board distinguishes the corporate form from other legal forms that permit or require a board structure, but do not require election of the board by the firm's beneficial owners.

Third, though largely or entirely chosen by the firm's shareholders, the board is formally distinct from them. This separation economizes on the costs of decision-making by avoiding the need to inform the firm's ultimate owners and obtain their consent for all but the most fundamental decisions regarding the firm. It also permits the board to serve as a mechanism for protecting the interests of minority shareholders and other stakeholders.

Fourth, the board ordinarily has multiple members. This structure facilitates mutual monitoring and checking eccentric decision-making. However, there are exceptions to plurality of the board. Many corporation statutes permit business planners to dispense with a collective boarding in favor of a single general director or one-person board. This can be for the evident reason that for a very small corporation, most of the board's legal functions, including its service as shareholders' representative and focus of liability, can be discharged effectively by a single elected director who also serves as the firm's principal manager.²⁹⁵

3.3.5 Investor Ownership

Ownership interests in a corporation comprise two key elements: the right to control the firm, and the right to receive the firm's net earnings. The law of business corporations is principally designed to facilitate the organization of investor-owned firms i.e. firms in which both elements of ownership are tied to investment of capital in the firm. More specifically, in an investor-owned firm, both the right to participate in control which generally involves voting in the election of directors and voting to approve major transactions, and the right to receive dividends are typically proportional to the amount of contribution to capital of the firm. Company

²⁹⁵ Id. at 13.

laws uniformly provide for allocation of control and earnings pro rata to contributions as the default rule.²⁹⁶ Nonetheless, other forms of ownership meant to facilitate an important role in contemporary economies like corporations owned by investors of capital i.e. “capital cooperatives”.²⁹⁷

Sometimes corporate law itself deviates from the assumption of investor ownership to permit or require that persons other than investors of capital, for example, creditors or employees, participate to some degree in either control and/or net earnings. “Worker codetermination” is an eye-catching example.²⁹⁸ The wisdom and means of providing for such non-investor participation in firms that are otherwise investor-owned remains one of the basic controversies in corporate law.

3.4 Theories of the Firm

Notwithstanding the fact that corporations having their roots in the 17th century have been the engines for the growth of the modern capitalist economies all over the world, theorization of the firm dated back only to a century time.²⁹⁹ It is acknowledged in a wide range of economics literature that the root of most economic theories of the firm lies in R. H. Coase’s article titled *The Nature of the Firm*.³⁰⁰

In the named work Coase attributed the emergence of the firm for three reasons.³⁰¹ *First*, the need to reduce higher costs of organizing production through the “price mechanism” of the market system necessitated acting under the umbrella of a corporation. *Secondly*, the natural uncertainty of business life makes very short term contracts unsatisfactory so that to operate being incorporated becomes a solution to that limit. And *thirdly*, incorporation allows wider use of capital resources by facilitating accumulation of resources in the form of contributions in the capital of the enterprise which enables purchase of capital intensive means of production like modern technology.

It is true, theories of the firm have not yet evolved to the satisfaction of economists and it has been repeatedly recommended that further endeavors have to be invested in to refine the existing ones and/or come up with totally distinct versions. That being the general characterization of the existing economic theories of the firm, in this section attempt is made to summarize them with a reasonable precession.

3.4.1 The Neoclassical Theory

In the pre-1930s, there was a general understanding that firms were tools of realizing economies of scale in the production of goods and services.³⁰² This was specifically achieved by breaking tasks down and assigning a work force to specialize on each task unit to lower costs of production, and by facilitating wider use of capital goods because it would supply a huge sum of fluid finance and increase creditworthiness over and above an individual producer would offer to creditors.

In the same corollary, this theory understands a firm as “set of feasible production plans” encompassing acts pertaining to the input, production and output aspects of the production process.³⁰³ It placed the manager at the centre of the production process to plan and execute the various activities within and outside of the enterprise under the spirit of the constant mission of maximizing owners’ welfare. Firms combine inputs and

²⁹⁶ Id. at 14.

²⁹⁷ Id.

²⁹⁸ Since the time of the Nazi government, German corporate boards have continued to involve employees’ representatives.

²⁹⁹ Hart, Oliver, *An Economist’s Perspective on the Theory of the Firm*, 89 COL. L REV. 1757 (1989).

³⁰⁰ Ulen, Thomas S., *The Coasean Firm in Law and Economics*, THE JOURNAL OF CORPORATION LAW 301-304 (1993).

³⁰¹ Coase, R. H., *The Nature of the Firm*, ECONOMICA 390-398 (November 1937).

³⁰² See Ulen, Thomas S., supra note 318, at 304.

³⁰³ See Hart, Oliver, supra note 320, at 1758.

technology embodied in a production function in a way that maximizes profits. The theory introduces “mathematical formalization,” put flash light on the firm’s response to changes in the external environment and important in the analysis of the consequences of strategic interaction between firms under conditions of imperfect competition.³⁰⁴

The neoclassical theory is praised, *inter alia*, for its attempt to dispose the production function in an elegant and general mathematical formula, relevance to analyze production choices of the firm in response to changes in the extra-firm environment, and importance in analyzing consequences of strategic interactions between firms under conditions of imperfect competition.³⁰⁵ Nonetheless, it suffers from shortcomings including but not limited to failure to explain how production is organized in a firm and how conflicts of interest between the firm’s constituencies are resolved. Furthermore, it is criticized for its general ignorance of the question what happen in cases of merger of firms or splitting of a firm, and does not determine, in black and white, where a firm starts and ends.³⁰⁶

3.4.2 The Principal-Agent Theory

This theory starts by tagging owners as “principal” and management as “agent”. It also conceives a modern corporation to be publicly-held and controlled by a separate manager which poses a difficulty of monitoring by shareholders (owners).³⁰⁷ Eventually, managers controlling the firm might have tastes and preferences at the odds with those of owners of the firm, a cost to the latter. The principal-agent theory takes the firm to be a “production set” wherein a professional manager makes production choices even that owners do not have ever observed due to lack of information and recognizes the possibility of conflict of interest among the firm’s constituencies.³⁰⁸ Put it differently, power of the management should not be belittled in the sense that the manager may have goals different from and/or detrimental to the legitimate interest of owners so that owners may not be able to implement their own plan directly.

So, at the heart of this theory is how to keep “agency costs” as low as possible.

According to this theory, owners are recommended to get allied with the manager by placing the latter on an incentive scheme like “making managers part-owners of the firm.”³⁰⁹ This can be done by making compensation of managers dependent upon the profit performance of the firm, or by giving managers stock options or warrants in such a way that their value, when exercised, becomes greater than the share price of the firm. The theory also proposed reliance on the competitive market for managerial compensation based on the assumption that successful managers would receive higher salaries in other companies based on the assumption that successful management means operating the firm in the interests of the owners.³¹⁰ That is why it is otherwise named as “managerial theory of the firm.”³¹¹

Failures to answer what defines the firm and to tell about the organizational structure of the firm are some of the shortcomings of the theory.³¹²

³⁰⁴ Id.

³⁰⁵ Id.

³⁰⁶ Id.

³⁰⁷ See Ulen, Thomas S., *supra* note 318, at 312.

³⁰⁸ See Hart, Oliver, *supra* note 320, at 1759.

³⁰⁹ Id. See also Ulen, Thomas S., *supra* note 318, at 313.

³¹⁰ See Ulen, Thomas S., *supra* note 318, at 313.

³¹¹ See Hart, Oliver, *supra* note 320, at 1759.

³¹² Id.

3.4.3 Transaction-Cost-Economics

This approach traces the seeds of the firm in the “thinking, planning, and contracting costs that accompany transaction.”³¹³ Coase contends that the cost of learning about and bargaining over terms of transactions between independent firms counts for the lion-share of transaction costs.³¹⁴ Nonetheless, the cost of transactions may be lower if carried out within the firm than in the market which pin points on the firm as a tool of efficiency. But, how?

Hence, the theory proposes that such costs can be reduced by giving authority over terms of trade within a limit to one party formed by vertical integration of those independent firms.³¹⁵ But, so doing induces its own costs attributed to increased possibility and thus cost of errors in decision making, and inflexibility due to centralization of power.³¹⁶ It is this power, according to the theory, that defines boundary of the firm to rest on a point where managerial cost savings of the firm equates with cost of consequent errors and rigidity.

Alchian and Demsetz, however, rejected the central idea of the theory that firms are characterized by authority relations.³¹⁷ Its failure to put light on justifications for the preference of the firm not the market to solve problems of joint production and monitoring has discredited the value of the theory.

3.4.4 The Nexus-of-Contracts Theory

It is a known fact that owing to the exclusive nature of property rights over objects, one cannot make use of, control or enjoy any other privilege accorded only to the right holder. In cases where in two or more resources are “highly complementary”, meaning one is worth of almost nothing in the absence of the other, the owners should arrange a scheme of exploiting the resources to ensure the maximum possible utility to them and the society at large.

Contractual failure is a common point of interest to the previous theories though all failed to explain conclusively how bringing a transaction into the firm mitigates this problem. The nexus-of-contracts approach does not take it as a problem at all rather it conceives the firm as a “web of contracts among customers, employees, managers, investors, suppliers, and third parties with the legal fiction of the company serving as the central node through which all of these contractual relationships are mediated”.³¹⁸ Therefore, the firm grows until the cost of organizing production internally or under the umbrella of the firm exceeded the cost of organizing it through the market.³¹⁹

This theory is believed to have its roots in the views of Alchian and Demsetz that both internal and external affairs of a firm are subject to contracts of so similar character across different forms of business enterprises so that they may be called as “standard contracts”.³²⁰ The modern public corporation, characterized by limited liability, indefinite life, separation of ownership and control or management, freely transferable shares and votes, limited corporations and partnerships are the typical examples of such “standard contracts”.³²¹

³¹³ Id. at 1760.

³¹⁴ Id.

³¹⁵ Id.

³¹⁶ Id.

³¹⁷ Id. at 1761.

³¹⁸ See Hart, Oliver, supra note 320, at 1764. See also Ulen, Thomas S., supra note 318, at 320.

³¹⁹ See Ulen, Thomas S., supra note 318, at 319.

³²⁰ Id. at 317.

³²¹ Id. See also Hart, Oliver, supra note 320, at 1764.

Even if the firm is established to take advantage of the efficiencies of team production, it inseparably is challenged by the problem of remote direct monitoring by the owners. Due to the fact that ownership of public corporations is dispersed among shareholders and, for the sake of convenience, administration is delegated to managers, the share holders are not, arguably, exercising the control element of ownership as a bundle of property rights. This separation is presumably tolerable only to the extent that the increase in the profits is greater than the increase in agency costs.³²²

This theory too does not run-away from criticism. Among others, its failure to define boundary of the firm, to address why particular standard forms are chosen, and to appraise the considerable costs of contract formation, interpretation and enforcement are on the forefront.³²³

3.4.5 Property Rights Theory of the Firm

It is the latest of the known economic theories of the firm and has much in common with the principal-agent approach and transaction-cost theory of the firm. It assumes the centrality of contracts in governing the relations between firms as suppliers.³²⁴ Put differently, it concurs the view that relations within and outside of the firm are governed by contracts. Nonetheless, complete contracts are costly to conclude so that contingencies are unavoidable. Consequently, the question how to fill gaps in contracts is what the property rights theory of the firm is all about.

According to this theory, the owner of the relevant physical asset is the ultimate power to resolve such gaps in contracts.³²⁵ As an integral part of the ownership right, it is the owner who can pass a valid decision as to whether it must form part of another firm or used separately. Moreover, ownership of physical assets has a far reaching effect on the control of human assets.³²⁶

Merger of the firms controlling “assets sufficiently complementary”, meaning each asset by itself is useless, is highly recommended by this theory.³²⁷ This is because to let two different owners and thus two different management teams to control each separately would be detrimental to actors’ incentives since it would increase the number of parties with holdup power and inculcate tendencies of opportunism. The vertical integration of firms owning such highly complementary products, one supplying to the other, is the minimum size for a firm. In the absence of considerable lock in effects, the theory advises non-integration of firms because to do things through the market would enable them secure optimal returns. Hence, one should know characteristics of the merging firm and who will own the new company before effecting the merger.

As is a culture in theoretical scholarship, this theory too is criticized for lack of a room for organizational assets and for its failure to understand the monitoring problems of the modern publicly-held corporation.³²⁸

3.5 Perceived Advantages and Disadvantages of Incorporation

Incorporation involves both comparative advantages and disadvantages over other forms of business organizations. Save some jurisdiction-specific pros and cons, incorporation offers some common advantages and disadvantages in all systems all over the world. Subsequently, a summary of the main advantages and disadvantages of incorporation is presented.

³²² See Ulen, Thomas S., supra note 318, at 320.

³²³ See Hart, Supra Note 320, p.1764. See also Ulen, Thomas S., supra note 318, at 321.

³²⁴ See Ulen, Thomas S., supra note 318, at 316.

³²⁵ Id.

³²⁶ See Hart, Oliver, supra note 320, at 1766-7.

³²⁷ Id. at 1770.

³²⁸ See Ulen, Thomas S., supra note 318, at 317.

3.5.1 Advantages

Whilst many businesses prefer to trade as soleproprietors or partnerships, nearly all significant businesses operate as an incorporated company. Exclaiming on the contributions of the invention of the limited liability company to the skyrocketing economic growth of the West, Professor N.M. Butter, president of Colombia University, once opined that “the limited liability company is the greatest single discovery of modern times. Even steam and electricity are less important than the limited liability company.”³²⁹ The main specific advantages of incorporation that flow from the central features of corporations either directly or indirectly are summarized below.

3.5.1.1 Perpetual Corporate Personality

Once effectively formed, a company has its own legal identity and ceaseless life.³³⁰ It is therefore automatic that third parties contract with the ‘company’ and not with individual directors and shareholders, and only the company is liable for non-performance. Legal actions are brought against it and taken through its agents in its name. The separate corporate personality of an incorporated company would also allow dual-relationship of shareholders with the company. It is to emphasize on the possibility for a company to make a valid contract with any of its shareholders/directors. Hence, possible is for a person to be a shareholder (owner), director, creditor and employee of the company at a time. Consequently, a person can receive dividend as a shareholder, remuneration as a director, lease rent as a leaser; can earn interest as a creditor and can supply goods from his/his family business as a supplier.

Accruing from the corporate personality independent of the person of shareholders of a corporation, change of stakeholders won’t affect existence of the company. If any of the directors, management, employees or shareholders leave, retire, or die, that won’t affect the being of the company. This means companies survive the death of the owners and it is possible for the directors and shareholders involved with the company to change over time. Therefore, the continued existence of a company emanates from the independent and immortal personhood it acquires on registration and is facilitated by the straightforward process of issue, transfer and sale of shares.

Nonetheless, a company’s existence will cease if it is formally wound up, liquidated or by order of court or other authority.³³¹ *Inter alia*, the perpetual succession of corporations can provide more perceived security for employees, creditors and investors than other business structures do. It is for this reason that, as noted earlier, companies like the Royal Exchange and Insurance companies of London have been in business for long.

3.5.1.2 Limited Liability

Starting a new business is often a risky project. Hence, the protection the rule of limited liability offers is perhaps the most important advantage of incorporation.³³² As noted previously, in contrast to the case in other forms of business organizations, the shareholders of a company have a limited or capped liability for the debts of the business. The extent of their liability is to the amount paid for their shareholdings and, if there are any, to the unpaid amount on shares. Hence, in case of liquidation of a company, if the company's

³²⁹ DINE, JANET AND KOUTSIAS, MARIOS, COMPANY LAW 1 (6th ed., 2007).

³³⁰ GOULDING, SIMON, COMPANY LAW 13 (2nd ed., 1999).

³³¹ Advantages of company Business, http://www.tutor2u.net/business/finance/legal_company_advantages.htm (last visited on March 10, 2014).

³³² GOULDING, SIMON, *supra* note 348, at 13.

assets are insufficient to meet its liability, nothing is required to be contributed by the owners so that none of their personal assets will be at stake.

This limit on the shareholders' liability contrasts with the situation for partnerships and sole traders where there is potentially unlimited personal liability to the extent of exhausting personal possessions for the debts of the business. A limited company can therefore allow investors to take a calculated business risk without however the prospect of losing everything they own. Apparently, this advantage of incorporation stems from the separate juristic personality of corporations.

The principle of limited liability however does not entitle director-shareholders the protection of limited liability all the time. Meaning, if the shareholder is also a director of the company then the limit on their liability does not always apply. Indeed, if creditors lose money through director-fraud, the directors' personal liability is unlimited.

3.5.1.3 Pool of Capital

It is a general understanding that capital forms one of the fundamental factors of production. To qualify on the relevance of money in any economic activity, it is commonly described as the "blood vessel of business". So, businesses, irrespective of the legal form, have to have assets to commence operation. It is possible to solicit such capital from money suppliers in credit or through inviting the public to contribute for the capital of a company. The former is however disfavored because it involves interest cost and it may not be in sufficient supply specially to begin a larger venture.

While partnerships can serve the purpose of raising capital from multiple pockets, the advantage of pooling resources to a greater degree pertains to public companies. From the very start, a public company offers shares to the public to subscribe. People from all walks of life in a country and beyond may buy shares which are priced usually at low levels. Moreover, there is no restriction on the number of members in a public company. In this way, a public company can collect a huge sum of money whereas a sole trader or a partnership, and even private companies, should raise capital from a limited number of sources so that their capital is perhaps limited to contributions in a narrow circle. Consequently, the fact that capital of a public company is generally raised from the public would allow it avail the economies of large scale operations.

Moreover, from the point of view of imploring additional capital, public companies may raise capital at any time by issuing new shares and/or debentures. The new shares can be offered to existing shareholders or new investors, although only public limited companies can offer shares to the public. Besides, the possibility of issuing multiple share classes can be used to offer flexibility in rights to vote and therefore control the company, receive dividends and extract capital if the company is wound up, and inclusion of preemption rights to protect the interests of existing shareholders may attract investors to take advantage of such privileges. These privileges are not available in other business organizations.

More often than not, the formation of a corporation can suggest that the business has permanence and is committed to effective, professional and responsible management.³³³ This often inspires a sense of confidence in suppliers, customers and the public at large towards a limited company, and it may lead many companies, particularly larger businesses, not to deal with an entity that's not a limited company. Incorporating a business can therefore open up new business opportunities that would not otherwise be

³³³ Advantages and Disadvantages of Registered Company, <http://www.slideshare.net/WisteriaFormations/limited-company-registration-advantages-and-disadvantages> (last visited on March 10, 2014).

available. In connection with the better credit standing of a company,³³⁴ the possibility of securing bank loans without the need for the directors to give a personal guarantee or charge over their estates is among such opportunities.³³⁵

3.5.1.4 Transferability of Shares

The shares of a public company are often freely transferable. This makes investment in the shares liquid so that an investor is not bound to remain with the company if she/he decides to leave. Nonetheless, the free transferability of shares of limited companies presupposes a well-functioning capital market. Having a direct bearing on the formation of new corporations, primary and secondary security markets have to be in place to enable security holders sell them for the possible maximum payment in a competitive market.

Moreover, when it is proposed to sell the business as a going concern, all required is to transfer the entire shareholdings to the purchaser and thus facilitate easy changes in management and ownership. This will save time and money of the promoters. And this is more an opportunity to corporations than other standard legal forms for business enterprises.

3.5.1.5 Miscellaneous Advantages

It is corporations that have created the majority of job opportunities across the world.³³⁶ To facilitate proliferation of much more strong corporations in particular and strengthen the private sector in general will naturally bring about additional employment opportunities to tackle the globally increasing unemployment which would in turn mean uncountable things.

In response to the ever increasing concern towards corporate social responsibility (CSR) in national policies and the global arena, to have several successful corporations in an economy may mean, in consequence to activities of the companies done to discharge their social responsibilities, an addition on the efforts for social development of communities.

As noted earlier, the most important element of modern businesses has become technological knowhow and not physical materials. The level of development of technology and innovation reached today is partly of large corporations that invest millions and billions of dollars to undertake research and development (R & D) projects that elevated happiness and satisfaction in human life. Again to have several successful corporations in a competitive business environment would avail us an additional engine that support research and innovation.

Moreover, incorporation of as many companies as possible in an economy in diverse sectors of industries would ensure sustainability of growth of the economy because they can afford to buy or develop up to date technology which would maximize general factor productivity on a continuous basis.

³³⁴ The fact that a registered company can create a **floating charge** will make it better treated by creditors than all other business establishments. A floating charge is a mortgage of (usually) all the company's assets, both present and future, and on terms that the company may deal with the assets in the ordinary course of business while the creditor retains the right to follow them. The floating charge is a factor in the choice of business format because only registered companies can create floating charges. A sole trader or partnership, with exactly the same assets, cannot give this type of mortgage. So, if the business needs to borrow money and the bank (or other lender) wants a charge on all the assets, the business must be a registered company.

³³⁵ Advantages of Setting up a Limited Company, <http://www.informdirect.co.uk/blog/2013/8/7/10-advantages-of-setting-up-a-limited-company/> (last visited on March 10, 2014).

³³⁶ MNCs and TNCs: Their Role and Socioeconomic Impact on Host Societies, <http://www.ips.org.pk/globalization/1007-mncc-and-tncs-their-role-and-socioeconomic-impact-on-host-societies> (last visited on March 25, 2014).

As noted above, the presence of an effective securities market is a requisite for the utmost beneficence of investors in public companies. But the market to emerge and operate efficiently demands proliferation of public limited companies for the market to host transactions involving their securities. The market primarily transacts with securities developed largely due to the shares and debentures issued by public companies. So, development of corporate culture in an economy facilitates the growth of a healthy primary and secondary capital markets and vice-versa. Public companies also contribute to the growth of financial institutions and banks.³³⁷

Save the difficulties to ensure that a company is heading to the direction intended to by the owners, the separation of ownership and management in corporations would save time and energy of owners so that they can invest in another productive activity. The separation of ownership and control would again facilitate recruitment of smart minds to lead the business which in turn may enhance performance and success of the venture. And so on!!

3.5.2 Disadvantages

As mentioned earlier, incorporation as a limited company involves drawbacks compared with the other forms of business establishments. Attempt is made to summarize some of them subsequently.

3.5.2.1 Compromise on Privacy

The duty of disclosure of a company demands a degree of transparency on its affairs. *Inter alia*, information about annual return of the company and accounts detailing on the financial position of the company, which will be on public record, need to be filed with Company Registrar each year. A company also should file, in a self-assessment system, an annual company tax return which shows the income and deductions of the company and the company's income tax payable every year.³³⁸ As a result, anybody can request a copy of the file and so can look up all the registered details of the company.

