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ADDIS ABABA UNIVERSITY COLLEGE OF LAW AND GOVERNANCE STUDY SCHOOL OF LAW

Regulating Domestic Financing to Foreign Investment in Ethiopia

A THESIS SUBMITTED TO THE SCHOOL OF LAW, ADDIS ABABA UNIVERSITY, IN PARTIAL FULFILLMENT OF MASTER OF LAWS DEGREE (LL.M) IN BUSINESS LAW

By:

Yigrem Minda Hailu

Addis Ababa, Ethiopia
September 2021

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Advisor

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Approved by Board of Examiners

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Examiner	Signature	Date

September 2021

Addis Ababa

Declaration

I, Yigrem Minda Hailu, hereby declare that this work is original and has not been presented in any other institution before. This thesis represents my work and contains no material which has been previously submitted for a degree or diploma at Addis Ababa University or any other institution, except where due acknowledgment is made.

Name: Yigrem Minda Hailu

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Verification

I, Martha Belete Hailu, have read this thesis and approved it for examination.

Advisor: Martha Belete Hailu

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Acknowledgment

Before anything else, I'd like to kneel myself before God, the Almighty, who allowed me to begin and complete this course of study.

I would also like to express my sincere gratitude to my thesis advisor, Martha Belete Hailu, who relentlessly guided me throughout this research work.

I want to express my sincere appreciation and blessings to everyone who contributed in any manner to the research.

Finally, but importantly, I want to express my gratitude to my loving family for their unwavering support during my academic career.

Dedication

This thesis is dedicated to My Friend, Classmate, and Coworker BAYE SHIFERAW KIDANE whom I lost suddenly. May he rest in peace.

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List of acronyms

AACCSA	Addis Ababa Chamber of Commerce and Sectorial Association.
BT	Bilateral Treaty
BIT	Bilateral Investment Treaty
Br	Ethiopian Birr
DBE	Development Bank of Ethiopia
EIC	Ethiopian Investment commission
FDI	Foreign Direct Investment
FPI	Foreign Portfolio Investment
FDRE	Federal Democratic Republic of Ethiopia
HERP	Homegrown Economic Reform Plan
IFC	International Finance Corporation
IPO	Initial Public Offering
IMF	International Monetary Fund
MFI	Micro Finance Institution
MCR	Minimum Capital Requirement.
MoF	Ethiopian, Ministry of Finance
MoTI	Ethiopian, Ministry of Trade and Industry
NBE	National Bank of Ethiopia
NYK	Know Your Customer
PLC	Private Limited Company
Sh.Co	Share Company
SMEs	Small and Medium Enterprises
SOE	State-Owned Enterprise
UNCTAD	United Nations Conference on Trade and Development
USD	United sate of American Dollar
WB	World Bank

Abstract

Ethiopia as a developing nation faces a negative balance of payment, domestic savings are insufficient to meet domestic investment demand, there is a consecutive budget deficit. The very idea of attracting FDI to Ethiopia is to utilize the capital available from foreign investors. However, regulating domestic sources of financing to foreign investment has given a little place. Thus, there is a gap in the regulation of the consumption of domestic capital made by foreign investors.

In the recent capital market proclamation, there is no equity reservation made for the domestic investor, which leads to the dominance of the economy by foreign investors. Empirically, from a capital perspective, foreign investors dominate the borrowing from DBE. In addition, the bank is also unable to recoup its loan from certain foreign investors since it does not strictly follow banking principles and rules while making loans.

The MCR provided under-investment proclamation seems it is not determined on the economic analysis since it is the same for almost all sectors. Because of the absence of a comprehensive national price index, under-pricing and over-pricing of import and export are not well regulated. As a result, illicit transfers of funds may occur. Moreover, even if leasing capital goods is intended to fill capital gaps, there no law that forbids foreign investors from being acquiring capital goods from a capital good financing company.

The problem is more aggravated for a reason that repatriation of capital and its proceeds is fully liberalized and consequently foreign investor may repatriate their capital including capital gained from the "domestic sources of financing".

After needful analysis, the researcher concludes that regulating the domestic financing of foreign investors in Ethiopia is disregarded while focuses mainly on attracting foreign investment.

Therefore, the researcher mainly recommends that the amendments of some investment laws, capital market proclamation, the empowerment, and independence of DBE, the establishment of some departments/teams in NBE and EIC. The prohibitions of importation of used machinery with some exceptions.

Key Words: Capital, Domestic Source of Financing, Domestic Investment, Foreign Investment, Regulating Financing

Chapter One: Research Proposal

1.1. Background of the study

Accelerating inward transfer and diffusion of knowledge, skill, technology, and increasing the inflow of foreign investors is one of the objectives of Ethiopian investment law among others. Having its tremendous contribution to acquire foreign currency, the government of Ethiopia stipulates that it is working to get a better result from FDI.[1]

After the foreign company came up with its initial capital required by the law[2], they may need additional capital to start their business or to increase their capital during the operation of their activity. Such capital may be fulfilled from finance markets mainly through borrowing from banks, from leasing agreements (financial leasing, operating leasing, and hire purchase leasing), from the issuance of new shares, through retained earnings, and through the issuance of debenture (bond) are mentioned among others. In this regard, the Ethiopian legal, institutional framework encounters some problems.