These days, information from a 'Companies House' is increasingly being made available even on-line. The information includes a copy of the annual accounts and details of the company's directors, including share ownerships, other directorships, home addresses, etc. Some people do not like this amount of information being publicly available because there can be possibilities of the information being used illicitly by its potential rivals to the detriment of interests of the company.

However, this view is counterbalanced by the argument that the availability of such information can make it easier for the company to get credit because a search at a 'Companies House' can show that the company is of a certain size and appears to be stable and growing.

3.5.2.2 Administration Cost

Establishing a corporation is a complex process. Among others, it requires preparation of required and often technical documents, registration with the central regulatory authority and fulfillment of certain requirements related to the amount of capital, number of directors, etc. for listing on a stock exchange, etc. all involving costs. As well, there will be legal fees involved.³³⁹

³³⁷ What are Advantages of a Public Company, <http://www.preservarticles.com/2012022823825/what-are-the-advantages-of-a-public-company.html> (last visited on March 10, 2014).

³³⁸ Company Advantages and Disadvantages, <http://www.allbusinessstructures.com.au/company-advantages-and-disadvantages> (last visited on March 10, 2014).

³³⁹ Advantages and Disadvantages of Limited Company Registration, <http://www.slideshare.net/WisteriaFormations/limited-company-registration-advantages-and-disadvantages> (last visited on March 10, 2014).

A corporation can be subject to greater regulation that can add to the cost of doing business. Various regulations may have to be complied with, for example, to sell shares, or raise capital. A corporation will be required to keep records of its shareholders, directors and officers, any changes of the shareholders, directors and officers, as well as records of its debts. Records of various other transactions or changes in the corporation must also be kept up to date.

Holding board and general meetings and keeping minutes is the integral part of day-to-day activities of a company. Moreover, accounting costs of a company tend to be more expensive and complicated than any other legal form of business. Remuneration to directors, as well, adds on costs of the corporation. These all make the costs of general operational administration highly considerable. Whereas, a sole trader does not face any of these and a partnership is required to comply with lesser regulations, apparently lowering their costs of administering their business.

3.5.2.3 Miscellaneous Disadvantages

Registered companies are subject to a different tax structure i.e. corporation tax. So, the choice of legal structure can make a substantial difference to the amount of tax paid on the same trading profits. Depending on the special rights and restrictions attached to the shares, and how the profits of the corporation are paid out to the shareholders, there is the possibility of “double taxation”: the corporation must pay taxes on its profits and the shareholders may be subject to taxation on the profits paid out. This can result in greater taxation than had it not been incorporated.³⁴⁰

As a matter of principle, shareholders or owners of corporations delegate the administration to a body of persons called board of directors. The board of directors hires management to look after the day-to-day affairs of the corporation. The management is an agent and the owners collectively are the principal. However, it is quite possible that the management may act to further interests other than those of the owners of the corporation. It is otherwise known as the ‘Berle-Means’ story of 1932³⁴¹ that depicts the continued reality of American corporations. That appears as a limitation on the exercise of the control element of ownership and a disadvantage consequent to, though may be unavoidable in other cases of agency relationships, the form of establishment. When this happens, it is called a “cost of agency”. A sole-trader/partnership structure is very flexible provided the ownership and control patterns are simple, i.e. a small number of people owning and contributing to the business in a very straightforward way.

To conclude, business associations of different kinds have been in existence since long ago. To date, most effective businesses have been run under defined legal forms each offering its own comparative advantages and disadvantages. In particular, though subject to recurrent reforms to accommodate developments in business life, a defined system of corporate business has been in place since the 18th century. The corporate systems in UK, France, Germany, and the USA have been considered the most effective and influential in the escalation of corporate law all over the world including Ethiopia.

After going through the discussions on the historical account of corporate law and business in the four “origin” systems of modern corporate law, save minor differences among them, it can be construed that all have been in agreement as to the prominent role of the private sector in general and corporations in particular for their overall development and determined to facilitate the play field for its efficient operation. It is what

³⁴⁰ Forms of Business Corporation, <http://accountingexplained.com/misc/forms-of-business/corporation> (last visited on March 10, 2014).

³⁴¹ Hopt, Klaus J., *Modern Company Law Problems: A European Perspective* 3 (Keynote Speech OECD, 2001).

the tirelessly frequent reforms on their company law regimes suggest. Moreover, even if how far automatic the relation between workable system of company business and expansion of successful corporations has yet to be ascertained, it cannot be wrong to assume that proactive and responsive company laws in force in these systems have hardened and deepened the base of corporate businesses.

The bold lesson which Ethiopia in particular should learn from the success stories is how far relevant to embark on proactive and sympathetic legislative measures can help for an extensive corporatization of businesses. Incorporation is not an end by itself. Rather, it is a means to institutionalized production which all the time promotes efficiency.

CHAPTER FOUR

CORPORATIZATION IN ETHIOPIA AS A TOOL OF COPING WITH GLOBALIZATION AND ACCESSION TO THE WTO

4.1 Policy Measures Taken in Ethiopia towards Economic Liberalization and Integration

As noted in chapter two, the international economic organizations have been working to ensure economic openness and integration so that the world becomes an economic unit. The deeds of the Bretton Wood's institutions under their structural adjustment programs, as reinforced later by the WTO, are particularly celebrated in that respect. The integrationist experiment has also been sought to by African governments with differing orientations in pursuance to the tempos of the respective times. The Lagos Plan of Action (LPA), abated after criticized by the North for its inward-looking orientation to the betrayal of the advocacy for broad based globalization, the New Economic Partnership for Africa's Development (NEPAD) which is apprehensive about African "ownership and management" of development projects financed by foreign sources, and regional co-operations are among the endeavors towards economic cooperation and integration at the continent level.¹

Moreover, as noted in Chapter Two, countries' records on the impact of economic openness have been composed of both positive and negative consequences. In the same fashion, experiences of African countries are composed of both success stories and failures. In particular, it is found that FDI helped in the growth of sub-Saharan Africa while the impact of trade liberalization, at the odds with its effect in higher-income African countries, was insignificant and negative on the growth of low-income-countries. Moreover, economic openness, leave alone correct it, end up with expanding the negative trade balance in Africa.² In another study, it is reported that, because a large part of retained earnings from FDI is repatriated, a minus to the host economies' domestic savings and thus investment, FDI may have negative total effect on the growth of poor nations.³

Concerning Ethiopia, before looking into policy reforms it has undertaken to integrate with the global economic order, it would be proper to assess its relationship with the key actors in the economic liberalization and integration. Like the other poor nations of the world, it has been beneficiary of the financial and technical supports of the World Bank and the International Monetary Fund (IMF) at least since 1991. The initial moment that triggered such a relationship between Ethiopia and the international economic organizations traces back to the time when the Transitional Government of Ethiopia (TGE) took steps to foster rehabilitation and reconstruction of the war-damaged economy by preparing the Emergency Recovery and Reconstruction Programme (ERRP) under the sponsorship of the international community, including the Bank through the African Development Fund (ADF).⁴

Having regard to the desperate need of finance for the reconstruction of the economy, the Bank Group's Economic Prospects and Programming Paper (EPPP) of 1993 acknowledged the need for further support in the form of structural adjustment loan to Ethiopia. The fact that the Government of Ethiopia had successfully concluded a Policy Framework Paper (PFP) with the IMF and the World Bank in September

¹ Mengistu Bessir, *The Effect of Foreign Direct Investment on Trade Balance: the Case of Sub-Saharan Africa* 19-32 (2006) (unpublished master's thesis, Addis Ababa University).

² Id. at 24&64.

³ Mekonen Bekele Wakeyo, *Foreign Direct investment in sub-Saharan Africa and Its Contribution to the Economic Growth* 121 (2001) (unpublished master's thesis, Addis Ababa University).

⁴ African Development Bank Group, *Ethiopia: Structural Adjustment Programme Project Performance Evaluation Report (PPER)* 4 (2000) Operations Evaluation Department (OPEV).

1992 and a Structural Adjustment Facility (SAF) with the IMF,⁵ increased the confidence of the international community as to Ethiopia's commitment to undertake the decisive measures to empower the private sector and integrate with the international economic order. Following these positive developments, Ethiopia became eligible to participate in the Special Programme of Assistance for Africa (SPA). A Consultative Group meeting held in November 1992 endorsed the reform programme and mobilized donor support for its implementation. Later, on 23 June 1993, the Boards approved an ADF loan of UA 63.55 million in support of the programme.⁶

Thus, under the scheme of the Bank's Structural Adjustment Program, Ethiopia hosted a program financed principally by the Bank Group through the ADF which pledged a sum of UA 63.55 out of which UA 63.54 million was fully disbursed, the World Bank through the International Development Agency (IDA) which pledged UA 181.81 million but disbursed UA 182.32 million, government of Switzerland (UA 5.09 million), Germany (UA 8.73 million), and others (UA 27.35 million), in the period between 1993 and 1996.⁷ The said reform program involved three phases⁸ and was subject to fulfillment of about 18 conditions, 15 to be satisfied for the release of the first tranche and 3 for the release of the second tranche.⁹

Broadly speaking the project was meant to:

*...the promotion of sustainable development and poverty reduction through a fundamental transformation from a centralized planning to a market economy. The Government's reform programme comprised a broad spectrum of macroeconomic and stabilization measures and structural reforms all aimed at reducing internal and external imbalances, removing economic rigidities and distortions, improving the efficiency of resource use and creating an enabling environment for the development of the private sector.*¹⁰

Even if this author lack access to an independent assessment of the program, it is reported that it was over all "a success when evaluated against its objectives"¹¹ because, according to the report, it was possible at last to get Ethiopia outward-looking and undertake appropriate policy measures aimed at containing imbalances in the economy, promoting the role of market forces in the allocation of resources and removing impediments to the development of the private sector. The main policy measures taken to achieve compliance with the preaching of the donors and realize the country's development objectives were macroeconomic reforms like public enterprise reforms, domestic price liberalization, foreign trade and investment liberalization, and private sector reforms.¹²

Moreover, although the IMF is not a development agency, the Fund has become a key actor in the sphere of development. By using its natural entry into many low-income economies in times of macroeconomic crises

⁵ Id.

⁶ Id.

⁷ Id. at 5.

⁸ Id. (In the first phase, which started since the beginning of 1992/93 fiscal year, primacy was given to macroeconomic stabilization involving tightening of fiscal policy, strengthening of monetary control, and exchange rate adjustment. The second phase concentrated on the initial structural reforms intended to complement stabilization objectives such as correction of price distortions, tariff reforms, and the stimulation of private sector supply response through the provision of an enabling environment. In the third phase of the reform programme, reserved for after the transition period in 1994/95 and beyond, more fundamental structural reforms emphasizing on allocative and productive efficiency to be achieved by building competitive markets, a closer integration with the international economy, a marked shift in the boundary between public and private production, and reduction or elimination of costly controls would be introduced. At this stage, the programme would concentrate on the resolution of the land ownership issue, privatization of public enterprises, financial sector reforms, and civil service reform.)

⁹ Id. at 7.

¹⁰ Id. at 4.

¹¹ Id. at 10.

¹² Solomon Mamo, *Determinants of FDI in Ethiopia* 28 (2008) (unpublished master's thesis, Maastricht University).

and its persisting presence long into the post-stabilization phase, the Fund also reinforced the reform programs of the Bank by subjecting its services to conditions usually named as “IMF conditionalities”. Nonetheless, the IMF got involved in structural adjustment programmes in the face of fierce and bombarding critics on the speculation that they would hurt the poor mainly through reductions in public expenditures on health, education and other social services from which the poor benefited. Despite that, however, the IMF championed exchange rate adjustment and public expenditure reductions in the stabilization measures, and of trade liberalization and the abolition of price controls in the set of structural reforms in a wide range of territories including Ethiopia.¹³ In particular the frequent devaluation of the Ethiopian Birr (ETB or simply Birr) per US dollar: 17.705 (2012 est.)16.899 (2011 est.)14.41 (2010 est.)11.78 (2009) 9.57 (2008)) was carried out under the advice of the IMF though the domestic economy did not respond well to take advantage of it.¹⁴

In light of the policy dictations of the World Bank and the IMF, since 1991, Ethiopia has been marching under the course of “market-based liberal type of economic system, albeit under the ideological guises of so-called ‘revolutionary democracy’ initially and ‘developmental state’ currently.”¹⁵ It also adopted a long list of policies, programs and strategies and action plans in the various sectors under the grand spirit of market economy. From the view point of foreign investment and trade, it undertook several pro-trade and investment measures stemming from the outward-looking stance and the conviction that foreign trade and investment contribute for the economic transformation of the country and abolition of poverty.

Pertaining to foreign trade, since 1992 the EPRDF-led government has been implementing “a comprehensive trade reform program in the context of broad liberalization package.” Among the reforms are a significant reduction in import duties and other charges,¹⁶ elimination of quantitative restrictions and export taxes, devaluation of the Birr, price deregulation, introduction of a system of export incentives like duty drawback and bonded manufacturing warehouse scheme systems, and establishment of Export Promotion Agency which was later absorbed as a department in the Ministry of Trade and Industry.¹⁷

In addition to the pro-trade national measures, Ethiopia traveled far towards freer trade by assuming international legal responsibilities signified by its membership to international trade pacts like NEPAD, COMESA and Cotonou. Ethiopia’s accession to the WTO is also another remarkable move towards the trade liberalization project. Moreover, to encourage its integration with the advanced market economies of the West, Ethiopia has been eligible to benefit from the non-reciprocal preferential trade arrangements including the Generalized System of Preference (GSP) offered by many advanced nations to poor nations, Everything But Arms (EBA) offered by the EU, and the African Growth and Opportunity Act (AGOA) presented by the US. These all are hoped to widen the market access for exports from Ethiopia and the market size producers can consider in their location decisions.

Nonetheless, as will be treated here in below in a reasonable detail, Ethiopia’s performance in exploiting the market access opportunities has been insignificant implying the meaning of joining the WTO unless it moves shortly to correct the supply side constraints. Stated differently, while to provide the market access may be a single positive condition, as the late Prime Minister Michael Manley of Jamaica rightly concluded after a

¹³ Collier, Paul and Gunning, Jan Willem, *The IMF’s Role in Structural Adjustment 2* (1999) (World Bank and Centre for the Study of African Economies, WPS/99-18).

¹⁴ IMF and Ethiopia’s Economic Growth – By Dr. Daniel Teferra, <http://diretribune.com/?p=6265> (last visited on 25 April 2014).

¹⁵ DIGEST OF ETHIOPIA’S NATIONAL POLICIES, STRATEGIES AND PROGRAMS xiii (Taye Assefa ed., 2009).

¹⁶ The remarkable reduction in custom duties has made Ethiopia one of the most liberal traders in the world even before formally joining the rule-based multilateral trading system-the WTO. Tariff ranges were lowered from 0-80% in 1992 to 0-32% in 2002. This in effect means a reduction of weighted average custom tariff rates from 28.9% to 17.5% in the same period.

¹⁷ Bulti Terfassa, *Ethiopia’s Trade and Investment Policy*, in DIGEST OF ETHIOPIA’S NATIONAL POLICIES, STRATEGIES AND PROGRAMS 285 (Taye Assefa ed., 2009).

painful experience with the IMF prescription, “the problem in poor countries is not the search for market for sophisticated wheat farmers, already capable of a high level of productivity, but how to get a simple peasant to become an efficient producer in the first place.”¹⁸ So, the pressing problem has turned out to be how to improve production and productivity in the poor countries including Ethiopia.

Insofar as investment is concerned, the government of Ethiopia has acknowledged the key role the private sector will have in the move towards poverty alleviation and sustainable development.¹⁹ In light of this enthusiasm, the government has been introducing several pro-investment measures to solicit resources from both domestic and foreign investors to foster increased production and productivity. *Inter alia*, the government has been liberalizing foreign trade, promulgating liberal investment laws for the promotion and encouragement of private investment, issued a modern labour law, facilitated a forum for consultation between the private sector and the government, strengthening and enhancing institutional support for the export sector through the strengthening of existing institutions.²⁰

Nonetheless, regardless of these reforms aimed at attracting private investment in the country, investment from domestic sources, in proportion to the low level of national savings, has been very minimal and disorganized. The call for FDI too, as can be learned from the discussion in the next section, has not brought superb results so that FDI inflow to the country has been only at a rudimentary level. Not only is the problem that FDI is low in the country, lack of competitive domestic firms bared the country from reaping the maximum possible advantage from FDI and resist FDI-induced threats to the economy.

Therefore, if the mere fact that Ethiopia’s economy is outward-looking so that it is characterized by trade and investment liberalization would not warrant economic growth, and if building on domestic capacity can be the only solution to take advantage of opportunities and resist economic integration via trade and investment tends to offer, then, it would be normal to ask the question this thesis is interested in, as provided explicitly very initially, that whether corporatization can be an option to ensure development of internationally competitive domestic firms. This author found out that the answer is in the affirmative. For the how question, please keep on looking into the following sections.

4.2 Ethiopia’s Performance in International Trade

Ethiopia, one of the homes of ancient civilizations of the world and age-old statehood, has been a partner in international trader with a varying degree of influence over time. However, since the time this author has access to information on the foreign trade record of the country, its trade balance has been negative except once in the early 1970s.²¹ More strikingly, the trend has not been reversed although the volume of exports has been increasing in absolute terms due in part to market access availed to products from Ethiopia under different preferential trade arrangements mentioned above and other bilateral trade agreements. As the table below illuminates, it has been the case with many African countries too.

In an extensive survey, Hailegiorgis examined the impact of trade liberalization on Ethiopia's trade balance based on data for the period 1974-2009, and found that trade liberalization led to a worsening trade balance as a result of a rapid increase in imports in Ethiopia than exports.²² Anteneh also reached a similar conclusion

¹⁸ IMF and Ethiopia’s Economic Growth – By Dr. Daniel Teferra, <http://diretribune.com/?p=6265> (last visited on 25 March 214).

¹⁹ Preamble (2nd para) of the Investment Proclamation reads as “WHEREAS, it has become necessary to further increase the inflow of capital and speed up the transfer of technology into the country.”

²⁰ *See* Bulti Terfassa, *Supra* Note 17, p.295.

²¹ Berhane Tesfaye, *Determinants of Export Performance of Ethiopia*, 9 (2000) (unpublished masters thesis, Addis Ababa University).

²² Hailegiorgis Biramo Allaro, *The Impact of Trade Liberalization on the Ethiopia's Trade Balance*, 2 AMERICAN JOURNAL OF ECONOMICS 75-81 (2012).

that regardless of Ethiopia's trade liberalizing measures, the export performance could not match import growth and to the worse trade deficit reached 20.5% of GDP in 2002 as compared to 7.2% before liberalization.²³ The negative trade balance of the country would in turn pose a problem of poor balance of payment position of the country. The latter will practically constrain the actual growth rate of the country. Hence, it is certain that free trade per se did not improve export performance and economic growth of the country.

Table 2: Trade balance in East Africa, % GDP (1989-91 vs. 2009-2011)²⁴

Countries	Average Trade Balance (1989-91)	Average Trade Balance (2009-2011)
Seychelles	-2.0	-8.0
Uganda	-12.3	-10.7
Congo, Dem. Rep.	-1.0	-11.7
Tanzania	-24.0	-12.0
Kenya	-4.7	-14.0
Eritrea	----	-15.0
Rwanda	-10.0	-18.5
Madagascar	-8.0	-24.0
Ethiopia	-4.0	-19.0
Burundi	-17.3	-29.7
Comoros	-21.7	-33.0
Average	-10.5	-17.8

Based on different econometric studies, Ethiopia's performance in international trade even after trade liberalization and under the preferential trade arrangements has not been satisfactory. As is evident from the table above, the negative trade balance before liberalization has been constantly widening and exceeds the East Africa's average. Despite a considerable rise in Ethiopia's export to EU, a study conducted by United Nation Economic Commission for Africa (UNECA) reported that Ethiopia utilized only 24% of the EU-ACP agreement.²⁵ Concerning the impact of the EBA initiative, research conducted by the OECD reported

²³ Antench Bizuayehu, *The Impact of Trade Liberalization on Trade Balance and Economic Growth: the Case of Ethiopia* 58-61 (2005) (unpublished masters thesis, Addis Ababa University).

²⁴ UNITED NATIONS ECONOMIC COMMISSION FOR AFRICA, SUB-REGIONAL OFFICE FOR EASTERN AFRICA, TWO DECADES OF TRADE LIBERALIZATION AND MARKET EXPANSION IN EASTERN AFRICA –TOWARDS A NEW ECONOMIC GEOGRAPHY? 8 (2011) (available on line at www.uneca.org).

²⁵ Wolde Bulto Adugna, *Ethiopia's Accession to the WTO with Emphasis on Foreign Market Access* 62 (2006) (unpublished master's thesis, Addis Ababa University).

that most African countries have hardly ever used the scheme, only with a utilization rate of less than 3% for the possible reason of supply constraints.²⁶ Moreover, notwithstanding the increasing trend of export to the US, Ethiopia's utilization rate of the AGOA preference based on UNECA's calculation for 2004 was only 9%.²⁷ Concerning Ethiopia's trade relationship with COMESA member countries, it was not satisfactory.²⁸ From the forgoing discussion, it can be construed that economic openness alone won't ensure beneficence of a country from foreign trade.

Moreover, projecting the mosaic picture of these bits and pieces to the advent of Ethiopia's membership to the WTO, it is forecasted that:

*... the Most Favored Nation mechanism and improved market access might not be important aspects of Ethiopia's membership in WTO. Therefore, hasty marriage with WTO would have little significance for Ethiopian export market access. This finding is coincided with the Diagnostic Trade Integration Study by WB [World Bank], which argues that: "...there would not be an immediate benefit except to signal to the international community that Ethiopia's trade regime is bound to the international rules of the game."*²⁹

While Ethiopia has tariff-free access to the world's largest economies-the EU and the US and generally faces lower tariffs in other of its major markets than it applies itself, it exhibits low trade share of GDP and yawning trade deficit. Therefore, the major factors that account for such poor performance must lie in its domestic economic framework. Following Dan Ciuriak,³⁰ the factors that hinder Ethiopia's exports can be enumerated in rough order of importance as follows:

- a) **The macroeconomic policy mix:** the use of the exchange rate as an external anchor for domestic price stability resulted in a steep rise in the real effective exchange rate through the 2000s, undermining the competitiveness of exports and of import-competing production.
- b) **High trade costs:** Ethiopia is one of the most difficult places in the world from which to engage in the global economy, ranking 123rd out of 155 countries in the World Bank's 2010 trade logistics survey and 159th out of 183 countries in terms of trading across borders in the World Bank's 2010 Doing Business survey. The complexity of the process of exporting and importing, the slow and expensive transportation to ports of neighboring countries, cumbersome customs procedures, several indirect effects of the large trade imbalance and high direct trade costs and long lead times for import and export closely associated with heightened uncertainty concerning the exact amount of time that is required to import or export, which can be even more damaging for traders than the time costs themselves, add a part to the total trade costs.
- c) **Private sector under-development:** Ethiopia's industrial structure is dominated by a relatively small number of government-owned firms and party-owned conglomerates, implying a possible high degree of market concentration, and characterized by relatively high administrative barriers to entry as Ethiopia's rank in ease of starting a business under the World Bank's Doing Business methodology (163 for 2013 and 166 in 2014) suggest.³¹ According to surveys on Ethiopia's manufacturing sector, there were only 1,930 manufacturers defined as "large and medium scale" in the country employing 133,673 persons in 2008/09, and 43,338 "small scale" manufacturing

²⁶ Id. at 67.

²⁷ Id. at 70.

²⁸ Id. at 72.

²⁹ Id. at 128.

³⁰ Dan Ciuriak, *Supply And Demand Side Constraints As Barriers For Ethiopian Exports – Policy Options* 3-25 (2010) (Trade and Development Discussion Paper No. 02/2010, BKP Development Research & Consulting GMBH).

³¹ The World Bank Group Doing Business, Measuring Business Regulations, available online at: <http://www.doingbusiness.org/data/exploreeconomies/ethiopia> (last visited on 5 April 2014).

establishments, more than half of which are grain mills, employing 138,951 persons.³² Nonetheless, these are very small numbers for a country with a total population in excess of 80 million. Since a significant contribution to trade growth comes from new firms entering export markets with new products, an underdeveloped private sector results in a weak supply response to new market opportunities afforded by trade liberalization. Moreover, the role of FDI in tapering the gap has been very insignificant. Therefore, Ethiopia is off to a late start in developing its domestic industrial culture.

- d) **Poor producer services:** Some of the most sought after services needed to accelerate the efficiency of production in the goods sector, such as finance, telecommunications and transport, are relatively inefficient themselves.
- e) **Thick borders:** Ethiopia's trade with its immediate neighbors is comparatively low in good measure because of the poor connections to the regional borders and inadequate border infrastructure; ignoring the special cases of Djibouti (for which trade statistics are distorted by inclusion of goods in transit) and Somalia as well as oil imports from Sudan, Ethiopia's two-way trade with its immediate neighbors in 2008 amounted to US\$118 million, little more than one-fifth the amount that would be expected given the size and proximity of these nations. Moreover, Ethiopia still faces significant tariff barriers in its African trading partners, with a simple average of about 9.54% in the countries that are part of the Tripartite Free Trade Area (TFTA) negotiations.³³

Moreover, the fact that Ethiopia's export commodities have for long been similar agricultural products³⁴ whose demand in world market has been fluctuating, if not declining, constitutes the other facet of the trade deficit problem. The fate of such items in the global market on the advent of Ethiopia's membership to the WTO may not improve because developed countries will be entitled, of course have been accused for doing the same, to invoke safety and technical standards³⁵ which will add on the cost of producers and their competitiveness in the world market. Therefore, the need to work on diversification of export commodities and expansion of finished and semi-finished items is what simple logic dictates us in redressing the problem. Put differently, much of the policy action required to improve Ethiopia's trade performance thus lies in adjusting the monetary policy mix and expanding Ethiopia's industrial supply capacity.³⁶ Yet, in consequence to the fact that the supply-side response will be constrained by, as will be elaborated later, the small size and number of industrial firms in Ethiopia and given the lead times involved in starting up enterprises, a high priority should be given to reforms aimed at facilitating new firm formation, both to take advantage of new opportunities in the domestic market for import replacement as well as to service export markets.

Moreover, resort to FDI as a tool of correcting the supply side economics,³⁷ save challenges it involves, has not been such successful to flow to Ethiopia in complement to the lower domestic saving. Despite

³² Dan Ciuriak and Claudius Preville, *Ethiopia's Trade and Investment: Policy Priorities for the New Government* 6 (2010) (Ethiopian Management Professionals Association (EMPA) Conference: *Management Priorities of the Newly re-elected Ethiopian Government*, Addis Ababa, 25 September 2010).

³³ See Dan Ciuriak, supra note 30, at 17.

³⁴ Coffee has been the single most important export item which alone brings a considerable share of foreign currency for the country since long past. Hides and skins, pulses, oil seeds, vegetables and fruits, beeswax, live animals, flower, and chat constitute the traditional export commodities of Ethiopia.

³⁵ GATT, Art. XX

³⁶ See Dan Ciuriak and Claudius Preville, supra note 32, at 7-12.

³⁷ Stephen Thomsen, *Southeast Asia : The Role of Foreign Direct Investment Policies in Development* 4 (1999) (OECD, Directorate for Financial, Fiscal and Enterprise Affairs Working Papers on International Investment).

(... Indonesia, Malaysia, the Philippines and Thailand (referred to hereinafter as the ASEAN4) — have all to a varying degrees welcomed inward investment for its contribution to exports. As a result, although only a small share of total investment or employment in each economy, FDI has been a key factor driving export-led growth in Southeast Asia. Foreign firms have by no

advancements in reducing the number of procedures required to start a company, the time it takes to establish a company and the minimum capital required, Ethiopia's ranking under the World Bank's Doing Business is still lower (i.e. 127 in 2013) implying the possible lower consideration of Ethiopia by investors in their locational decisions.

Besides, even if very recently, Ethiopia has developed its first industrial park in Dukem with China's support.³⁸ This has been considered as a vital first step in the direction of creating a viable, and dynamic industrial culture in Ethiopia. Combined with further reduction in the cost of establishing new firms, the development of further industrial areas, and facilitation of links between these industrial areas with Ethiopia's institutes of higher learning especially its engineering schools and domestic suppliers would be an important step in reducing the microeconomic barriers to Ethiopia's ability to export successfully.

Some people, implying the need to enhance domestic production and productivity, tended to conclude that "premature trade liberalization has further undermined prospects for the economic development of sub-Saharan Africa as productive capacities in many sectors are not sufficiently competitive to take advantage of any improvements in market access."³⁹

Thus, a clear complementary or even to some extent alternative policy initiative to the sectoral focus of the Growth and Transformation Plan (GTP) (in fact left a year to cease unless extended under a revised version) and action plans to come to the scene in the future would be to target the administrative procedures that serve as bottlenecks to getting new enterprises up and running in Ethiopia. This would allow the market to search out the niches to exploit which in terms of goods production is playing to the strength of the market as a mechanism rather than having government try to "pick winners".

In a way that concludes the foregoing discussion in this section and recommending part of the solution, Terfassa noted that:

... To benefit from expanded market opportunities, Ethiopia should consider the issue of supply side constraints like low level of investment and other factors (high cost of production, low productivity and high freight costs) which are making our local production unable to take advantage of market access, offered by the AGOA, EBA, and [in the future] WTO as well as other initiatives.

The main cause of supply side constraint is the low rate of investment, implying that the trade and investment liberalization made so far are not adequate to attract enough resource, market and efficiency seeking firms.

While the WTO system ensures market access to exporters, only countries having strong competitive firms can reap the benefit of the accession. Poor countries like Ethiopia with weak private sector and few competitive firms will be challenged by widening merchandise trade deficit, (unless minimized through increased export and an appropriate import management strategy) and increased and unsustainable external debt and continuing external sector disequilibrium.⁴⁰

means been the only actors, but they have played a leading role in those sectors with the fastest export growth such as electronics. Through such investment, host economies have rapidly been transformed from agriculture and the exploitation of raw materials into major producers and exporters of manufactured goods.)

³⁸ Xiaochen Fu, *Promoting Manufacturing Foreign Direct Investment from China to Ethiopia* 16 (2012) (unpublished master's thesis, John F. Kennedy School of Government, Harvard University).

³⁹ Jomo Kwame Sundaram, et al., *Globalization and Development in sub-Saharan Africa* (2011) (DESA Working Paper No. 102 ST/ESA/2011/DWP/102).

⁴⁰ See Bulti Terfassa, *supra* note 17, at 291.

Overall, the recommended solutions point to the need to foster investment and diversification of export goods to fix the gap in the export and import sector of the country. But, how!? Having regard to the low level of domestic savings so that the Ethiopian economy remains subsistence, and reliance on the private domestic investment is unlikely to improve performance of the economy, the credit given to FDI in fueling growth in the country has been considerable. Nonetheless, the inflow to and the role of FDI in the transformation of Ethiopia's economy, as splendidly treated in the following section, has been very low and in some respects counterproductive.

4.3 Foreign Direct Investment (FDI) Inflow to Ethiopia

In tracing evidences on foreign investment in modern Ethiopia, one can go as far back as the early 20th century when European governments had obtained interest in the first railway and banking ventures in the country.⁴¹ Foreign investors owned investment worth of USD130 million in 1991 that survived the socialist *Derg* well known to expropriate private property in general and foreign holdings in particular.⁴² Assets under foreign ownership (FDI stock) have been on a constant rise then after to reach USD5.8 billion in 2012.⁴³ The following sub-section, starting with the big picture of FDI in Africa in general, is devoted to the discussion of FDI inflow to the country and its actual and potential implications on the national economy of Ethiopia.

4.3.1 A Historical Perspective on FDI Inflow to Ethiopia

In response to the push from the international economic institutions towards economic liberalization and integration coupled with the limited supply of cash from domestic sources, and perhaps the growing recognition that FDI can play an important role in the economic growth, usually modeled from the exaggerated success stories of the "Asian tigers", low-income countries have increasingly engaged in competition to attract foreign investment. Consequently, the developing world in general and African countries in particular have been in a fierce competition to overwhelm investors to locate their ventures within their territories. Astonishingly, in 2012, the developing world managed to receive 52.03% of the global inflow which was much lower than one-fifth of world inflow in 2000.⁴⁴ A new high of USD 759 billion, more than half of global FDI, was also received by the developing world in 2013.⁴⁵

In the same fashion, African countries have been liberalizing the environment for and incentivizing foreign investment. Nearly all countries on the continent have been revising their laws governing FDI and lifted limitations on the movement of capital since 1990s.⁴⁶ To the dismay of such efforts, however, data proceedings on the trend of capital flows manifestly depict the fact that the share of Africa in capital inflows has been very minimal except the figure has been rising in absolute and relative terms in the last two decades. Since 1970, FDI inflows to Africa ranged between USD400 million in 1980 and USD 58,894 million in 2008.⁴⁷ The share of Africa in the annual global FDI inflow has been on the rise over these years. It was 0.74% in 1980 to reach 1.5% in 1995, 3.24% in 2008 and 3.7% in 2012.⁴⁸

⁴¹ The British owned Bank of Cairo had shareholding in the Bank of Abyssinia, the first modern banking company in the history of Ethiopia. And the French government shared interest in the railway company.

⁴² UNCTAD, <http://unctadstat.unctad.org/TableViewer/tableView.aspx?ReportId=89> (last visited on 27 March 2014).

⁴³ Id.

⁴⁴ UNCTAD, <http://unctadstat.unctad.org/TableViewer/tableView.aspx?ReportId=88> (last visited on 27 March 2014).

⁴⁵ Id.

⁴⁶ Moss, Todd J., Ramachandran, Vijaya, and Shah, Manju Kedia, *Is Africa's Skepticism of Foreign Capital Justified? Evidence from East African Firm Survey Data 3* (2004) (Center for Global Development, Working Paper Number 41)

⁴⁷ UNCTAD, <http://unctadstat.unctad.org/TableViewer/tableView.aspx?ReportId=88> (last visited on 27 March 2014).

⁴⁸ Id.

Yet, not only is the share of Africa from the total world FDI inflows negligible, it has been hosting by far a very small amount even out of the total flow to the developing world. Africa managed to attract only 5.36%, 5.05%, 8.81% and 7.11% of FDI poured to the developing world in 1980, 1995, 2008 and 2012 respectively.⁴⁹ The petty performance of Africa in receiving FDI compared to the rest of the developing world implies that countries on the continent lag behind countries in other regions (Asia, Latin America and the Caribbean) with which they compete to influence the location decisions of capitalists from all over the world.

Furthermore, the distribution of FDI within Africa has not been even across the continent. Eastern Africa performed better in 2012 by hosting 26.57% of the FDI that flowed to the continent while Western Africa has kept on the lead by hosting 33.61% in the same year.⁵⁰ FDI that came to Eastern Africa in 2012 corresponds to less than 1% of the global inflow and to less than 2% of the amount flowed to the developing world.⁵¹ The other feature of FDI in Africa has been the sectoral bias to mineral extraction.⁵² Besides, 'South-South' investments like FDI from the BRICS and South East Asia to LDCs, though yet a small proportion of global capital flows, have been new trends of FDI in general and growing source of capital to Africa.⁵³

The performances in terms of FDI attraction at country levels are also of considerable disparity.⁵⁴ Figures for 2012 build upon South Africa's historical prominence as an FDI destination attracting about one-fifth of the entire foreign investment made in the continent, more than double of its closest African rival, Morocco. In that year, FDI flowed to South Africa amounted to USD4.6 billion capitals and created roughly 14,000 jobs.⁵⁵

Over all, the share of FDI Africa has been garnering is insignificant. Although it is admissible that much of the ideological resistance has faded, studies attribute the negligible FDI inflow to Africa and beneficence out of it largely to the combined effects of political and macroeconomic instability, weak infrastructure, corrupt and poor governance, uncertain and restrictive economic policies, inhospitable regulatory environments, disadvantage in human capital, poor and ineffective marketing strategy, intensification of competition for FDI inflows due to globalization of smaller markets, and so forth.⁵⁶

⁴⁹ Id.

⁵⁰ Id.

⁵¹ Id.

⁵² See Moss, Todd J., Ramachandran, Vijaya, and Shah, Manju Kedia, *Supra* Note 46, at 4.

(... Additionally, there has been a long-standing concentration in the extractive sectors, particularly petroleum. Nearly all of the investment going to Angola, Nigeria, Equatorial Guinea, Sudan, and Chad is oil-related, with the bulk of the investment in the former three invested in offshore facilities. In the most recent 5-year period, these five countries accounted for 43.5 percent of Africa's total FDI (roughly matching oil-concentration in previous periods). In addition, much of the foreign investment in Ghana, Zambia, Namibia, Botswana, and South Africa, and more recently Tanzania, has been in large mining projects.)

⁵³ Mlachila, Montfort and Misa Takebe, *FDI from BRICs to LICs: Emerging Growth Driver?* 5 (2011) (International Monetary Fund Working Paper WP/11/178, African Department).

(... LICs have been among the beneficiaries of the surge in FDI from BRICs. FDI flows from BRICs to LICs reached about US\$2.2 billion in 2009, about 2–3 percent of total FDI flows from BRICs. Of this total, Sub-Saharan Africa (SSA) LICs received about USD0.9billion. Among BRICs, China is the biggest contributor to growth of BRICs' FDI to LICs between 2006 and 2009. As a result, on a stock basis, Chinese FDI to LIC has reached US\$13 billion in 2009. The growth of the stock of Chinese FDI is particularly striking; it increased 20-fold in just seven years from 2003 to 2009 (Table 1). In Africa, China is the biggest investor among BRICs.)

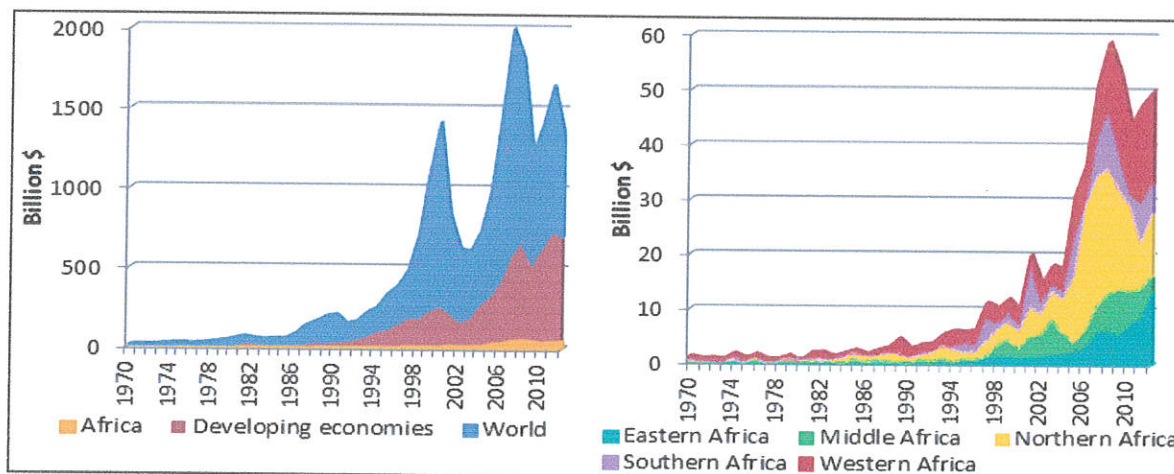
⁵⁴ See Moss, Todd J., Ramachandran, Vijaya, and Shah, Manju Kedia, *Supra* Note 46, at 4.

(... The third trend is strong concentration in a few countries. In the most recent 5-year period[1998-2002], just three countries (South Africa, Angola, and Nigeria) accounted for 55 percent of the total. The top fifth (10 out of 48 countries) account for 80 percent, and the bottom half account for less than 5 percent. This trend has held for at least the last three decades, with the top 10 countries accounting for more than 75 percent of the continent's total FDI inflows.)

⁵⁵ <http://www.fdiintelligence.com/Locations/Middle-East-Africa/African-Countries-of-the-Future-2013-14?ct=true> (last visited on 27 March 2014).

⁵⁶ DAS, DILIP K., *THE ECONOMIC DIMENSIONS OF GLOBALIZATION* 4 (2004).

Figure 1: FDI inflows worldwide, to developing economies and to Africa (1970-2010)⁵⁷



Nonetheless, given the fact that there have been investment-friendly policy transformations, infrastructural improvements, advantages in labour and land cost, cessation of hostilities in a number of African countries, privileged access to markets in the developed world (like AGOA), positive growth forecasts, regional framework for development (the NEPAD), and other pro-investment conditions in the continent, it is reasonable to be optimistic that Africa may garner much more FDI and benefit from it in the mid and long run.

Despite the strident call for it, Ethiopia has not been a good destination of FDI so that a meaningful comparison in terms of FDI inflow may not be made with territories falling within the developing world, and even with sister African countries offering equivalent comparative advantages to investors. Of course, FDI inflow to the country has been on a constant increase though limited in amount. If we consider FDI inflows to the country after 1991, Ethiopia hosted 0.0034% in 1995, 0.072% in 2012 of world inflows while its share out of the FDI that came to Africa was only 0.24% in 1995, 0.19% in 2008, and 2% in 2012.⁵⁸

More specifically, Ethiopia's share of FDI directed to the Eastern Africa⁵⁹ has been very low—only 2.09% in 1995, 1.75% in 2008 and 7.3% in 2012.⁶⁰ In 1995, Ethiopia was the third from the last exceeding only Somalia with FDI USD one million and no FDI in Eritrea while the top three attraction sites—Tanzania, Uganda and Zimbabwe in sum garnered nearly 60% of FDI flowed to the region.⁶¹ In 2008 too, Ethiopia stood at the fifth from the last followed by Kenya, Somalia, Zimbabwe and Eritrea in the order of the level of FDI attraction. In the same year, the four frontrunners in the region, Tanzania, Madagascar, Zambia, and Uganda, in descending order of performance, garnered about 68% of FDI that flowed to the region.⁶² In 2012, more than 73% of FDI inflow to the region was taken by the best four destinations namely Mozambique, Uganda, Tanzania, and Zambia.⁶³ In the same year, Ethiopia, placed on the fifth rank in the region attracting USD970 million which is five folds less than of Mozambique, the best attraction of the year in the region.⁶⁴ With USD

⁵⁷ <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx> (last visited on 27 March 2014).

⁵⁸ UNCTAD (own calculation).

⁵⁹ Based on UNCTAD groupings, the region constitutes the sovereign states of Burundi, Comoros, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Mozambique, Rwanda, Seychelles, Somalia, South Sudan, Uganda, and Tanzania.

⁶⁰ UNCTAD (own calculation).

⁶¹ Id.

⁶² Id.

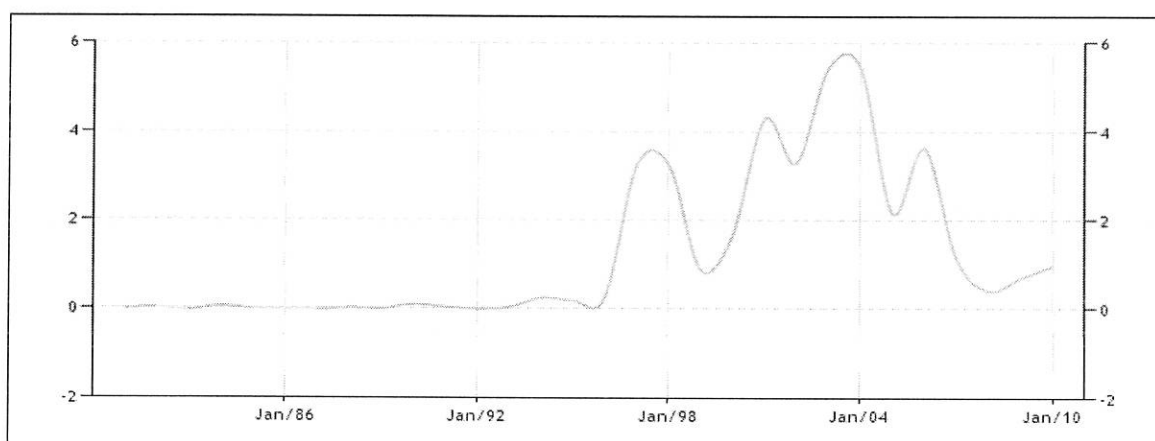
⁶³ Id.

⁶⁴ Id.

one billion inflows, it is reported that Ethiopia was second to South Africa in the amount of FDI inflow on the African continent in 2013.⁶⁵

In concomitance to the noted low level of FDI in Ethiopia, out of the total investment projects licensed in the country between 1992 and 2012, FDI's share was only 24% which corresponds 37% of total invested capital.⁶⁶ Besides, FDI's contribution to the national Gross Domestic Product (GDP) has been considerably low; it was limited only to 2% during the period 2004-2010 while the figure in South East Asia was much bigger.⁶⁷ To the worst, it is noted that "currently FDI is contributing negatively to poverty reduction" in the country.⁶⁸

Figure 2: FDI net inflows (% of GDP) in Ethiopia (1980-2010)⁶⁹



Moreover, the spatial distribution of FDI within Ethiopia is not uniform. For the period 1992-2005, 58.46% of licensed projects with a corresponding investment capital of 35.64% of total FDI flowed to the country were located in Addis Ababa seconded by the Oromia Regional State which hosted 29.12% of the projects expending 28.25% the total foreign capital entered the country.⁷⁰ The trend continued in the time after 2005.⁷¹ When one steers to the agricultural sector, the Oromiya regional state hosted a markedly higher number (59%) of the licensed agricultural projects.⁷²

⁶⁵ <http://www.ethiopiafirst.info/etnews/index.php/component/k2/item/501-fdi-to-ethiopia-second-best-in-africa.html> see also <http://www.mfa.gov.et/news/more.php?newsid=2301> (both last visited on 27 March 2014).

⁶⁶ ETHIOPIAN ECONOMICS ASSOCIATION, REPORT ON THE ETHIOPIAN ECONOMY 196 (2013).

⁶⁷ World Bank, *China FDI in Ethiopia: A World Bank Survey 1* (2012).

⁶⁸ Remla Kedir, *The Impact of FDI on Poverty Reduction in Ethiopia: Co-integrated Approach* 74 (2012) (unpublished master's thesis, Addis Ababa University).

⁶⁹ <http://www.tradingeconomics.com/ethiopia/foreign-direct-investment-net-inflows-bop-us-dollar-wb-data.html> (last visited on 27 March 2014).

⁷⁰ See Solomon Mamo, *Supra* Note 12, at 32-33.

⁷¹ See Remla Kedir, *Supra* Note 68, at 31-32.

(Out of the total 1350 projects (from 1992-2011) 840 of the projects were situated in Addis Ababa. This is because of the regions' better infrastructure, stable political environment and better supply of trained man power. Oromia Region has attracted sizable amount of FDI with respect to the amount of capital invested. That is, of the total FDI operating in Ethiopia during 1992-2011, 36.9% of the capital was invested in Oromia... [during this period] About 4% of the total FDI was invested in the Amhara region.)

⁷² *Id.*

Although the incentive system adopted by the law tends to encourage foreign investment in the least developed regions of the country by providing special benefits,⁷³ their performance in attracting FDI is very poor. Concentration of FDI in Addis Ababa and the surrounding Oromiya zones is perhaps dictated by the relative proximity to the available infrastructural facilities of the country and endowment with the requisite resources (land, transportation, a relatively skilled labour, etc.). Nonetheless, the attraction of the recently hosted commercial agricultural investments to the regional State of Gambella Peoples⁷⁴ and the remote areas of Oromiya is a noticeable change in the trend of distribution of the FDI.

Regarding the sectoral distribution of FDI in the country: namely in the primary sector, the secondary sector, and the tertiary sector, it varied over the years. In contrast to the public assumption based on the key role agriculture plays in the national economy,⁷⁵ the primary sector, the cash crop farming accounting one-half, took only 28% of FDI directed to the country while the secondary and tertiary sectors took 36% each in the period 1992-2005.⁷⁶ In a more extensive survey for the period from 1992 to 2012, Remla Kedir found that manufacturing accounted for 42.9%, agriculture for 26.5%, real estate, machinery and equipment rental and consultancy service together for 13.86% of the total FDI Ethiopia hosted.⁷⁷ Construction contracting including water well drilling constitutes 11.73% while the mining, health and tourism industries are areas that have not received much FDI in the country each holding less than 1% of the total inflow.⁷⁸

From the view point of country of origin of FDI in Ethiopia, China, India, Sudan, Germany, Italy, Turkey, Saudi Arabia, Yemen, the United Kingdom, Israel, Canada and the United States have been the major sources of FDI in Ethiopia.⁷⁹ Yet, FDI from Asian countries has been as important as FDI from Europe and North America.⁸⁰ For instance, Saudi Arabia accounted for half of the total FDI received by Ethiopia during the period 1992-2005.⁸¹ In the 2011/12 fiscal year of Ethiopia, India and Turkey alone contributed a considerable share of the FDI channeled to the country.⁸² India is the leading private sector investor, with over 450 companies investing a total of US\$4.35 billion.⁸³ From horticulture and agriculture, Indian investors are now also diversifying to manufacturing, agro-processing, information technology, and other sectors.⁸⁴

As is evident from Table 3 below, FDI inflow to Ethiopia is on a constant rise throughout the years except a resolute decline in 1999, perhaps in consequence to the war with Eritrea, and in 2008 in response to the global financial crisis. Nonetheless, leave alone Ethiopia to be among the best FDI destinations in the world, as noted above, its performance is not sensibly comparable with performance of sister African countries. So

⁷³ The Regulation in Art.5(2) specifies these territories to be the States of Gambela Peoples, Afar, Somali, Benshangul/Gumuz, and remote zones of Oromia and Southern Nations, Nationalities and Peoples and entitles investors an income tax deduction of 30% for three consecutive years after the expiry of the income tax exemption period specified in the Schedule attached to it.

⁷⁴ Koprucu, Feza, *Ethiopian Land Grab* (2011) (ICE Case Studies, Number 246) (available online at <file:///C:/Users/0wner/Desktop/Ethio-IMF-World%20Bank/Bank-researchs/Ethiopian%20Land%20Grabs.htm>, last visited on 27 March 2014).

⁷⁵ Ethiopia's economy is based on agriculture, which accounts, in 2010/11, for about 41.1% of the gross domestic product (GDP), 90 percent of foreign currency earnings, and 85% of employment. Generally, the overall economic growth of the country has been highly associated with the performance of the agriculture sector.

⁷⁶ See Solomon Mamo, *supra* note 12, at 33-34.

⁷⁷ See Remla Kedir, *supra* note 68, at 33.

⁷⁸ *Id.*

⁷⁹ http://unctad.org/sections/dite/fdistat/docs/wid_cp_et_en.pdf (last visited on 27 March 2014).

⁸⁰ Teshome Adugna, *Structures, Opportunities, and Impacts of FDI in Agriculture Sector in Ethiopia* 14 (2010) (unpublished, Ethiopian Civil Service College).

⁸¹ See Solomon Mamo, *Supra* Note 12, at 34.

⁸² <http://ethiopianbusinessreview.com/index.php/focus/item/117-top-10-fdi-sources-in-ethiopia-in-2011-12> (last visited on 27 March 2014).

⁸³ *Id.*

⁸⁴ -----, *Ethiopia's Grand Renaissance, Sponsored Section-Ethiopia*, 3 (Published in Foreign Affairs) (available online at www.foreignaffairs.com/ethiopia-sponsored-section).

far, its share in the Eastern Africa region is low. Albeit limited in amount, it is undeniable that FD has brought about positive contributions to Ethiopia. *Inter alia*, it has appeared as an additional source of investment capital to the level Ethiopia has managed to attract.

Though limited in parallel to the smaller amount of FDI in Ethiopia, job opportunities have been created to Ethiopians and aliens. Foreign financed agricultural projects licensed between 199 and 2010 alone were expected to create about 962,000 (342,000 permanent and 620,000 temporary) employment opportunities.⁸⁵ More specifically, FDI that flowed to Ethiopia from the top ten sources in the period 8 July 2011-7 July 2012 alone created employment opportunities to 86,348 (21,275 permanent and 65,073 temporary) people.⁸⁶ Yet, the number of employees in foreign financed projects is negligible (ranging between 0.002% in 1995 and 1.471% in 2008)⁸⁷ compared with the total labour force in the country. Out of these jobs, agriculture took the lion's share (64%) followed by the manufacturing sector which accounts for 18%.⁸⁸

The other positive impact of FDI involves its role in bridging the sever gap in technical knowhow in the LDCs like Ethiopia. Even if not automatic, there is little evidence as to East Asian countries⁸⁹ and sub-Saharan Africa⁹⁰ have been benefiting from modern production technologies and managerial expertise FDI brought in. Even if anecdotal, a survey found that technology and management skills transfers are significant in the Chinese owned investments and a more favorable policy support by the Ethiopian government towards Chinese FDI was recommended for better results.⁹¹ Another study also observed signs of spillovers of technological know-how to domestic firms though at an elementary level and recommended, for better beneficence of Ethiopia from FDI through technology transfers, the need to develop competitive domestic firms, boosting the absorptive capacity of existing firms, promote more FDI in the form of joint ventures, and promote linkages between domestic and foreign firms.⁹² Over all, it is apparent from the foregoing discussion that much more has to be done to attract more beneficial FDI and enjoy fruits of exogenous capital as a supplement to domestic investment. More strikingly, FDI Ethiopia has so far garnered also exhibits externalities to the disadvantage of the national economy. In the following lines attempt is made to put some light on the downsides of FDI in Ethiopia.

⁸⁵ See Teshome Adugna, supra note 80, at 16.

⁸⁶ Ethiopian Business Review available at: <http://www.ethiopianbusinessreview.com/index.php/statistics/item/88-top-10-fdi-sources-in-ethiopia-in-2011-12> (last visited on 28 March 2014).

⁸⁷ See Remla Kadir, Supra Note 68, at 36.

⁸⁸ Id. at 37.

⁸⁹ See World Bank, supra note 67, at 1.

⁹⁰ Kaplinsky, Raphael et al., *China and Sub Saharan Africa: Impacts and Challenges of a Growing Relationship* 17.

⁹¹ Alemayehu Geda and Atenafu G.Meskel, *Impact of China-Africa Investment Relations: Case Study of Ethiopia* 24-29 (2009) (African Economic Research Consortium. AERC, Nairobi).

⁹² Yared Lemma, *The Impact of Foreign Direct Investment (FDI) on Technology Transfer* 92 (2011) (unpublished master's thesis, Addis Ababa University).

Table 3: FDI inflow to Ethiopia (1991-2013)⁹³

Year	FDI in USD
1991	6,000,000
1992	170,000
1993	3,500,000
1994	17,210,000
1995	14,140,000
1996	21,930,000
1997	288,490,000
1998	260,670,000
1999	69,980,000
2000	134,640,000
2001	349,400,000
2002	255,000,000
2003	465,000,000
2004	545,100,000
2005	265,111,700
2006	545,257,100
2007	222,000,600
2008	108,537,500
2009	221,459,600
2010	288,271,600
2011	626,509,600
2012	970,000,000
2013	1,000,000,000

4.3.2 FDI Related Problems in Ethiopia

The bold feature of recent FDI in Africa in general and Ethiopia in particular pertains to those in the agricultural sector. The peculiar features consists of the large scale and pace of the deals following the food crisis of the 2008, the shift in focus from cash crops to staples and bio-fuel crops, the shift in parties involved from private-private to government-government deals, and a shift in their orientation from international specialization and trade to protectionism. Ethiopia in particular handed over 1.2 million hectare of most fertile land in the period between 2004 and 2009 to rich governments and individuals to produce and export food for their own people.⁹⁴ The figure rose to 3 million hectare in 2011.⁹⁵ Moreover, the number of foreign financed agricultural projects approved since 2007 reached 815, land being leased for approximately one USD per year for 2.5 acres for up to 99 years.⁹⁶

Nonetheless, the fact that the Ethiopian government was offering large tracks of its most fertile land for the production of food for export while more than 13 million Ethiopians needed food aid would make the investments unyielding to many. The World Bank's report titled "*The Global Land Rush: Can it yield sustainable and equitable benefits?*" found that such FDI in agriculture are "always focused on countries with weak land governance." By making reference to past farmland deals, the report forewarns that no jobs or infrastructure development will be forthcoming. It says that although the investments promised jobs and infrastructure, investors failed to follow through on their investments plans, in some cases after inflicting serious damage on the local resource base.⁹⁷ According to the named report, rarely if ever were efforts made to link land investments to countries' broader development strategy, consultations with local communities were often weak, and conflicts were common, usually over land rights.⁹⁸ There is no clear information as to the case in Ethiopia has been different at any rate.

Moreover, most of the purchases have remained as opaque as ever and are not open to public scrutiny or guided by any sound development targets so that foreign private companies are resisting a global code of conduct that would ensure transparency while local elites continue to benefit from deals that encourage corruption and increase food insecurity.⁹⁹ Employment opportunities created by such FDI are also counterbalanced by land-grab-induced-

⁹³ UNCTAD

⁹⁴ Ogalo, Victor, *Foreign Investment in Agriculture in Eastern Africa: A General Overview of Trends and Issues 7* (2011) (Unpublished).

⁹⁵ Id.

⁹⁶ Koprucu, Feza, *Ethiopian Land Grab* (2011) (ICE Case Studies Number 246) (accessible online at: <file:///C:/Users/Owner/Desktop/Ethio-IMF-World%20Bank/Bank-researchs/Ethiopian%20Land%20Grabs.htm>, (last visited on 27 March 2014).

⁹⁷ Klaus Deininger et al., *The Global Land Rush: Can It Yield Sustainable and Equitable Benefits?* 24 (2011).

⁹⁸ Id. at 131.

⁹⁹ See Ogalo, Victor, supra note 94, at 11.

unemployment and displacement. Leave the socio-political distress induced by the “land rush” to the local communities, the land deals in Gambella in particular end up with ecological destructions and severe economic conditions. So, according to a reporter of the Christian Aid, “the real advantage of these agricultural investments could not be seen and the real danger to the country is that the land is given away for next to nothing”.¹⁰⁰

Even if not in the agricultural sector, the usual examples of success in the line of economic openness and integration, have been promoting export-oriented FDI. It is, therefore, self-evident that not all FDIs are beneficial so that the government of Ethiopia should be considerate of the potential benefits and disadvantages that may flow with foreign investments and concentrate, as directed by the investment proclamation,¹⁰¹ on the encouragement and expansion of investment, especially in the manufacturing sector, hoped to strengthen the domestic production capacity and thereby accelerate the economic growth of the country and improve the living standards of its peoples.

The other FDI-induced threat is the problem of “license hunters”. It is the disparity between the number of licensed projects and the number of projects entered into operation. Even if lately and not yet to the satisfaction of interests of the local people whose lives have been confounded as a result of them, especially the agricultural investments that grabbed lands of citizens, the government of Ethiopia had withdrawn licenses of some of them and reduced landholdings of some others.¹⁰² It is therefore apparent that an effective system of scrutiny at entry and follow-up has to be put in place to identify beneficial investments from the bad ones.

Moreover, crowding out of the immature domestic businesses is the other experienced downside of the FDI in Ethiopia. For instance, although competition from Chinese shoe imports has led to an upgrading of production processes and design in many domestic firms, it has simultaneously had a negative impact on employment and domestic output. A study of 96 micro, small and medium domestic producers reported that in consequence to Chinese competition, 28% were forced into bankruptcy and 32% downsized activity. The average size of micro enterprises fell from 7 to 4.8 employees, and of small and medium-sized enterprises from 41 to 17.¹⁰³ Thus, employment opportunities FDI created have been counterbalanced by FDI-induced unemployment.

Environmental concerns also have surfaced since the time foreign-owned commercial farms started operation.¹⁰⁴ Moreover, the mechanized agricultural investments in different parts of the country have been causing deforestation and ecological destruction.¹⁰⁵ Cases of human rights abuses and poor labour conditions in foreign-financed investments, though should be studied intensively, have been reported.¹⁰⁶

Even if not acceptable at any rate, such problems are usually noted by governments of poor countries because they compromise on these issues very initially and deliberately lax labour and environmental

¹⁰⁰ Land rush.FLV, <https://www.youtube.com/watch?v=3OslqPOOXa4> (last visited on 30 March 2014).

¹⁰¹ Preamble of the Investment Proclamation No. 769/2012.

¹⁰² Capital, http://www.capitalethiopia.com/index.php?option=com_content&view=article&id=4035:investment-agency-revokes-licenses-of-over-1000-companies&catid=54:news&Itemid=27 (last visited on 25 March 2014). See also 2Mercato.com, <http://www.2merkato.com/news/alerts/2792-ethiopia-investment-agency-to-revoke-2497-investment-permits> (last visited on 25 March 2014).

¹⁰³ Tegegne GebreEgziabher, *The Developmental Impact of China and India on Ethiopia with Emphasis on Small Scale Footwear Producers* 17 (2006) (Paper prepared for OECD in the framework of “Development Impact of the economic ascendancy of China and India on other developing countries”).

¹⁰⁴ Felix Horne, *Understanding Land Investment Deals in Africa, Country Report: Ethiopia* 44-49 (2011) (the Oakland Institute).

¹⁰⁵ Id.

¹⁰⁶ Id. at 37 & 47.

standards, and human rights protections under the guise of attracting more FDI. It is also in view of this writer that the government of Ethiopia should reconsider its stance and work on marshaling more rational FDI-pulling-factors like provision of quality education to ensure human development and supply of glamorous workforce, infrastructural development, good governance, property rights protections, reliable and predictable justice machinery, and so forth to convince foreign investors locate their ventures in Ethiopia than assuming onerous terms¹⁰⁷ in FDI deals.

4.3.3 The Legal Framework on FDI

Endorsing the general belief that attracting FDI forms an integral part of a 'proved' development policy mix, to which the success of the emerging economies that are heading to a sustainable economic transformation is often attributed to, Ethiopia looks forward to receiving more FDI. Under the purview of the philosophy of "market oriented economy" of the EPRDF-led government, Ethiopia has been looking forward to receiving as much foreign capital as possible by liberalizing the investment environment and offering incentives and guarantees.¹⁰⁸

To that effect, as noted earlier, even if Ethiopia lacks a separate FDI policy and law, the government promulgated investment law that covers both domestic and foreign investments. The investment code has been the law of the nation subject to frequent revisions¹⁰⁹ the latest version of the law being "Investment Proclamation No. 769/2012" (here after the Proclamation) and "Investment Incentives and Investment Areas Reserved for Domestic Investors Council of Ministers Regulation No.270/2012" (here after the Regulation) meant to give effect to the former.

By virtue of this law, in except areas reserved exclusively for the government of Ethiopia,¹¹⁰ areas in which investment can be made jointly with the government,¹¹¹ and those reserved to domestic investors,¹¹² which a foreigner cannot launch a venture in, FDI has been sought after¹¹³ to supplement domestic endeavors towards the economic growth of the country. Moreover, the government of Ethiopia has established the Ethiopian Investment Agency (EIA) accountable to the Investment Board chaired by the Minister of Industry and responsible, *inter alia*, to promote, coordinate and facilitate foreign investment in the country.¹¹⁴

¹⁰⁷ Elias N. Stebek, Between Land Grabs and Agricultural Investment: Land Rent Contracts With Foreign Investors And Ethiopia's Normative Setting In Focus, MIZAN LAW REVIEW, Vol. 5 No.2. 204-211 (2011).

¹⁰⁸ The proclamation provides incentives in the form of income tax exemptions and deductions in the eligible investment areas (Art.23 of the proclamation *cum.* Art.5 of the regulation), loss carry forward (Art.12 of the regulation), exemption from custom duty except in limited circumstances (Art.13-14 of the regulation), ownership of immovable property (Art.24 of the proclamation), guarantee against expropriation of investment to be effected only if it is justified by a public interest (Art.25 of the proclamation), and free remittance of funds (Art.26 of the proclamation).

¹⁰⁹ The Government of Ethiopia, in recognition of the role of the private sector for the realization of the aspired poverty alleviation and economic transformation, has revised the investment law over four times (Procl. No.15/1992, Procl.No.37/1996 as amended by Procl. No.116/1998, Procl.No.280/2002 and Procl. No.769/2012) in the last twenty years (1992-2012) to make the environment more transparent, attractive and competitive for both domestic and foreign investors.

¹¹⁰ Art.6(1) of the Proclamation

¹¹¹ Art.6(2) of the Proclamation

¹¹² Art.7 and 8 of the Proclamation *cum.* Art.4 of the Regulation

¹¹³ The preamble and Art.5(7) of the Proclamation

¹¹⁴ More specifically, the major activities of and the one-stop shop services the EIA renders to foreign investors can be enumerated as follows:

- promoting the country's investment opportunities and conditions to foreign and domestic investors;
- issuing tax identification number (TIN), investment permits, business licenses and construction permits;
- notarizing memorandum and articles of association and amendment;
- issuing commercial registration certificates and effecting renewal, amendment, replacement or cancellation;
- effecting registration of trade or firm name and amendment, replacement or cancellation;
- issuing work permit, renewal, replacement, suspension or cancellation;

In addition to national moves towards freer capital inflow, Ethiopia also concluded bilateral investment treaties (BITS) with several potential sources of FDI.¹¹⁵ These treaties have the effect of making issues of investment tripartite (triangular) relationships-relationships between the investor and the host economy, the host economy and the home economy, and the investor and the home economy. So, they facilitate the involvement of home economies with investment activities of their nationals (both humans and corporations) to strengthen investment protections by extending its diplomatic hands at different levels of the investment process.

Moreover, Ethiopia committed itself to Double Taxation Avoidance Treaties (DTTs), laws to the parties and believed to have a positive bearing on FDI inflows. In the period from 1996 to 2008 alone, it concluded such agreements with Algeria, Romania, Check Republic, Russia, France, South African, Israel, Tunisia, Italy, Turkey, Kuwait, and Yemen.¹¹⁶ Hence, subject to Art. 9(4) of the FDRE constitution, these treaties form part and particle of the investment regime of Ethiopia. Furthermore, Ethiopia issued labour law, tax law, property law, and others which may have an indirect bearing on FDI.

4.3.4 Challenges and Opportunities for FDI inflow to Ethiopia

A brief elucidation of the factors that hindered FDI inflows to the country in the past and the opportunities that can be harnessed to attract more FDI to the country in the future will be presented in the subsequent sub-sections.

4.3.4.1 Challenges

Even if comprehensive research works on the subject are rare, based on some sector and country specific studies, attempt is made to explore factors that have retarded FDI in Ethiopia. The World Bank investigated, on request of the Ethiopian Government, 69 Chinese enterprises doing business in Ethiopia with a 95 question survey in May/June 2012. The survey covered various aspects of the FDI climate in Ethiopia including infrastructure, sales and supplies, land, crime, competition, finance, human resource, and questions about general opportunities and constraints for doing business in Ethiopia. The study reported that Chinese FDI in Ethiopia has been constrained by several factors including but not limited to poor trade regulations and inefficient customs clearance procedures, the perceived foreign exchange rate risks, inconsistent and inefficient tax administration, inadequately educated workforce (6-7 years education),¹¹⁷ insufficient local access to finance, and bureaucratic administration.¹¹⁸ Included in the list of such constraints are: difficulty to access land and electricity, higher tax rates, corruption, poor transportation facilities, and so forth.¹¹⁹

-
- grading construction contractors;
 - registering technology transfer agreements and export-oriented non-equity-based foreign enterprise collaborations with domestic investors;
 - negotiating and, upon government approval, signing bilateral investment promotion and protection treaties with other countries; and
 - advising the government on policy measures needed to create an attractive investment climate for investors.

¹¹⁵ From 1994 to 2009 Ethiopia concluded BITs with: Algeria, Kuwait, Austria Libya, Belgium and Luxemburg, Malaysia, China, the Netherlands, Denmark Russia, Djibouti, South Africa, Egypt, Spain, Equatorial Guinea, Sudan, Finland, Sweden, France, Switzerland, Germany, Tunisia, India, Turkey, Iran, United Kingdom, Israel, USA, Italy, and Yemen.

See Ethiopian Investment Agency, *An Investment Guide to Ethiopia: Opportunities and Conditions* 35 (2013), (accessed online on 25 March 2014 at http://www.cia.gov.et/english/files/brochures/Investment_Guide.pdf).

¹¹⁶ Id.

¹¹⁷ Education statistics highlight Africa's current disadvantage in human capital. World Bank data place recent literacy rates of young people (ages 15-24) at 45, 75, and 77 percent, respectively, in Ethiopia, Tanzania, and Zambia as opposed to 97 and 99 percent, respectively, in Vietnam and China.

¹¹⁸ See World Bank, *supra* note 67, at 21.

¹¹⁹ Id. at 9.

Another study covering manufacturing FDI from China to Ethiopia, added weak design of Special Economic Zones (SEZ) including the Eastern Industrial Zone in Dukem, low rank in political stability among all African countries, gaps in working culture and low labour productivity to the list of business constraints in Ethiopia, and concurs the problems of corruption and high foreign exchange risks.¹²⁰

Moreover, save its commitment towards trade liberalization, Ethiopia shares the common problem of poor trade logistics in many landlocked African countries which manifest itself in the form of higher inland transport cost, higher port and terminal handling fees,¹²¹ higher customs clearance and technical control fees, higher costs of document preparation and letters of credit, and higher cost of foreign exchange, high shipping costs to and from Ethiopia.¹²² This is a problem in particular to those investors who produce for foreign markets, desperately needed in large number to mobilize the national economy and take advantage of access to international markets, and/or rely on imported inputs.

Besides, based on World Bank's Doing Business rankings, Ethiopia, though on top of some of the BRICS countries, stood 124th among 185 countries in 2013 and 125 in 2014.¹²³ This practically means, Ethiopia is only at this rank in terms of ease of doing business its performance rated against ease of, each involving sub-elements, starting business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency.¹²⁴ It may have a negative implication on Ethiopia from being chosen by foreign investors. In addition, intensity of competition for FDI among countries in the developing world in general and Africa in particular won't be an easy race for Ethiopia to win.

Moreover, since the time Ethiopia started to liberalize its economy, export earnings could not catch up with the fast growing imports resulting in a huge deficit in trade balance to the extent that the export value covers only around one-fifth of imports.¹²⁵ Because a huge trade deficit is considered as a risk factor for a country like Ethiopia, it may discourage FDI while export-oriented FDI can be part of the solution.

4.3.4.2 Opportunities

In spite of constraints noted above in the business environment, Ethiopia still offers various comparative advantages that foreign investors may consider in their location decisions. *Inter alia*, it provides labour cost advantage to labour intensive producers. Although the level of education in Ethiopia in general is at a lower rank and still remains problem-fraught, labour productivity in some well-managed firms producing apparel, leather products, agribusiness, wood products, and metal products in Ethiopia approximates to levels in China and Vietnam while wages in Ethiopia are one-fourth of China's and one-half of Vietnam's.¹²⁶ So, if provided with on-the-job-trainings in the short run and quality education in the long run, the workforce dwelling in Ethiopia can be a considerable opportunity to undertake profitable ventures even in the technology-intensive manufacturing sectors.

¹²⁰ See Xiaochen Fu, *supra* note 38, at 22-26.

¹²¹ YACOB H/MARIAM, OF WHO IS ASAB? ETHIOPIA'S QUEST FOR A PORT 11-12 (2012) (ያዕቆብ ኃ/ማርያም ፣አሰብ የማን ናት? የኢትዮጵያ የባህር ባር ጥያቄ፤ 11-12 (2004 ዓ.ም.) ይመለከታል::).

¹²² *Id.* at 88.

¹²³ World Bank Group, Doing Business, Measuring Business Regulations, <http://www.doingbusiness.org/data/exploreconomies/ethiopia> or <http://www.doingbusiness.org/rankings> (last visited on March 25, 2014)

¹²⁴ WORLD BANK INDEPENDENT EVALUATION GROUP, DOING BUSINESS: AN INDEPENDENT EVALUATION TAKING THE MEASURE OF THE WORLD BANK-IFC DOING BUSINESS INDICATORS 3-10 (2008) (available online at: <http://www.worldbank.org/icg>, last visited on 27 March 2014).

¹²⁵ See Bulti Terfassa, *Supra* Note 17, p.296.

¹²⁶ DINH, HINH T., ET AL., LIGHT MANUFACTURING IN AFRICA: TARGETED POLICIES TO ENHANCE PRIVATE INVESTMENT AND CREATE JOBS 3 (2012) (Africa Development Forum, the World Bank).

Besides, Ethiopia has many natural resources that can provide valuable inputs for light manufacturing industries supplying both domestic and export markets. Abundance of natural resources that supply raw materials such as skins for the footwear industry, hard and soft timber for the furniture industry, and land for the agribusiness industry, cotton for the garments industry; and agricultural land and water resources for agro-processing industries.¹²⁷

Duty-free and quota-free access to U.S. and EU markets under the AGOA, EBA, GSP and the Cotonou Agreement can be another incentive for export-oriented investors time bound, though.¹²⁸ More essentially, Ethiopia's accession to the WTO can also be taken as an assurance for the country's commitment towards economic liberalization and recognition of internationally accepted practices and standards in the regulation of proprietary interests involving a foreign element. Moreover, Ethiopia's memberships to regional strategic partnerships like COMESA, NEPAD and IGAD would formally widen the reach of products from Ethiopia, again in the best interest of manufacturers for export. The fact that Ethiopia is the second populous country in Africa¹²⁹ and fourteenth in the world¹³⁰ resembles the higher potential of the domestic market itself for market-seeking FDI.

The rise in the cost of labour and land, and introduction of stricter compliance standards in the East Asian countries,¹³¹ destinations of considerable FDI to the developing world since 1980s, obviously urge investors to relocate their business establishments to other areas that would avail them a better comparative advantage in that respect. If Ethiopia works purposefully to do away with hindrances to FDI in the past, due to its proximity to Asia and Europe than its competitors in African, the Caribbean and Latin America, it could beat its rivals in some respects and attract more beneficial FDI than ever.

Despite the fact that foreign investors regard Africa in general as a high-risk investment region and Ethiopia in particular is placed at a lower rank in terms of political stability,¹³² the Ethiopian government advocates the political stability of the country as an incentive to foreign investors. The fact that Addis Ababa has been a diplomatic city of Africa being the home of offices of international and Africa-based organizations and embassies may add something positive on the goodwill of the country which in turn may raise confidence of investors.

Hence, it is automatic from the foregoing discussions that Ethiopia has to devise a comprehensive investment policy¹³³ that would properly address the identified challenges and harness the opportunities to ensure an excellent performance in the field of FDI attraction to complement the grand effort towards the aspired economic transformation. Moreover, domestic regulatory and institutional reforms would mean nothing unless corroborated by general image building efforts, supporting of existing investors, diversification of the

¹²⁷ Id.

¹²⁸ Id.

¹²⁹ See ETHIOPIAN ECONOMICS ASSOCIATION, *supra* note 66, at 288.

¹³⁰ Access Capital, *Investing in the "Ethiopian" Stock Market*, 4.

¹³¹ See World Bank, *supra* note 67, at V.

¹³² See Xiaochen Fu, *supra* note 38, at 24.

¹³³ UNCTAD(2005), *World Development Report, 2&6* (... 'A Better Investment Climate for Everyone' addresses the trade-offs between private and social interests: At the heart of the problem lies a basic tension. . . . Most firms complain about taxes, but taxes finance public services that benefit the investment climate and other social goals. Many firms would also prefer to comply with fewer regulations, but sound regulation addresses market failures and can therefore improve the investment climate and protect other social interests

... A good investment climate is not just about generating profits for firms—if that were the goal, the focus could be limited to minimizing costs and risks. A good investment climate improves outcomes for society as a whole. That means that some costs and risks are properly borne by firms.)

economy, trade liberalization, privatization and marketing of investment opportunities in much of which Ethiopia has to exert an unwavering effort.

In a broader trajectory, the task of promoting FDI in Africa in general and Ethiopia in particular is hoped to be more fruitful if countries integrate regionally¹³⁴ because the regional integration widens the market size, facilitates conflict prevention and amicable dispute resolution, deters the incidence of policy reversal, and facilitates regional surveillance mechanism based on peer pressure which in turn will promote good governance. Besides, provision of a more improved and equitable market access in the West to products originating from the developing world is a role the international community has to work on to ensure enhanced flow of FDI to the developing world including Ethiopia. Should these all done, it is possible to remain optimistic that it is not the impossible for Ethiopia to attract more FDI in the mid and long run.

In conclusion, it is noted that freer trade alone won't ensure beneficence of Ethiopia from international trade. To harness the prime advantage of becoming part of the multilateral trading system (the WTO) (i.e. access to international markets), Ethiopia will be required to promote development of competitive firms producing diversified commodities of a competitive quality. So far, noting the low level of national savings, FDI's role in narrowing the gap has been very minimal. More strikingly, FDI has appeared, save the noted benefits to the national economy, to be problematic at the same time. What is then often recommended for the maximization of benefits and reduction of the bad effects of FDI and narrow the widening trade deficit is proliferation of competitive domestic firms. But, the question this work tried to assess is would corporatization be of any meaningful importance for the development of such competitive Ethiopian firms? How?

4.4 Corporatization as a Tool of Coping with Globalization and Accession to the WTO

Per capita income in Ethiopia has been among the lowest in the world despite increase in the last decade.¹³⁵ This in part undermines the rate of gross domestic saving and investment activities of the country. A relatively high rate of gross domestic saving was recorded in 2011/12 at only 16.5% of GDP.¹³⁶ The private sector, which according to the Central Statistical Agency of Ethiopia (CSA) categorization includes endowment fund enterprises and foreign investment,¹³⁷ of the Ethiopian economy has been immature and characterized by low capacity utilization and productivity, small size operators, concentration on very few local resource-based production or light manufacturing, exclusive dependence on imported inputs and orientation towards import substitution despite export promotion by the government.¹³⁸

Even if it is reported that the private sector contributed over 80% of GDP in the last couple of years,¹³⁹ it is the informal and traditional sub-sector that accounted for the lion's share. For instance, the informal agricultural sector accounted for about 40% of GDP in 2008/9 while the informal industry and services sector contributed 12.8% of GDP in the same year.¹⁴⁰ Therefore, the contribution of the modern private sector to the GDP has been very low.

In the last two decades (1992-2012), the number of investment projects owned by the domestic private sector accounted for 75% of the total number of licensed projects but corresponding only 10% of the investment

¹³⁴ DINH, HINH T., ET AL, supra note 126, at 14.

¹³⁵ ETHIOPIAN ECONOMICS ASSOCIATION, supra note 66, at 292.

¹³⁶ Id. at 16-18.

¹³⁷ Id.

¹³⁸ Id. at 174-175.

¹³⁹ Id. at 191.

¹⁴⁰ Id.

capital.¹⁴¹ Therefore, the public sector remained to be the leading investor with 25 public projects that consumed 53% the capital expended seconded by FDI with 783 projects corresponding 37% of total investment capital.¹⁴² To the worst, this low level of domestic private investment by and large dominates in the spearhead sector of the economy, the service sector.¹⁴³ The drastic growth of the services sector to take over the lead from agriculture (contributed 45% of GDP in 2011/12)¹⁴⁴ and wider engagement of the private sector in it has been characterized as unhealthy and a potential challenge to sustainable development of the economy. The macroeconomic imbalance such a trend caused is believed to aggravate the inflation that hit the country.¹⁴⁵

Among a host of factors, the shallow access to finance has been the biggest challenge for the development of the domestic private sector in Ethiopia¹⁴⁶ due in part to the preferential treatments and priority given to public sector projects.¹⁴⁷ Thus, internal financing has been the ultimate source of finance for about 86.3% of domestic investors.

Therefore, should Ethiopia foster sustainable economic growth under the gamut of globalization, it is development of the private sector often recommended by a wide array of literature in the field competitive domestic firms being at its heart. It is understandable that in a liberal system, investment decisions by capital owners are left to the person perhaps as part of the individual's "freedom of action". In light of this, a person or group of persons, subject to the mandatory requirements of the relevant laws, is at liberty to choose the legal form of the business they intend to establish. It is however reasonable to expect such choices to be considerate of the opportunities and risks each legal form involves. But at times when a legal form is preferable for the maximization of national interests and benefits, the governor may tend to promote one form than the rest by offering incentives to investors who intend to invest in that preferred form than others.

To that end, it is argued in this work that incorporation should be better incentivized than other forms of businesses. Nonetheless, it should not be taken to mean the other forms must be prohibited or discouraged. Rather it is in the profound interest and assumption of this author, and of course, expected of the government to work hard to bring about a more favorable business environment than ever to foster development of the private sector. Being focused on the need to promote incorporated businesses than non-incorporated enterprises, this writer reached this conclusion based on the following facts.

Incorporation, as noted in Chapter Three, can, *inter alia*, serve as pool of scant resources to undertake momentous businesses. Having regard to the fact that the severe scarcity of finance has constrained development of the Ethiopian private sector which in turn restrained growth and structural transformation of the economy, corporatization may facilitate accumulation of the available capacity to undertake competitive ventures.

Moreover, given the global trend that recent FDIs took the form of acquisition and mergers (A&M), it is argued that a host country receives a diversified FDI or non-resource seeking FDI only when it has reached a certain minimum level of development.¹⁴⁸ This is because investment decisions are considerate of the costs of doing business and the profit possibilities which are fundamentally determined by the level of development of

¹⁴¹ Id. at 196.

¹⁴² Id.

¹⁴³ Id. at 198.

¹⁴⁴ Id. at 6.

¹⁴⁵ Id. at 184.

¹⁴⁶ Id. at 202.

¹⁴⁷ Id. at 195.

¹⁴⁸ See Solomon Mamo, *supra* note 12, at 42.

the recipient countries. It is true, in LDCs the purchasing power of the people is very low and there is no adequate supply of infrastructure and skilled work force. While FDI can raise the infrastructure and increase the productivity of the labor force of the host country, but it requires a certain minimum level of labor productivity. It can also improve the purchasing power of the people of the host country but it requires a certain minimum level of per capita income. Hence, it has become certain that FDI generally tends to follow, rather than lead, domestic investments so that developing countries need to pay much attention to boosting domestic investment than prioritizing FDI promotion.¹⁴⁹

Hence, it is a must for Ethiopia in the first place to have well founded businesses to attract FDI in the form of A&M and reach a level of development to take advantage of FDI. But it is unlikely to have them very shortly given the low levels per capita income and national savings. Meanwhile, what Ethiopia can do is to put the available material and human capacities to foster development of competitive enterprises in the mid and long run. The possible tool of pooling such resources together and operating meaningful ventures is to promote incorporation.

Development and success of the private sector presupposes entrepreneurial skills manifested in the form of innovation, transformation, ambition, independence, planned and intentional behavior.¹⁵⁰ With respect to enterprises that intend to join the international market, which Ethiopia needs as many as possible to take advantage of economic globalization, it is very crucial and indispensable to take knowledge-based intelligent risks that pave ways for new challenges and opportunities. Nonetheless, such minds have been in short supply in Ethiopia, perhaps worse than the shortage of material resources.¹⁵¹ Hence, the corporate form may serve not only as a means of pooling finance but also skilled personnel. If the required skill and knowledge is not in a sufficient supply within the circle of owners, the nature of corporations allow to buy it from the market. In fact soleproprietors and partnerships could do the same but it is possible to assume that corporations will potentially attract those minds because they can offer better benefits to them than the other forms.

Therefore, the prevalent poverty of the Ethiopian people would not allow a reasonable mind to expect proliferation of financially strong and internationally competitive soleproprietors or partnerships so that to opt to corporatization because it can bridge the scarcity of sufficient capital in individual pockets by pooling resources together to run meaningful ventures that could be of a competitive stand in the integrated global economic order whereby Ethiopia can harness opportunities and defend challenges that integration poses.

Yet, the culture of incorporated business in Ethiopia, as presented below, is at its rudimentary level. Hence, the very important issue that follows revolves around how to marshal incorporation than ever. As is explicit from the reading of the last chapter, the matured systems in corporate business have been utilizing the law, *inter alia*, to mold business behaviors of their people and promote incorporation.

Even if the history and business mentality of the Ethiopian people entirely varies from the said communities, to admit the importance of the law in encouraging incorporation even in Ethiopia coincides with one of the universal purposes of law-to mold social behavior-by mandatorily requiring observance of certain standards or by otherwise incentivizing attraction to that contour. From the view point of the issue at hand, it is very clear that the legal reforms should adopt the second line. So, the discussion on what sort of reforms of the law may contribute for faster proliferation of companies is postponed to a later section in this chapter preceded by a note on the record of corporate Ethiopia.

¹⁴⁹ See Jomo Kwame Sundaram, et al., *supra* note 39, at 29.

¹⁵⁰ Tsige Gebremeskel, *Entrepreneurial Attitude and Business Success*, JBAS. Vol.1, No.1. 70 (2009).

¹⁵¹ *Id.* at 89.

4.5 History of Company Business and Law in Ethiopia

Unlike the case in foreign trade, Ethiopia's experience in company business in its modern legal structure is very brief. For the sake of convenience, attempt is made to assess incidences having a bearing on the development of company business and law in Ethiopia in the pre-*Derg* and post-*Derg* periods. The *Derg* era is used as a line of separation because the socialist government did nothing positive for the advancement of corporate culture rather it smashed out the promising beginnings during the last years of the imperial time.

4.5.1 The pre-*Derg* Period

The first business corporations in Ethiopia came to the scene only by the turn of the 19th century and start of the 20th century. Inspired by modernity of the Europeans, and, of course, based on profound recommendations of his counselors and advocacy of foreign-educated young Ethiopians, the Emperor put down the impetus for modern corporations. The Franco-Ethio Railway Company (1897), the Bank of Abyssinia (1905), and the Society for the Promotion of Agriculture and Trade (1909) were among the oldest modern companies formed in Ethiopia.¹⁵² A notable feature of these corporations was that they were of the nature of their French counterparts¹⁵³ so that they were of almost similar stand with companies operating today under the auspices of the existing company law.

Emperor Haileseelase I also inherited the legacy of modernization of his predecessor. Pertaining to the development of the private enterprises, the Emperor proclaimed the company law and bankruptcy law in 1933.¹⁵⁴ Continuing his inspiration for modernity and prosperity, the Emperor promulgated laws and took other measures having a positive bearing on the development of the private sector. The Commercial Code of the Empire of Ethiopia of 1960, which survived over half a century without being altered was among the prominent projects. The Commercial Code was not meant only to the regulation of company matters for it contains rules on a wide range of issues.¹⁵⁵

Under the Commercial Code of Ethiopia, two models of corporations namely Share Companies, the counterparts of the English public companies, the French *Société anonyme* and the German AG, and Private Limited Companies (PLC), equivalent to the English private companies, the French *Société à responsabilité limitée* and the German GmbHs, are recognized.¹⁵⁶

Art.304 of the Commercial Code defines share Company as a company whose capital is fixed in advance and divided into shares,¹⁵⁷ and whose liabilities are met by its assets. A share company cannot be established with a capital of less than 50,000 birr and with less than five members.¹⁵⁸ A share company can be established among founders or through public participation subject to drawing of a public memorandum, full subscription of the capital and deposit of at least one quarter of the par value of shares in a bank to the account of the company opened in its own name.¹⁵⁹

¹⁵² BAHRU ZEWEDE, A HISTORY OF MODERN ETHIOPIA (1855-1991) 101-103 (2nd ed., 2002).

¹⁵³ FEKADU PETROS GEBREMESKEL, ETHIOPIAN COMPANY LAW 18 (2012).

¹⁵⁴ Id. at 19.

¹⁵⁵ It is only Book II in general and Titles XI, XII, XIII, and IX (i.e. Arts304-560) in particular of the code that deals with company matters. The rest are devoted to the treatment of other issues.

¹⁵⁶ Commercial Code, Arts.212(1)(e & f) *cum.* Arts.304 & 510.

¹⁵⁷ Id. Arts.325-346.

¹⁵⁸ Id. Art.306 *cum.*307.

¹⁵⁹ Id. Arts.313, 316, & 317.

Governance and management of a share company is carried out by a board of directors composed of 3-12 shareholders appointed by a general meeting of the company¹⁶⁰ and shareholders' meetings. Subject to their own procedures, rules of majority and quorum, three kinds of shareholders' meetings namely ordinary meetings, extraordinary meeting, and special meeting are recognized by the law. The central difference in these meetings lie on the business each is destined to deal with.¹⁶¹ Appointment of one or more auditors is also required in all share companies.¹⁶² Share companies are empowered to issue additional shares and debentures to raise more capital to widen their business.¹⁶³

A private limited company (PLC) on its part is a company which a group of persons between 2 and 50 can establish by bringing contributions worth of not less than 15,000 Birr to undertake any venture other than in the banking, insurance and similar businesses.¹⁶⁴ The principal distinctive feature of a PLC is, unlike a share company, its inability to issue transferable securities like shares and debentures.¹⁶⁵

Management of PLCs is entrusted to one or more managers appointed by members, memorandum or articles of association for such a period considered desirable so that a board structure is missing in such companies. Meetings of members are not required all the time. Only in PLCs with more than twenty members is required holding a general meeting annually.¹⁶⁶ Moreover, appointment of three or more auditors is required only in PLCs with twenty or more members.¹⁶⁷

In so far as the statistics of registered companies in Ethiopia, it was made possible to have only nine public companies involved in trading and investment activities in the time between 1956 and 1963.¹⁶⁸ The other remarkable achievement of the time was emergence of a well functioning stock market in Addis Ababa.¹⁶⁹ By the end of the imperial regime, there were companies with more than six thousand shareholders.¹⁷⁰

The time that followed the downfall of the imperial regime was hostile to the private sector. The socialist government of President Mengistu initially smashed out the promisingly progressing private sector. It nationalized all private business enterprises, outlawed incorporation of companies and limited private property. Hence, the time from 1974 to the last years of the *Derg*, despite it issued a policy of mixed economy lately and thereby showed, at least in theory, a smoothening stance towards the private sector, can be considered as the historical period that sterilized the seeds of corporate business implanted in the pre-*Derg* time.

4.5.2 The Post-*Derg* Period

The EPRDF-led government that overthrew the military dictatorship in May 1991 pronounced its orientation of market-oriented liberal economy at the very initial point by leaving its leftist temptation while it was in the field out of the public parlance. It then declared its credence in the role of the private sector for economic transformation of the country. By giving the right to private property a constitutional basis, it adopted policies and strategies to enhance performance of the private sector. Despite, it adopted a separate law governing

¹⁶⁰ Id. Arts.347-367.

¹⁶¹ Id. Arts.417-428.

¹⁶² Id. Art.368-387.

¹⁶³ Id. Arts.429 and the following.

¹⁶⁴ Id. Arts.510-513.

¹⁶⁵ Id. Arts.510(3) *cum.* 522 & 523.

¹⁶⁶ Id. Arts.525(2) *cum.* 532.

¹⁶⁷ Id. Art.538.

¹⁶⁸ *See* FEKADU PETROS GEBREMESKEL, *supra* note 152, at 19.

¹⁶⁹ Id.

¹⁷⁰ Id.

companies operating in banking and insurance businesses, the regime still in power failed to reform the general company law of the country and establish institutional amenities that would support corporatization.

Nonetheless, in spite of the pro-private sector standpoint of the existing government, the private sector has been getting out of the shield only slowly. In the first two years of the EPRDF government, 125 companies (i.e. 119 private limited companies and 6 share companies) were incorporated.¹⁷¹ The figure showed improvement in the subsequent years yet insignificant, though.

Most of the smallest Ethiopian businesses are not organized as companies but as sole proprietorships,¹⁷² so that the general business environment in Ethiopia can be uttered to be inspired by the “kiosk mentality”. Incorporation since 2000 has been at a relatively higher rate but in the face of government reluctance to reform laws and form institutional setups which could support proliferation of companies. A bold feature of corporate Ethiopia is that private limited companies account for nearly all of the total number of corporations. Among companies incorporated in Ethiopia till the end of 2008, the number of PLCs accounted for 96% (9504) while the number of share companies was limited only to 4% (393) of the total companies.¹⁷³ Fekadu also noted the imbalance in the number of share companies and PLCs (share companies accounted for only 1.4% while PLCs accounted for 98.6%) in his survey of companies registered in the period 2003-2009.¹⁷⁴ Even if not as such exaggerated, the number of private companies considerably exceeds the number of public companies almost in all jurisdictions across the world.¹⁷⁵

The total number of share companies in all sectors of the economy reached 508, PLCs 13, 687; partnerships 539, joint ventures 27 and public enterprises 202 in 2010.¹⁷⁶ At this point in time, share companies represent only 3.6% of all registered companies in the country meaning PLCs account for the remaining lion share. The fact on the ground reveals that there has not been such a fundamental change in the trend of incorporation then after. These numbers are very insignificant in the country of where its people are in excess of 80 million by projection. Hence, the need to exhaust the room for possible development of incorporation is what follows from diagnosing the problem. In the following few paragraphs attempt is made to explore the possible significance of the law in that respect.

4.6 Some Desirable Legal and Institutional Reforms to Promote Company Business in Ethiopia

Over all, the current state of the private sector in general and corporate business in particular is very limited to energize the aspired economic growth and prosperity in Ethiopia. Besides, the underdeveloped private sector would down size beneficence of the country from the widespread economic globalization. Hence, for the development of business corporations in Ethiopia so that they constitute the majority of significant enterprises in the private sector, as it is the case in the capitalist world, pragmatic measures have to be undertaken.

In fact, as noted earlier, the underdevelopment of the culture of incorporation in Ethiopia may be attributed to a host of factors so that the solutions to foster rapid corporatization may be forwarded by different disciplines across the board. Looking forward to read such other contributions from the respective

¹⁷¹ Fekadu Petros Gebremeskel, *Emerging Separation of Ownership and Control in Ethiopian Share Companies: Legal and Policy Implications*, MIZÂN LAW REVIEW Vol. 4 No.1. 13 (2010).

¹⁷² Hamilton, Booz Allen, *Ethiopia Commercial Law & Institutional Reform and Trade Diagnostic* 19 (2007) (United States Agency For International Development).

¹⁷³ Nigusie Tadesse, *Major Problems Associated with Private Limited Companies: the Law and the Practice* 94 (2009) (unpublished master's thesis, Addis Ababa University).

¹⁷⁴ See Fekadu Petros Gebremeskel, supra note 170, at 14.

¹⁷⁵ See Chapter Three of this thesis.

¹⁷⁶ Berhane G/Mariam, *The Law of Corporate Taxation in Ethiopia* 30 (2010) (unpublished master's thesis, Addis Ababa University).

disciplines, this writer will be restricted in this section to put a flash light on what changes of the law can help in that respect. Here in below, some normative and institutional reforms the need of which, in view of this author, are boldly visible and of tremendous impact on development of corporate business are dealt with.

4.6.1 Company Law Reform

The issue of company law reform has been advocated for by different stakeholders. From the academia, Fekadu Petros noted the desperately needed modification of the law could be an engine for the rapid proliferation of domestic corporations in a pace much faster than happening today.¹⁷⁷ The need to reform Ethiopia's company law has also been admitted by the concerned public authorities too. Even if no one can tell for sure what changes it will come up with because it is yet to come, the project of revising the Commercial Code inclusive of the law governing company matters has been underway by a committee constituted by the Ministry of Justice. Even if the committee has had a working draft since 2005 hoped to become a law in 2007, it still remains a mere draft.¹⁷⁸

Moreover, should Art.10(1)(b) of the investment proclamation which provides investment including FDI may take the form of a "business organization incorporated in Ethiopia" have a practical significance, it is automatic that the general company law of the country should be up to the accepted standards and practices of the advanced world. Put differently, it would be awkward to expect foreigners especially from jurisdictions where company laws constantly strive to warrant utmost satisfaction of the capitalists to incorporate their business in Ethiopia, a country where the relevant law has not been substantially altered for over half a century. Nonetheless, sophistication of the law to serve expectations of potential foreign investors may make it unfit for the domestic business environment, which was the case in all modern laws accruing from the 1960s codification project, so that due attention must be paid to make the new law, to the extent possible, be considerate of both domestic and foreign stakes.

In so far as the question of what changes should be made to the existing company law to encourage incorporation, a consensus seems to have been reached on the extent of the change that it is not expected to bring about wholesome variation of the old law. Rather to update certain rules that lag behind the accepted norms in the developed world and inclusion of certain new issues left out in the old law, and ensure the overall system promotes incorporation. Booz Alen Hamilton, who as a matter of principle admitted adequacy of the existing law, recommended in a work meant to explore the desirable commercial law and institutional reforms, and trade diagnostics in Ethiopia the need to update the existing company law.¹⁷⁹ So, in this section we will be restricted to pin point some of the badly needed changes the new law should be considerate of. For the sake of precision, it is possible to categorize the advocated changes in to the ones concerning share companies, private limited companies, and corporate governance and investor protections. In the following lines, attempt is made to put light on the desirable changes in line with this outline.

4.6.1.1 Concerning Share Companies

To prepare share companies for future public ownership and to conform to modern share company law in other countries, the need to at least update certain provisions of the existing law is involuntary. The *first* and low-hanging change pertains to company models. In fact, as noted in Chapter Three, the known legal forms of companies within the didactics of "limited liability" are devised to respond to the needs of investors and encourage incorporation. Even if any of the company forms recognized in the company law of Ethiopia were

¹⁷⁷ See FEKADU PETROS GEBREMESKEL Supra Note 152, at 19.

¹⁷⁸ See Hamilton, Booz Allen, supra note 171, at 4.

¹⁷⁹ Id. at 19.

alien because they were brought together with the law, to date inclusion of new models of companies has become a very clear point to consider in the efforts of revising the relevant law. If need be, it is possible to consider the French *Société par Actions Simplifiée* (SAS), a new legal form of corporations meant to facilitating joint venture among two or more company-shareholders¹⁸⁰ and unlimited companies, companies limited by guarantee, and public interest companies recognized under the English Company Act.¹⁸¹ If not, as should be with PLCs, “to allow one-member share company and make clear that a company may have any number of wholly-owned subsidiaries”, thus revising Art.307, is a must to conform modern share company laws.¹⁸²

In advocating a single-member share company, this author has had in mind, as envisaged in the investment proclamation,¹⁸³ the possibility of incorporation of productive investment companies by an individual, a foreigner or an Ethiopian, who can meet the minimum capital requirement and intend to take advantage of limited liability and other incentives. Hence, to widen the *carte du jour* of corporations will help accommodate preferences of capitalists so that they can invest their assets on productive ventures in the form they wish. Even if observable, it should be underlined however that comprehensive rules governing the particulars of the new legal form, which this writer does not intend to encompass in this work, must be brought together.

Nonetheless, the Draft Revised Version of the 1960 Commercial Code of Ethiopia retains the requirement of a minimum of five members for establishment of a share company¹⁸⁴ and envisaged the establishment of a single-member PLC¹⁸⁵ so that if it gets force as it appears today, there will be no change with respect to share company models. Yet, there is a possibility of reconsidering the issue and inculcate a new form of company in the country. Even if the government turns deaf ears to the issue in the upcoming law but possibly constraining incorporation of businesses merely due to its absence, it will continue to be a point in whose respect a reform is in the vanguard.

The *second* issue which should be considered for update has a bearing on the issue of minimum capital. Once again the international experience gravitates to the abolition of a requirement of minimum capital.¹⁸⁶ The Draft Revised Version of the 1960 Commercial Code of Ethiopia also maintains the minimum capital requirement contained in the existing law i.e. 50,000 Ethiopian Birr.¹⁸⁷ The business community and a team of experts has made clear that, in proportion to changes in the economy, the minimum capital of a share company should be increased to an amount between Birr 400,000 and 500,000.¹⁸⁸ To the contrary, the need to consider eliminating or reducing the requirement of minimum capital was also recommended by another commentator of the field.¹⁸⁹ But, having regard to the need of soliciting huge capitals to undertake ventures that would bring about a meaningful progress to the Ethiopian economy in terms of marshaling its export performance and excelling beneficence form FDI, this author supports the introduction of a higher minimum capital.

¹⁸⁰ Centre for Law and Business, Faculty of Law, University of Manchester, *Company Law in Europe: Recent Developments, A Survey of Recent Developments in Core Principles of Companies Regulation in Selected National Systems* 22 (1999).

¹⁸¹ UK Company Act, §§3 & 6.

¹⁸² A single member company has become a common platform across the “origin” legal systems of modern corporate law and beyond. See in UK Company Act of 2006 §7(1), German Company Act of 1994, and Delaware General Corporation Law, §101

¹⁸³ Investment Proclamation No.769/2012, Art.10(1)(b).

¹⁸⁴ Draft Revised Version of the 1960 Commercial Code of Ethiopia, Art.307(1).

¹⁸⁵ Id. Art.510(2).

¹⁸⁶ See Hamilton, Booz Allen, supra note 171, at 22.

¹⁸⁷ Draft Revised Version of the 1960 Commercial Code of Ethiopia, Art.306(1).

¹⁸⁸ Addis Ababa Chamber of Commerce and Sectoral Association (AACCSA), *Recommendations and Position Paper of the Business Community on the Revision of the Commercial Code of Ethiopia* 24 (unpublished, 2008).

¹⁸⁹ See Hamilton, Booz Allen, supra note 171, at 22.

The *third* issue for consideration in the revision of the company law revolves around company governance. To that end it is possible to prescribe detailed governance rules in a separate “corporate governance code”,¹⁹⁰ which would conform to the trend in international practices, or, if Ethiopia sticks on the approach adopted in the existing law, to elaborate the present rules. To do so is believed to promote the trust of international and national investors, customers, employees and the general public in the management and supervision of stock corporations. To ensure such higher public confidence in corporate governance may encourage incorporation of several broad based companies.¹⁹¹

Because the separation between ownership and control of public companies is growing in Ethiopia,¹⁹² the need to be cautious to avoid shareholders’ exploitation by corporate managers and/or block-holders has become explicit. To re-design the law, of course having the purpose of protecting shareholder interests in view and create conducive environment for incorporation to undertake productive ventures is mandatory. Structurally, a two-tire board has been recommended in several jurisdictions.¹⁹³ Nonetheless, given the present low intensity of affairs and the elementary level of corporate Ethiopia, and divergence to a one-tire board as a result of frequent cooperation and open discussions between the two boards in dual board systems, it may not be a necessity to indoctrinate a dual board structure instantaneously. At any rate, to ensure a responsible and transparent governance system of companies remains a virtue any system should constantly aspire to instill.

One perspective of ensuring good corporate governance involves ensuring effective control by owners of company matters. Since shareholders control company matters via shareholder meetings, adding more details to the rules for convening, conducting, and voting at such meetings to make them transparent and participatory is very crucial. This demands to make the rules for notice to shareholders, setting the agenda, proxies, quorum requirements, postal vote and secret ballots in some cases (e.g., election of directors, vote counting), etc more pragmatic and flexible. International experience has shown that these seemingly minor details can be essential to protect the integrity of shareholder control.¹⁹⁴

The other perspective of ensuring good corporate governance involves clarification of the role and responsibility of a company’s board of directors which may add on assurance to shareholders as to protection of their investments. To that end, changing the law (Art.350) to provide that directors are to be elected at each annual shareholder meeting (i.e. reduction of their term of office to 1 year, save the first directors, as is the case with auditors although there should be no limit on how many times a director can be reelected) providing clear rules to ensure the continued existence of the enterprise and its sustainable creation of value are in place,¹⁹⁵ enabling a portion of shareholders to remove a director without having to prove cause or provide special compensation, thus revising Art. 354, is desirable.

To improve corporate governance and investor protection, further clarification of the duties of care and loyalty which directors, and perhaps managers in the present setting, have to their company, including their duty when they have a personal conflict of interest (thus revising Arts. 356, 357 and 364 among others) is due. To the least, the concept of “personal interest” should be defined to cover family relationships and rules

¹⁹⁰ While countries in the EU (the UK, Netherlands, France, Germany, Italy, Spain Switzerland, etc.) have adopted the style of crafting a separate governance code, the United States has had an unusual feature in an increasingly important area of corporate governance: it is almost alone among significant markets in having no single, authoritative national code of corporate governance serving as a generally-accepted benchmark of practices.

¹⁹¹ See the preamble of German Corporate Governance Code.

¹⁹² See Fekadu Petros Gebremariam, *supra* note 170, at 28.

¹⁹³ See paragraphs three and seven of the German Corporate Governance Code.

¹⁹⁴ See Hamilton, Booz Allen, *supra* note 171, at 23.

¹⁹⁵ See paragraph two of the Preamble of the German Corporate Governance Code.

for authorization of any contracts or transactions between a company and a director or any other person in control of the company and his/her relatives by “disinterested” directors should be added. These correspond to current international precedents and hoped to add on confidence of current and potential investors.

To expand the current rules in Art.365 for lawsuits against directors who breach their duties to shareholders to include managers and other persons in control of a company of either form is also desirable. Such suits are a weapon of last resort, but, as the current law recognizes, investors must be able to go to court if necessary.

Moreover, to provide shareholders and members access to company financial records may enhance actual influence of owners in company matters and confidence in directors and managers. These can also be expanded following international precedents. However, to require in the new company law that all companies over a certain size prepare independently audited financial statements, even at times other than required by a resolution of a general meeting or order of court,¹⁹⁶ at least annually may improve company’s determination to professionalism, transparency, and creditworthiness.

Besides, to come up with detailed and flexible procedures for mergers, scission, conversions of a company from one form to another, and a procedure for dissenting shareholders to opt out of a merger and receive payment of the fair value of their shares, which in some cases can be determined in a court appraisal proceeding. The draft law commendably recognized the concept of scission in addition to merger and conversion and made conversion possible from one form to the other. But, such necessary rules¹⁹⁷ have to be crafted to regulate such company matters.

In the *fourth* place, it is good to consider new rules to give a company more freedom and flexibility in declaring dividends and in buying back its own stock while at the same time placing detailed restrictions on execution of such affairs to protect creditors. To add provisions to the effect that dividends and buybacks are strictly prohibited whenever they would render the company insolvent or unable to service debt or whenever they invade capital requirements if that concept is retained, directors or managers who cause a company to pay prohibited dividends, and shareholders or members who accept them knowing they are prohibited, should be personally liable to return the amounts illegally received are among the foreseeable changes to be made in the new law.¹⁹⁸

And *fifthly*, to state in more detail the rules for stock will be a step forward to the development of a securities market. For example, to state that every share has one vote which promotes transparency and investor control thus revising Art.408 is decisive. Moreover, to state that any company may also have preferred stock with preference over common stock for dividends and/or liquidation distributions, but that all of the specific rights of preferred stock must be stated in the company’s publicly filed Memorandum of Association. Moreover, to allow companies to adopt such flexible strategies on conversion of shares from one form to the other¹⁹⁹ may be favorable to attract more investors.

4.6.1.2 Concerning Private Limited Companies (PLC)

To best serve the needs of closely held businesses, both large and small, and to conform to modern law in other countries, changes in the law governing PLCs is also unavoidable. *First*, as is advised with respect to share companies, the law (Article 510) should be altered to allow single-member PLCs and make clear that a PLC may have any number of wholly-owned subsidiaries. To allow a single member PLC, *inter alia*, would

¹⁹⁶ Commercial Code, Art.382.

¹⁹⁷ See for example the rules contained in Article L225-244 and Article L225-245 of the French Commercial Code.

¹⁹⁸ See for comparison §160 of Delaware General Corporate Law.

¹⁹⁹ See for some insight on conversion of shares, Article L228 of the French Commercial Code.

correspond to the practical inclination towards it,²⁰⁰ and prevent dissolution of PLCs for want of two members at times when dead lock is reached between two members owning 50% each. The draft of the Ministry of Justice, of course, has recognized a single-member PLC,²⁰¹ but yet has to envisage rules on related issues like expulsion and scission to make the reform more meaningful.

Second, even if inconsistent voices are heard (i.e. elimination or reduction of the minimum capital requirement²⁰² on the one hand and its increment²⁰³ on the other), this writer's stand concurs with the view that "the need to increase the minimum capital cannot be overstated" for the reasons mentioned with respect to the case in share companies.

To retain flexibility in that a PLC may structure its governance as it wishes (e.g. it could give all members equal management authority, or it could name certain persons as managers, or it could create an elected management body similar to a board of directors) may be favorable to potential investors. Yet, there seems a need to introduce a board structure in PLCs above a certain level of capital and/or members.

Moreover, to retain more flexibility in other wide range of issues like share of votes, profits, restrictions on sale of shares may be in the interest of investors. Hence, the law should be updated to the effect that members, by agreement, are allowed to decide on such issues in their articles of association. The intervention of the law will be material only when agreements cannot be reached.

Besides, formulation of a means of protecting minority shareholders and requirement of auditors in all cases are also issues for consideration in the revision of the existing law of PLCs.

4.6.2 Tax and Investment Incentives

As noted above, in a system where protection of private property rights are given a constitutional guarantee, what the government can do to influence the choice of the legal form of businesses investors may yearn to establish is to provide more incentives and support to establishments it tends to promote for some reasons. This approach stems from the assumption that businesses are primarily meant to maximize profit, *inter alia*, by reducing costs of doing business. In line with this argument, investors will prefer the legal form which would avail them incentives and support from the government. The incentives may take different forms.

Pertaining to the issue at hand, the government of Ethiopia should incentivize incorporation than the other forms for the noted reason that it may be a response to business challenges and opportunities economic globalization has been blowing. The incentives this section is intended to deal with are tax and investment incentives.

The income of a company is essentially derived from business activities or activities recognized as trade in which it is engaged, is susceptible to income tax. As a matter of principle, a company is legally required to report its profits to its shareholders, creditors, the Ministry of Trade and Industry, and perhaps to the tax authority on demand for tax valuation purposes at the end of each fiscal year.²⁰⁴ These properly reported profits constitute the income of the company.

²⁰⁰ Nigusie Tadesse, *supra* note 172, at 76.

²⁰¹ Draft Revised Version of the 1960 Commercial Code of Ethiopia, Art.510(2).

²⁰² See Hamilton, Booz Allen, *supra* note 171, at 22-23.

²⁰³ See Addis Ababa Chamber of Commerce and Sectoral Association (AACCSA), *supra* note 187, at 35.

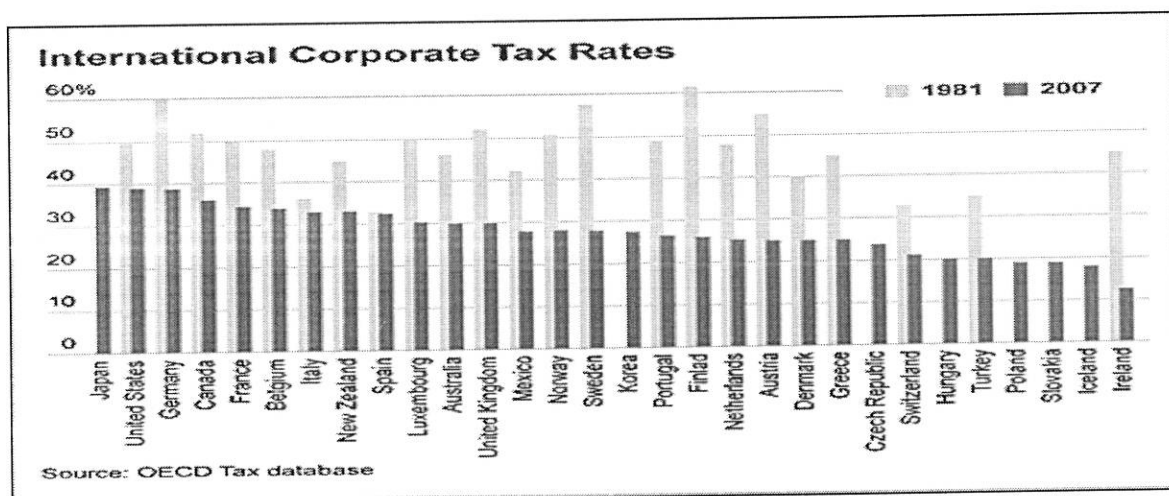
²⁰⁴ Commercial Code, Art.446-461.

In the contemporary Ethiopia, to levy and collect taxes on the profits of companies and on dividends paid to shareholders is a concurrent power of the federal and state government.²⁰⁵ Nonetheless, neither the current Income Tax Proclamation nor the Income Tax Regulation provides separate definitions for corporate income or corporate income tax. But, in line with the definition given to income and taxable income,²⁰⁶ it is possible to take corporate income tax to mean a tax imposed on the profits of a company earned during a tax year.

For the sake of comparison, it is possible to consider corporate tax rates across the world. According to available data on corporate rates of the world, countries have been reducing corporate tax rates over time. In the last decade or so, there has been a big shift in marginal tax rates.²⁰⁷ Most countries dropped their highest corporate tax rate over that period, and some of the biggest top tax bracket reductions were seen in Germany-which went from 52.3% in 1999 to 29.5% in 2012; Iran-which went from 54% in 1999 to 25% in 2009 (the latest data available); and Kuwait, which went from 55% down to 15%.²⁰⁸

The highest marginal tax rates in 2012 were found in the United Arab Emirates at 55%, the United States at 40%, Japan at 38.01%, and Angola, Argentina, Honduras, Malta, Pakistan, Sudan and Zambia-all tied at 35%.²⁰⁹ The lowest corporate tax rates of the year were seen, unsurprisingly, in those countries known as “offshore corporate tax havens” including the Cayman Islands, Bermuda, the Bahamas, Guernsey, the Isle of Man and Vanuatu along with Bahrain at top marginal corporate tax rate of 0%.²¹⁰ In the European Union, the lowest corporate tax rates were to be found in Bulgaria at 10%, Ireland at 12.5%, Latvia and Lithuania at 15%, and Romania 16% in 2012 while the highest is Belgium's, at nearly 34%.²¹¹

Figure 3: Corporate Tax Rates across the World²¹²



²⁰⁵ FDRE Constitution, Art.98(2).

²⁰⁶ Income Tax Procl. No.286/2002, Art.2(10&11).

²⁰⁷ http://www.google.com.et/imgres?imgurl=http://www.usnews.com/dbimages/master/6339/GR_PR_080815_Tax2.png&imgrefurl=http://www.eurotrib.com/story/2010/4/17/104924/076&h=366&w=496&tbid=C9BsWFH8J6YQ0M:&zoom=1&docid=KESiLClCz6ntjM&ei=MIHxzU92lMeqhyQOwqYDQDw&tbm=isch (last visited on 30 March 2014).

²⁰⁸ Global Finance, available at: <http://www.gfmag.com/component/content/article/119-economic-data/12526-corporate-tax-by-country.html#axzz31hNMftIQ> (last visited on 30 March 2014).

²⁰⁹ Id.

²¹⁰ Id.

²¹¹ Id.

²¹² http://www.google.com.et/imgres?imgurl=http://www.usnews.com/dbimages/master/6339/GR_PR_080815_Tax2.png&imgrefurl=http://www.eurotrib.com/story/2010/4/17/104924/076&h=366&w=496&tbid=C9BsWFH8J6YQ0M:&zoom=1&docid=KESiLClCz6ntjM&ei=MIHxzU92lMeqhyQOwqYDQDw&tbm=isch (last visited on 30 March 2014).

Leave the case of the “corporate tax havens” aside, because it hurts the tax revenue of countries like Ethiopia, corporate tax rates in the world range between Ireland’s 12.5% and United Arab Emirates’ 55% for 2012. In Ethiopia, the determined taxable corporate income is taxed at a flat rate 30% corporate tax.²¹³ By way of comparison, the current tax rate on companies is a bit lesser than the rates provided in tax laws enacted during the Socialist Regime but it is 200% higher than the rates provided during the Imperial era.²¹⁴ From the view point of international experiences, Ethiopia’s 30% flat rate is closer to the class of maximum rates and much higher than Africa’s (28.57% in 201 and 27.85% in 2014) and global averages (24.08% in 2013 and 23.48% in 2014).²¹⁵ Hence, the room to reduce the tax rate is wider.

Not only is the income of the corporation subject to taxation, dividends due by shareholders are also subject to a different class of tax and rate. The tax rate applicable to dividends paid by share companies and withdrawals of profits from a private limited company is the same, a 10% flat rate.²¹⁶

In Ethiopia, the total number of companies in all sectors of the economy is negligible²¹⁷ if one compares the number of companies in Ethiopia with the number of companies in the United States where there are more than 18 million companies and the United Kingdom 1.5 million companies. So, it will be legitimate to ask what is wrong in Ethiopia. Could it be because the tax law failed to do its job in encouraging corporate business? Berhane found the answer to be in the positive and opined as:

.... Yes, it could be one, and probably the primary one. One of the functions of tax law is leading the flow of resources in a certain manner by providing, for example, clear and specific incentives. Lowering the tax rate and eliminating the double or triple tax on corporate income can be one.²¹⁸

Hence, a considerable reduction of the corporate tax rate may be a means to get the immature culture of incorporation in Ethiopia to foster establishment of internationally competitive domestic companies which would take advantage of opportunities economic integration will bring and repel challenges thereof.

Moreover, the incentives contained in the investment law are meant to encourage investment in the sectors and regions the government believes to be less preferred by investors. By the same token, having regard to the importance of incorporated businesses in the Ethiopian context, to incentivize the legal form of incorporation to encourage investment corporations may contribute its part in the development of corporate business in Ethiopia.

²¹³ Income Tax Procl. No.286/2002, Art. 19(1).

²¹⁴ In the first Income Tax Proclamation No. 60/1944 and Proclamation No. 107/1949, there was no separate tax rate provided for companies. In these Proclamations, the business income tax rates for companies and individuals were the same subject to variation in rates on other factors such as traders, retailers and groups of activities. Decree No.19/1956 for the first time provided separate tax for incorporated bodies at 15% flat rate. This trend continues until to-date, but the rates vary. Proclamation No.173/1961 provided 16% flat rate tax on bodies corporate; and Proclamation No.255/1967 20%. So when compared with these three laws, the tax rate on bodies corporate in the current Income Tax Proclamation is higher. Proclamation No. 155 of 1978 and Council of State Special Decree No.18/1990, on the other hand, provide 50% flat rate tax on the taxable income of “organizations”. These rapid increases in the tax rate of bodies corporate resulted due to the ideological change in the political economy that took place during those years. Proclamation No.107/1994 reduced the tax rate in bodies corporate from 50% to 40%. Proclamation No.36/1996 again reduced the corporate tax rate on “organizations” from 40% to 35%. These reductions in the tax rates of bodies corporate again resulted from changes in ideology of political economy.

²¹⁵ Corporate Tax Rates, <http://www.kpmg.com/global/en/services/tax/tax-tools-and-resources/pages/corporate-tax-rates-table.aspx> (last visited on 30 March 2014).

²¹⁶ Income Tax Procl. No.286/2002, Art.34(1).

²¹⁷ See Berhane G/Mariam, supra note 177, at 30.

²¹⁸ Id. at 31.

4.6.3 Land Policy Reform

The land tenure system experienced in the pre-Derg Ethiopia is identified as one of the most complicated systems in the world and less researched.²¹⁹ The system lacked unanimity across the country. It rather was composed of sub-systems like *Rist*, *Gult*, communal, Diyesa, private, public or state, and church. During the last years of the imperial regime, private ownership became the predominant system whereby 60% of the peasant community or 65% of the total population owned private land.²²⁰ Of course, the then system was blamed for hindering the overall development of the country and “land to the tiller” was the renowned slogan of the revolutionists that buried the imperial rule.

The *Derg*, except that it reallocated landholding to end the pre-existing exploitative landlord-tenant class relation, it retained the ownership over the land to the state by the instrumentality of Procl.No.31/1975. By virtue of this law, all rural land belonged to the state in ownership, transfer of the use right by sale, mortgage, lease, or otherwise, except up on the death of the right holder to the surviving spouse or his children who did not attain majority, was prohibited. The re-allocation of land to each peasant was carried out by the authorized Peasant Associations (የገበሬ ማኅበራት).²²¹

The pre-*Derg* system was characterized by an exploitative landlord-tenant relationship, inefficient land use, possession insecurity, land fragmentation, in some areas to the extent of impossibility to plough with oxen, and so forth. These problems were prevalent during the *Derg* era except that the latter abolished the accumulation of land in the hands of few individuals which in turn aggravated fragmentation of farm lands. The restriction on the right to transfer land also prevented efficient use of the land. Overall, agriculture remained fundamentally subsistence and the tenure system lowered productivity of land.

It has remained to be a common quote that not less than 85% of the Ethiopian people is domiciled in the rural part of the country and has relied for long on subsistence farming. Moreover, agriculture furnished employment to 80% of the workforce in the country. Nonetheless, due to the poor productivity of the traditional farming practices and recurrent droughts and land mismanagement, it has been this portion of the society that has been severely affected by the degrading impoverishment. All microeconomic indicators show the fact that poverty in the country hits agonizingly the rural peasantry than the 15% urban community. At any rate therefore should any policy bring a pragmatic change in the economic and other affairs of Ethiopia, it is plain that such a policy has to be centered on the rural mass population. And, even to date, the principal asset of the majority of the Ethiopian people is therefore their land.

The EPRDF-led government on its part was not sure what stance to take up until it proclaims public/state ownership of land in its Constitution in 1995.²²² Moreover, the Constitution decentralized power of the government over land to the central government to issue laws and state governments to administer land in pursuance to the federal laws.²²³ In light of these Constitutional provisions, the first land law was the "Federal Rural Land Administration Proclamation No.89/1997 later replaced by Proclamation No. 456/2005.

²¹⁹ ETHIOPIAN ECONOMICS ASSOCIATION/ETHIOPIAN ECONOMIC POLICY RESEARCH INSTITUTE, A STUDY REPORT ON ETHIOPIAN LAND HOLDING AND DEVELOPMENT OF THE AGRICULTURAL SECTOR, 41 (2002) (የኢትዮጵያ የኢኮኖሚክስ ባለሙያዎች ማህበር/የኢትዮጵያ የኢኮኖሚ ፖሊሲ ምርምር ተቋም (ጥቅምት 1995) ፤ ስለ ኢትዮጵያ የመሬት ይዞታና የግብርና ዘርፍ ልማት ስለተደረገ ምርምር የቀረበ ሪፖርት፤ 41 (2002)).

²²⁰ Id. at 42.

²²¹ Id. at 43.

²²² FDRE Constitution, Art.40(3).

²²³ Id. Art.51(5) *cum.* Art.52(2)(d).

The latter law, among others, provides that land is a common property of the Nations, Nationalities and Peoples of Ethiopia and that it shall not be subject to sale or to other means of exchange,²²⁴ Land Administration Laws to be issued in the respective regions need to provide for free assignment of holding rights sufficient for subsistence to peasants and nomads, for protection against eviction and displacement from holdings on any grounds other than total or partial distribution of holdings effected pursuant to decision by the Regional Council, for determination of the extent to which holding rights would be assigned, etc.

In the regional Land Administration Laws (four regions have done so; Tigray-Proclamation No.23/89, Amhara-Proclamation No.46/2000, SNNPR-Proclamation No.53/2003, and Oromia - Proclamation No.56/2002), and Benishangul/Gumuz will be complete shortly) peasants are entitled to use the land in his holding to any agricultural work, rent it out, make development works on it and transfer them by sale or succession, get compensation at times of expropriation, etc.²²⁵

The existing land tenure has been criticized by commentators from within and abroad. *Inter alia*, it is blamed to leave the many landless and insecure landholdings. The issue of land ownership has been debated among stakeholders whose views range between the two extremes-private ownership and state ownership over the land.²²⁶ While the World Bank²²⁷ and opposition political parties in particular advocates for private ownership of land, EPRDF and the government stick on public ownership. It has tightened its stance by stipulating a constitutional provision on the issue which means any change in that regard is only by making a constitutional amendment and marginalizing compromise on land only “on its grave”.

The pro-private ownership camp alleges that private ownership of land will enhance land productivity by facilitating flexibility in the appropriation of land to a more productive use through free transfer by sale or lease from low producers to better producers, by encouraging investment on permanent developments and avoiding land disputes because it ensures secure possession, etc.²²⁸ A group within this camp basis its argument on principles of property rights; individual rights over land are not well known which may let the government take the benefit of doubt to push private entitlements; if known, not all are enforced; the restriction on transfer prevented landholders to make use of the available rights in a full-fledged manner.²²⁹

On the other hand, the EPRDF-led government argues for state ownership of land for fear of accumulation of land in the hands few individuals who would embezzle peasants at times of hardship.²³⁰ Nonetheless, except that its stance correspond the view of 61% of the study population, the fear of the government was a mere speculation. As reported by an extensive research, involving all regions except Gambella, conducted by the Ethiopian Economic Association/the Ethiopian Economic Policy Research Institute, even if private ownership over land is not a priority to them, 90% of the surveyed population profoundly confirmed that they won't sell their lands if it is allowed and only 4.5% tended to sell their land.²³¹ But, albeit how far the government then after satisfied them in ensuring possession security by its land certification projects,²³²

²²⁴ Federal Rural Land Administration Proclamation No.89/1997, Art.4.

²²⁵ Felix Horne, *Understanding Land Investment Deals in Africa, Country Report: Ethiopia 14* (2011) (the Oakland Institute).

²²⁶ See ETHIOPIAN ECONOMICS ASSOCIATION/ETHIOPIAN ECONOMIC POLICY RESEARCH INSTITUTE, supra note 220, at 50-53.

²²⁷ World Bank (1992).

²²⁸ See ETHIOPIAN ECONOMICS ASSOCIATION/ETHIOPIAN ECONOMIC POLICY RESEARCH INSTITUTE, supra note 220, at 51.

²²⁹ Id. at 52.

²³⁰ Id. at 50.

²³¹ Id. at 76-77.

²³² As of 2008, 6.3 million households (comprising 20 million parcels of land) in Oromia, Amhara, Tigray, and SNNPR have had their land registered as part of regional land certification efforts. Land certification efforts continue today in these four regions. In addition, land certification was expected to begin in at least one other region (Benishangul/Gumuz) in 2011.

because it was their prime concern,²³³ has to be assessed independently,²³⁴ they should prefer private ownership hoping that it would guarantee their indefinite possession if they yet feel unsecured. Even that time, a considerable number (38%) opposed the existing system and wished a secured private ownership in the alternative.²³⁵ Moreover, illicit practices of land transfers including sale were reported by the said study.²³⁶

Hence, taking note of the fact that the problems that hampered productivity of the agricultural sector in one way or the other are attributed to the tenure system,²³⁷ coupled with the practical pushes towards a system that accommodates the illicit land transfer deals and the firm stance of the government in favor of state ownership of land is based on a nonexistent fear, at least a more flexible mixed approach inclusive of state, private and communal ownership over land is justified.²³⁸

From the view point of corporatization, the existing land tenure does not allow contribution of land to form asset of a company by its holder because the ownership right is vested up on the state. That in turn means the majority of the people are prevented from appropriating their most valuable resource to more productive ventures. Perhaps, there could have been domestically initiated competitive corporations in the agribusiness which would maximize beneficence of the country from FDI in the sector.²³⁹ Proliferation of competitive domestic firms in this way could even help abrogate ill effects of the “land rushes” accused for evicting indigenous communities from their ancestral lands and destroying their lives.

Hence, as noted earlier, the government should reconsider its stance pragmatically to import at least mixed land tenure to accommodate practical demand and foster advances in the agricultural sector²⁴⁰ by opening the room for the free association of farmers and/or capitalists who may intend to undertake collaborative investments by joining their land and money in the form of incorporated companies. That is hoped to advance modern domestic agricultural firms and beyond.

4.6.4 Establishment of a Stock Exchange

Companies are started either privately by their promoters or through public subscription. Moreover, the initial capital might not be sufficient for running the business over the long term. That is when corporations look at the primary market to raise long term funds by issuing debt or equity securities. Investors in the primary market may intend to sell their shareholdings at some point in time. It is the secondary market that provides liquidity to them. In the modern world, it has become certain that one would not have been encouraged to invest in any instrument if there was no medium to liquidate his position.

The history of stock market in Ethiopia is brief, even shorter than the history of incorporated companies. The happening that triggered a ‘stock market’ took place in January 1959 when **HVA Ethiopia**, a Dutch sugar company, appointed the State Bank of Ethiopia as subscription agent for floating shares.²⁴¹ The State Bank of Ethiopia created the Share Exchange Department in 1960 in furthering its role as centre for stock

²³³ See ETHIOPIAN ECONOMICS ASSOCIATION/ETHIOPIAN ECONOMIC POLICY RESEARCH INSTITUTE, supra note 220, at 6 & 68-73

²³⁴ The problem of land-use insecurity emanates from and persists till today as a result of Proclamations No. 455/2005 and No. 456/2005 that reduce the scope and security of land use rights of smallholder farmers, pastoralists and communities and confer upon executive entities extensive powers to dispossess holders and reallocate land to ‘investors’.

²³⁵ Id.

²³⁶ See ETHIOPIAN ECONOMICS ASSOCIATION/ETHIOPIAN ECONOMIC POLICY RESEARCH INSTITUTE, supra note 220, at 113-116.

²³⁷ Id. at 137.

²³⁸ Id. at 69.

²³⁹ Spillovers in technological know-how and managerial skills from FDI are better bridged if there are domestic competitors linked to them.

²⁴⁰ ETHIOPIAN ECONOMICS ASSOCIATION/ETHIOPIAN ECONOMIC POLICY RESEARCH INSTITUTE, supra note 220, at 128.

²⁴¹ Solomon Abay, *Financial Market Development, Policy and Regulation: the International Experience and Ethiopia's Need for Further Reform* 129 (2011) (unpublished PhD dissertation, University of Amsterdam).

exchange.²⁴² Following its dissolution and replacement by Commercial Bank of Ethiopia and the National Bank of Ethiopia in 1963, the share dealing business of the State Bank of Ethiopia passed on to its successors. In response to the promising growth of the stock business, the Addis Ababa Share Dealing Group was then established by the National Bank of Ethiopia, share dealers and the financial institutions on the 9th of February 1965.²⁴³ The group started functioning with share dealings of 15 listed companies and four government bonds, and the number of listed companies reached 17 by 1966.²⁴⁴ In its stay, the group issued rules for the market, listed twenty two companies, and served as primary and secondary market place for shares issued through it and government securities.²⁴⁵ It operated in two ways, at the weekly meetings and at the over-the-counter offices of some of its members.²⁴⁶

The hopeful beginning of stock market in Ethiopia was unfortunately stifled by the socialist regime of the *Derg* which pushed the private sector to the margins and preferred direct bank borrowing than issue and circulation of bonds and treasury bills to finance developmental projects.²⁴⁷ It is also recalled that the *Derg* issued less circulated special bonds and introduced reforms that allowed individuals and firms to pursue economic activities but only on the eve of its demise.²⁴⁸

Following the government change in 1991 lots of measures, as noted earlier in this chapter, have been taken to encourage investment and trade by the private sector while state and party enterprises have continued to play immense roles in the economy.²⁴⁹ The Transitional and then the Federal governments reiterated the issuance of treasury bills, and bonds rarely, though.²⁵⁰ Despite the tremendous measures to heighten the role of the private sector and promising advances in that regard, the defunct formal securities market has not however come back into existence.

Voices calling for the re-establishment of a formal stock market have been heard at different times following the 1991 revolution. The academia,²⁵¹ donors and the business community, the National Bank of Ethiopia (NBE) and practitioners working for it, and the government were cognizant of the need to have and advocating for a full-fledged stock market as early as 1994.²⁵²

The business community represented by the Addis Ababa Chamber of Commerce, has been promoting the formation of a formal stock market and enthused to the extent of preparing Rules and Regulations Manual for the would be “Addis Ababa Stock Exchange (AASE)” in 1999.²⁵³ The Justice and Legal System Research Institute (JLSRI) on its part came up with a draft bill in 2001 and submitted the final version of the draft, after incorporating the views of stakeholders, to the Council of Ministers in 2003.²⁵⁴ The government also

²⁴² Id.

²⁴³ Id.

²⁴⁴ Abera Bayisasa, *Can Ethiopian Companies Meet the Listing Requirements of African Stock Exchanges?* 28 (2011) (unpublished master's thesis, Addis Ababa University).

²⁴⁵ See Solomon Abay, *supra* note 242, at 129.

²⁴⁶ Id.

²⁴⁷ Id. at 130-131.

²⁴⁸ Id.

²⁴⁹ Id. at 132-133.

²⁵⁰ Id.

²⁵¹ Abu Girma, *Problems and Prospects for the Emergence of a Stock Market in Ethiopia*, in PROBLEMS AND PROSPECTS FOR THE DEVELOPMENT OF PRIVATE SECTOR IN ETHIOPIA (Getachew Yoseph and Abdulhamid Bedri Kello eds., 1994) (Proceedings of the 3rd Annual Conference on the Ethiopian Economy on the theme, EEA).

See also Yishak Mengesha, *Prospects for a Securities Market in Ethiopia*, ETHIOPIAN JOURNAL OF ECONOMICS, Vol.VII, No.1. (1998).

²⁵² See Solomon Abay, *supra* note 242, at 134.

²⁵³ Id.

²⁵⁴ Id.

seemed dedicated towards establishment of the exchange as it made the issue part of its economic and financial policy reform paper submitted to the IMF for the period 1996/97-2000/01.²⁵⁵

Nevertheless, the government has postponed the formalization of the stock market for an undefined future. It invokes economic and non-economic reasons to justify the delay of formation of the exchange. *Inter alia*, the government alleges the absence of the requisite infrastructure and regulatory conditions, fear of pressure from the international community to liberalize the financial sector instantaneously, and a premature move would lead to unstable capital inflow and sudden outflow to the prejudice of the economy.²⁵⁶ Consequently, it remained, as yet, reluctant to endorse any of the draft bills and give rebirth to an institutionalized stock market.

Currently, because a formal stock market is missing in Ethiopia, both the primary and secondary markets are rather informal so that companies under formation and the ones already incorporated may use any institution of their preference to float their shares. It is not uncommon to use financial institutions as primary market places to newly issued stocks. More worrisome is that, shares to be resold have got no place other than the company itself. So, the stock holder intending to sell his holding is left to his luck in getting someone else to buy it, inevitably at an additional cost than it would take had there been a formal market.

Moreover, even if transactions involving securities could have been taking place, there is confusion, *inter alia*, as to how to address disputes concerning clearance and settlement of securities transactions due to the absence of a regulated formal securities exchange. These all apparently hampers the liquidity of shares and jeopardizes economic interests of actual and potential shareholders (investors). In the face of this faint scenario, new investors in stocks may be discouraged having a negative bearing on the pace of incorporation in the country.

This author would like to join the advocates in forwarding the question for how long trading in stocks should be left to take place in corridors. Having regard to the international trend in the sector, the significance of the capital market in channeling portfolio investments from over-liquid pockets to the ones in need, economic harm dealings in the abrupt way would cause to actual and potential shareholders, etc., it is more than belatedly to have an organized stock market in Ethiopia.

It is natural, as has been the case almost in all parts of the world that the way towards the establishment and development of a stock exchange cannot be level and successful for granted. In the same corollary, establishment and development of stock market in Ethiopia may be constrained by the following obstacles.²⁵⁷

- a. The immaturity of company business and the limited track record of them in making profits may not be capable enough to attract potential buyers to purchase their securities.
- b. The existing corporations are reluctant to go public and show a tendency of restricting the free flow of their securities.
- c. The separation of ownership and management in the existing companies is not in the degree it should be so that the management is interested in the affairs of the company not only in professional terms but also as an owner.
- d. The inexperience/limited experience of the business community in financial matters can lead to slow functioning of the stock exchange.

²⁵⁵ Id.

²⁵⁶ Id.

²⁵⁷ Id. at 146-148.

- e. The traditional attitude of the people towards money and the limited experience or inexperience of persons in the leadership of the existing companies in corporate portfolio management may cause the stock market end up with limited or no actors.
- f. The primacy given to foreign direct investment may mean a minimal interest in portfolio investment.
- g. The reported low income of individuals and households won't give them the luxury of investing in securities.
- h. The less conducive macro and political situation in the country may not attract investors leading to minimal issue and exchange of securities which makes the establishment of the market next to not having it. Etc.

The foregoing can in no way suggest that the country cannot establish and foster a stock market at all because most of the problems are either consequent to the very absence of the market itself or ones that can be repealed by taking certain prudent corrective measures. What matters most is, therefore, to appreciate the peculiarities of the problems surrounding it, assessing the international experience, identifying opportunities, devising measures and assess their efficacy in which, of course, we are not of good names. Lessons from experiencing itself may also be of paramount importance in dealing with the challenges than not attempting it at all.

There are yet good opportunities, consequent to the national and international phenomenon, for the establishment and development of stock market in Ethiopia. Mention of, *inter alia*, the following is noticeable.²⁵⁸

- i. An unprecedented and somehow successful development in the privatization of the economy in general and the financial sector in particular tells us that the securities market can develop in parallel.
- ii. The international community has revised its demands in the rapid liberalization of the financial sector following the economic and financial crises that hammered economies repeatedly making the fear of the government to have a stock market would expose Ethiopia to international pressure to open the financial sector very soon unacceptable.
- iii. The portfolio investment in the securities markets of the developing countries in the past is marginal so that capital inflow and sudden outflow is not an immediate threat to the securities market Ethiopia may manage to have.
- iv. The experience of security markets in Africa has to tell us that interest of investors from the global north is not so far considerable so that domestic actors of the Ethiopian stock exchange would get time to learn how to make use of the market and compete.
- v. So far, FDI in Ethiopia is lower than the demand, thus it is less likely to foreigners to have interest in portfolio investments in a short period so that international competition cannot be an automatic threat.
- vi. The 2008 financial and economic crisis has lowered the rate of inflow of capital to emerging and underdeveloped economies so that the far improbable is market crisis to destabilize the market in Ethiopia. Etc.

In Hamilton's study, many interviewees, noting the absence of a stock exchange or another mechanism for an open or liquid market in share trading, pointed out that there is a need for such a market.²⁵⁹ Currently persons

²⁵⁸ Id. at 149-151.

²⁵⁹ See Hamilton, Booz Allen, supra note 171, at 19.

who wish to buy or sell shares do so privately, either contacting prospective sellers or buyers directly (if they know who they are) or contacting the company, which in some cases arranges informal markets in its shares.

The presence of companies that meet the listing requirements of other stock exchanges and have capital, shareholders, profit and public float more than the minimum requirements of African stock exchanges²⁶⁰ is living evidence on the possibility of having such a market in Ethiopia. The only weaknesses founded on Ethiopian companies are the failure of companies in the adoption of IFRS as a reporting standard and the low number of equity shares issued (less than USD1 million) which arises due to the high par value of shares (USD58).²⁶¹ The fact that the number of share companies in the country is growing, though yet very low compared to the number of companies in the West, also appeals for the urgent establishment of stock exchange.²⁶² Moreover, by listing in exchanges, companies can improve their value, increase liquidity of shares, and raise additional capital with less cost as well as increase investor base by attracting foreign capital. In addition, the establishment of stock exchange in the country will help companies by reducing the cost that will be incurred to get listed abroad as an alternative.²⁶³

The voices summed call up on the government to envision the formation and development of domestic savings, and investment by establishing a formal stock exchange because it would increase liquidity of securities and thereby confidence of investors to invest in the primary and secondary markets. The domestic capital is more reliable as it is freer from the risk of sudden outflow than an external source, and foreign investors may not get the interest to invest in the Ethiopian securities market in the short and midterm.

4.6.5 Judicial Efficiency

Ethiopia has been practicing a federal state structure since the repugnance of the *Derg* and the lapse of the bridging Transition Government.²⁶⁴ The FDRE Constitution confers judicial power both in the Federal and State Governments on courts of law.²⁶⁵ Insofar as business disputes are concerned, the majority are subject to federal jurisdiction.²⁶⁶ Among others, federal courts have adjudicative power over cases where negotiable instruments are at issue, any matter relating to business organizations registered or formed under the jurisdiction of Federal Government organs.²⁶⁷

It is agreeable that to have an efficient judicial organ is decisive for the success of the overall developmental endeavors. When it comes to issues of business in particular, it is more desirable because most business affairs are time bound. Hence, it may not be wrong to guess that investors will be encouraged to undertake investments in a jurisdiction where the judiciary is efficient than in a territory where it is inefficient.

In light of this, if we consider the case in the Federal courts of Ethiopia, it is reported that there is a single commercial bench under the Federal First Instance Court located in Lideta Court accompanied by two other benches specializing on banking and insurance cases.²⁶⁸ The name "Commercial Bench" has been used to refer to the fifth civil bench to the exclusion of the sixth and twelfth benches. This very usage resembles the

²⁶⁰ Abera Bayisasahu, *Can Ethiopian Companies Meet the Listing Requirements of African Stock Exchanges?* 95 (2011) (unpublished master's thesis, Addis Ababa University).

²⁶¹ *Id.*

²⁶² *Id.*

²⁶³ *Id.* at 98.

²⁶⁴ FDRE Constitution, Art.1 *cum.* 46 *cum.* 47.

²⁶⁵ FDRE Constitution, Art.50(7) *cum.* 78.

²⁶⁶ THE WORLD BANK, ETHIOPIA: LEGAL AND JUDICIAL SECTOR ASSESSMENT 37 (2004).

²⁶⁷ The Federal Courts Proclamation Number 25/96 (as amended), Art.5.

²⁶⁸ Interview with a judge sitting on the commercial bench, at Federal High Court, Lideta Court (March 25, 2013 at 6:00 p.m.).

prevailing confusion as to what constitutes a commercial dispute. Nevertheless, the target of this section is to assess how far the Commercial Bench in particular is efficient in resolving commercial disputes.

Specialization has efficiency in view all the time. In light of this understanding, it is not uncommon to find specialized courts including but not limited to commercial courts like that of the British,²⁶⁹ French,²⁷⁰ German,²⁷¹ and Russian.²⁷² Ethiopia too attempted to have a special commercial bench during the imperial period.²⁷³ The EPRDF has also seen, though lately, the desirability of a special commercial bench and not a court. It is also true that this bench does not have its counterparts in the Federal High and Supreme Courts. This author suspects the absence of such a special bench at higher spheres of the judiciary not to defeat the very purpose of establishing this bench, obviously efficiency. This suspicion tends to divert the solution rather to establishing a full-fledged commercial court.

Nonetheless, the bench is not yet special in the strict sense of the term. As my informants ascertained, the judge sitting on this bench is of similar background in terms of education, experience and skills with others.²⁷⁴ Neither a special on-the-job-training nor formal education pertaining to the matters brought to the bench was offered to the judge. So, what is new with the bench is that it is reserved for the adjudication of certain business related matters by certain individuals but not demonstrating special expertise unless it is argued otherwise that the judge working on the bench has reached a level of special expertise as a result of frequent encounter of commercial cases. Absence of the requisite special expertise will pose a problem on the proper functioning of the bench which defeats the very purpose of its establishment.

The common saying which goes “justice delayed is justice denied” signifies the need to dispose cases as early as possible. So, speedy trial has been a universal virtue which all jurisdictions aspire to see it happen. It is looked for because if the time consumed in the litigation process is long, the purpose of the process may be lost at all in the meanwhile for different reasons. A speedy system encourages investment than a system characterized by delay.

Despite the fact that it is not possible to objectively describe what an efficient settlement of disputes by a court constitutes, it is possible to rate performance of courts in relative terms. If we assess performance of the Commercial Bench in terms of clearance rate²⁷⁵ congestion rate,²⁷⁶ and backlog index²⁷⁷ in the fiscal years from 2002 E.C. to mid of 2005 E.C., the Commercial Bench had a record of 75.68%, 68.93%, and 111.81% clearance rate in 2003, 2004 and first half of 2005 fiscal years respectively.²⁷⁸ Nonetheless, the Bench has

²⁶⁹ Denis Talon, 8 CIVIL LAW AND COMMERCIAL LAW, INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW 6 (1983).

²⁷⁰ Id.

²⁷¹ Id.

²⁷² Id.

²⁷³ The World Bank, *Ethiopia: Legal and Judicial Sector Assessment* 37 (2004).

²⁷⁴ The judge sitting on the commercial bench told this writer that the bench was created in response to BPR and he was assigned based on not disclosed guidelines the court set for assignment of judges to the bench.

²⁷⁵ Clearance rate refers to the percentage of total files which a court of law decided in a fiscal year or any other specific duration rated as:

$$\text{Clearance Rate} = \frac{\text{Number of files decided in a period} \times 100}{\text{Number of new files opened in same period}}$$

²⁷⁶ This technique, named otherwise as “procedure time”, calculates the average time the court would take to decide on cases it has. It can be computed by:

$$\text{Congestion rate} = \frac{\text{Total number of files opened in a period}}{\text{Number of files decided in same period}}$$

²⁷⁷ This method of rating efficiency of a court shows the ration of number of undecided files which should have been decided in a certain period of time with the ones resolved in that time frame. In short, it tells how many cases a court or bench has postponed to a future time.

²⁷⁸ The trend of the clearance rate shows a considerable decline in the first two years and an incredible increase in the first half of 2005. As the judge presiding over this bench told this writer, in the first two years the single appointed judge used to entertain

passed on 831 files to the second half of the 2005 fiscal year while scoring 111.81% clearance rate. That is why it has been said that this method of assessing performance of courts is not absolute and may not depict the full picture of the system. So, it is consistently advised to supplement this method by other means of assessing performance of courts like congestion rate and backlog index, done in the subsequent lines.

The Commercial Bench was scoring an increasing congestion rate as the case with the High and Supreme Courts in the study period. It took 1.40 years, 1.69 years and 1.84 years to decide on a case in 2003, 2004 and first half of 2005 fiscal years respectively. In the last fiscal year, therefore, a case took the bench to decide a case not less than 22 weeks.

The state in which the Commercial Bench has been from the view point of backlog of files is considerably increasing. It passed on about 157 files in 2003, 346 in 2004 and 831 in the first half of 2005 which corresponds 40%, 69% and 84% of the number of files it decided in each of the years respectively.

Table 4: Statistics on the Performance of the Commercial Bench²⁷⁹

Year (E.C.)	Files						Clearance Rate	Congestion Rate	Backlog Index
	From Last Year	New	Re-opened	Total	Resolved	To Next Term			
2003	0	514	32	546	389	157	75.68	1.40	0.40
2004	32	721	90	843	497	346	68.93	1.69	0.69
2005 (1 st half)	639	881	296	1816	985	831	111.81	1.84	0.84

The overall trend in terms of clearance rate, congestion rate and backlog index of the Commercial Bench reveals the fact that it has been overflowed by cases threatening its efficiency in terms of time, if not in quality too. Although delay in disposition of all legal matters is not desirable, delay in the adjudication of commercial cases has far reaching consequences including discouraging investment.

Moreover, while access to justice is a constitutional right,²⁸⁰ there is a single Commercial Bench in the Federal Courts situated at *Lideta* with a single assigned judge. This requires citizens to bear additional costs than in other matters in respect to which courts are relatively dispersed in different areas of the city. Furthermore, Addis Ababa homes one of the biggest commercial centers in Africa, Mercato, and majority of business organizations in the country which suggests the possibility of being greater than in any other part of the country of commercial disputes falling in the federal jurisdiction. To require the business community bring commercial disputes to a single bench and wait at average for more than 22 months to get decision is a manifestation of the defeat the purpose of establishing the bench.

insurance cases in addition to the ones allotted to this bench so that the bench was forced to pass on a considerable number of files to the year to come. What is new in 2005 is that, the judge is relieved from the work load associated with the insurance cases so that the bench has a promising clearance rate.

²⁷⁹ Federal First Instance Court Data Base, retrieved on 25 March 2013.

²⁸⁰ FDRE Constitution, Art.37

Therefore, although establishment of the special Bench is worth of praise in its own right, its poor performance in terms of backlog, congestion rate and clearance rate and questionable accessibility suggests the need to work on ensuring a reliable and efficient commercial justice to foster investment in general and incorporation in particular. To that end, the government may resort to duplicating the bench in other areas of the city in the short run and inculcate a separate commercial court in the mid and long term.

In supplement, Hamilton noted that despite the Ethiopian legal system that was created in the 1960s provides a solid foundation for the resolution of commercial disputes, the relative incapacity and inexperience of many of the lawyers and judges has been a constant challenge since then constraining their understanding of commercial transactions to accurately apply the system to business disputes. The length of time it took to attain a final decision in the courts and of the generally inexperienced pool of judges that decided the cases was also complained against by a wide range of stakeholders.²⁸¹

Not surprisingly, the dissatisfaction of the mass in the public justice system pushed the business community, although these methods are well accepted by Ethiopians, to the informal mediation or arbitration to get disputes resolved. The diversion to the alternative dispute resolution mechanisms, withholding their limitations, is not a problem in itself because it has to be supported and institutionalized even at times when the public justice system is efficient and proactive.

Nonetheless, despite the fact that existing centers offer great promise for providing businesses with a reliable dispute-resolution mechanism that is speedier and more private than the courts, such arbitration and mediation centers created so far in Addis Ababa are in short supply and of limited capacity.²⁸²

Hence, the need to foster institutionalized and efficient arbitration and mediation centers is vivid leave alone in the face of inefficient public justice system like ours, because arbitration and mediation appear universally accepted by the judicial and business communities. Ethiopia's business sector is still relatively immature, and trade levels are low. As this condition changes, the commercial disputes to be resolved will become more numerous and complex, and the system must adapt to deal with them. The challenge will therefore be to match their pace of reform and capacity to a high growth rate of new businesses and transactions consequent to the global integration.

²⁸¹ See Hamilton, Booz Allen, supra note 171, at 66-72.

²⁸² Id.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

Facilitated by and large by unreserved efforts of the World Bank, the IMF and the WTO economic globalization has been a deep-seated trend on planet earth in the last three decades. Economic globalization can be taken to mean the virtual integration of national economies through increased cross border trade and investment. The international economic organizations facilitated the integration process by dictating economic policies of their clients by, *inter alia*, making reforms towards economic openness their loan conditions. IMF 'conditionalities' and World Bank's structural adjustment programs, reiterated by WTO's principles and rules, influence economic policies of LDCs and developing countries towards economic liberalization and integration.

Nevertheless, the integration process has been taking place in the face of unfading heated debates between the protagonists and the contenders of globalization. The protagonists praise globalization for its positive contributions in the growth of economies by facilitating access to capital, transfer of technology and managerial skills, job creation and market access. The antagonists allege that environmental destructions, wealth inequality and human insecurities it caused counterbalance the positive results. In the latter's view, the bad effects hit the poorer South more severely than the richer North. Consequently, the contenders consistently call up on reforms of governance of the international economic system in a way that would serve the virtues of humanity, equity, democratic rule, and sustainable development. Put differently, should economic globalization work to the majority, they assert, it should be geared to priorities of the world's poor. To date, except there are certain symptoms of change in governance of the international economy, it may not be possible to tell for sure about the direction and intensity of the prospective changes will be.

Empirical evidences also reveal a blurred picture as to consequences of economic globalization is concerned. Even within the developing world, there were jurisdictions (South East Asia) where economic liberalization pulled millions from poverty and jurisdictions (sub-Saharan Africa) where it has not transformed, if not worsened, the malfunctioning economies and has not improved the poor living conditions.

In the last three decades, the principal actors of economic globalization have been TNCs and MNCs headquartered in the advanced rich countries. The latter's' share in international trade and investment accounts for the lion's share. Broadly speaking, despite recent improvements in capital inflows to and export from the developing world, it has been of limited share in the global economic operations. So far, there is no evidence as to a possible absolute reversal of the trend in the near future so that it is unavoidable for LDCs to become more integrated that ever. They should thus work proactively to ensure their domestic economies absorptive and responsive enough to opportunities globalization offers.

Ethiopia, in her part, has been forward looking economy at least since 1991. In light of the teachings of the IMF and World Bank, the EPRDF-led government adopted a market-oriented liberal economic policy under the ideological guises of "revolutionary democracy" in the past and "developmental state" currently. It has been in particular carrying out pro-trade and pro-investment measures stemming from the conviction that foreign trade and investment contribute a lot for the economic transformation of the country and abolition of poverty.

Elimination of quantitative restrictions and export taxes, devaluation of the Birr, price deregulation, introduction of a system of export incentives and establishment of Export Promotion Agency which was later absorbed as a department in the former Ministry of Trade and Industry and now Ministry of Trade are among

the pro-trade measures. Regional-trade-related binding commitments it has assumed, has accession to the WTO and eligibility to benefit from the non-reciprocal preferential trade arrangements including the GSP, EBA, and the AGOA are hoped to widen the market access for exports from Ethiopia which is vital to prospective market-seeking investors. The pro-investment measures include liberalization of foreign trade, promulgation of liberal investment laws, issue of a modern labour law, facilitation of a forum for consultation between the private and public sectors, and setting up of institutional support for the export sector.

Nevertheless, Ethiopia's performance in exploiting the already secured market access opportunities has been insignificant implying the negligible importance, if not negative implications at least in the short run, of joining the WTO unless it moves shortly to correct the supply side constraints in the foreign sector of the economy. Stated differently, the pressing problem has turned out to be how to improve production and productivity in Ethiopia. Moreover, constrained by the low level of per capita income and national savings, investment from domestic sources has been very minimal and disorganized despite the reforms aimed at boosting private investment in the country. FDI inflow to the country has also been at a rudimentary level so that its role as a source of capita has been limited. Connected to it, lack of competitive domestic firms in Ethiopia lowered the possible advantage it could collect from FDI and capacity to resist FDI-induced problems to the economy.

Thus, if the mere fact of economic openness alone could not warrant sustainable economic growth and benefit from integration, efficient use of and building on domestic capacity will come into view as the only solution for Ethiopia to take advantage of opportunities and resist downsides of economic integration. The question however appears to be whether corporatization can be an option to ensure development of internationally competitive domestic firms. The answer is in the positive. This is because, save others, incorporation would facilitate channeling of human and financial resources, both in short supply in Ethiopia, to more productive ventures that could boost the export performance of and FDI-related advantages to the economy.

Unfortunately, the history of corporate business in Ethiopia is very brief and the culture of incorporating businesses has been immature. To the worse, the private sector is by and large traditional and the modern wing of the private sector is characterized by small-scale manufacturing and inclination to the services sector. To facilitate pooling of resources together and thereby promote development of more productive and competitive firms in the corporate line, the prime and perhaps the only tool may be to incentivize incorporation. To that end, subject to frequent revision to ensure utmost satisfaction of investors, it is indispensable to devise a corporation-friendly legal and institutional business environment.

5.2 Recommendations

For the development of internationally competitive domestic corporate businesses and the culture of incorporation in Ethiopia, this writer recommends the following.

1. To promote incorporation and ensure that Ethiopia's company law conforms to modern corporate laws of model jurisdictions, at least, updating of the country's commercial law in general and company law in particular is more than due.
2. The government of Ethiopia is advised to reduce the corporate tax rate to a level that won't severely endanger its tax revenue in the short run.
3. (Public) corporation-specific incentives should be provided in the investment law to catch attention and influence decisions as to the legal forms of existing and potential investments in favor of companies.

4. To advance modern domestic agricultural investments and accommodate practical demands, the land policy and tenure system should be revised in a way that recognizes at least a mixed land tenure that encompasses public, private and collective ownership over land. This would open the room for free association of farmers and capitalists who may intend to undertake collaborative investments by joining their land and money in the form of incorporated agricultural firms.
5. In order to ensure liquidity of stocks, reduce transaction costs of dealing with stocks and thereby increase confidence of investors to invest in the primary and secondary markets, it is, therefore, recommended that the government of Ethiopia should shortly take a positive action towards the formation of a formal stock exchange.
6. Last but not least, it is recommended that the government should, in the short run, duplicate the existing commercial bench in different areas of the city and beyond, and envision establishing a full-fledged commercial court, in the long run to heighten investor security.

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