According to Ethiopian commercial law, only share companies can offer debentures for public subscriptions.[3] Other business organizations including a private limited company cannot issue debenture/bond.[4]

Lack of the institutional and legal frameworks that regulate the stock exchange market is one of the hindrances for the issuance of new shear to the public by share companies. This Lack of domestic capital market may force the investor to rely significantly on another domestic source of financing.[5]

On other hand, raising of finance domestically by the foreign investor should not be allowed under unrestricted manner, especially in a country like Ethiopia where the habit of domestic saving is not well developed,[6] and where the law liberalizes repatriation capital and current

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[1] FDRE Plan and Development Commission, Ten-Year Development Plan of Ethiopia, (2020/2021-2030/2031), http://www.pdc.gov.et/# accessed Jun 10, 2021 , 60

[2] Investment Proclamation, 2020, Art 9, Pro. No 1180, Fed.Neg. Gaz. Year 26, no. 28.

[3] Commercial Code Proclamation, 2021, Proc. No 1243, Fed.Neg. Gaz. Year 27, no. 23. See Article 407 and the following

[4] ibid, Art. 510(3)

[5] Young-Iob Chung, South Korea In The Fast Lane: Economic Development and Capital Formation (Oxford University Press 2007) 119.

[6] Solomon Abay,'Financial Market Development, Policy and Regulation: The International Experience and Ethiopia's Need for Further Reform' (DPhil thesis, University of Amsterdam 2011). 261-262

account.[7] Regulating domestic sources of financing to foreign investment is a crucial issue if not, a foreign investor could take what we saved. Currently, because of the poor regulation and supervision of NBE and DBE, some foreign investors took a considerable amount of loans from the DBE and disappeared without making the return of it.

Since payment of the principal and its interest of the loan obtained from abroad is made through the provision of foreign currency, borrowing from abroad should be in strict follow-up and through appropriate interference by the concerned regulatory authorities. In Hungary for instance, foreign credit is possible only with the authorization of the National Bank and only in cases when the conditions of such credits are more favorable than those of domestic bank credit.[8] Through Setting of Indicative minimum price for selected import items Directive,[9] the NBE focus only on regulating underpricing of importers, while disregarding the overpricing of the exporter. In such cases, illegal or criminal means may be used under the cover of financing and the act of money laundry-“Investment laundering” may take place. In Ethiopia, there is no market reservation in the primary and secondary markets to domestic investors.

Considering the above-competing interests, the paper tries to examine the bottlenecks that foreign companies face when they get into financing from a domestic source; and investigate the legal and institutional regulatory frameworks available for a domestic source of financing.

1.2. Statement of Problem

Since the formal security market is not yet established; the existence of very few capitals lease companies with limited service; the inability of the domestic bank to provide loans for foreign investors at the starting and during the operational stage causes difficulty to obtain capital domestically in Ethiopia.

On the other hand, there is a gap in a legal and institutional framework that enables to effectively regulate domestic sources of financing to foreign investment in Ethiopia. Neither the recent capital market proclamation[10] nor the new commercial code[11]provides market reservation in the capital market for the domestic investors.

The investment law demands almost the same amount of MCR regardless of the type of the project. The highest MCR is insufficient to start a capital-intensive business. Hence, foreign

[7] Zakariyas Berhanu,‘Foreign Capital Outflow Regulation under Ethiopian Bilateral Investment Treaties and Domestic Investment Laws’ (2018) 7 Haramaya Law Review 75

[8] Istvan Salusinszky, 'Financing Investment in the Eastern European Countries' (1976) 10 Int'l L 65, 4

[9] Setting of Indicative minimum price for selected import items Directive, No FXD/52/2017

[10] Capital Market Proclamation, 2021, Proc. No 1248, Fed.Neg.Gaz. Year 27, no. 33)

[11] Commercial code (n 3)

investors may look for a domestic source to finance their business operations.

The DBE does not execute its borrowing activities properly concerning some foreign investors, mainly investors engaged in the garment and textile industries. In this regard, the NBE did not exert its strong hand on the DBE for non-compliance with banking regulatory laws.

On other hand, as the investment law as well as BIT that Ethiopia conclude are fully liberalized reparation of current and capital account, a foreign investor may easily repatriate their capital including what they gat from a domestic source.

As a result, the country is grappling with two interconnected issues: namely, a question of further providing finance domestically for foreign investment (the access question) and a question of designing a proper regulatory framework for it (a regulation question). The challenges surrounding these two questions are the subject of the study. Nonetheless, no legal research has been conducted which balance the interest of both the foreign investor and the country.

1.3. Research Questions

1. Do domestic means of financing options are sufficiently available for foreign investment to fulfill their financial needs in Ethiopia?
2. Is the legal regime that regulates domestic financing to foreign investment in Ethiopia adequate and appropriate?
3. Is there an institutional framework to effectively regulate domestic financing to foreign investment in Ethiopia?

1.4. Hypothesis

1. The means available to finance foreign investment from domestic sources is inadequate in Ethiopia.
2. Currently, there is a gap in legal and institutional frameworks to effectively regulate domestic financing to foreign investment in Ethiopia.

1.5. Objectives of the Study

The general objective of the study is to analyze the operational and regulatory framework of the Ethiopian legal regime in regulating domestic financing to foreign investment. The specific objectives of the research are:

1. To examine how foreign investment is domestically financed in Ethiopia.
2. To examine legal and institutional frameworks that are desired to effectively regulate domestic financing to foreign investment.

1.6. Significance of the Study

As there is no research undertaken concerning domestic financing to foreign investment in Ethiopia, this study helps the policymaker to consider domestic financing in their endeavor to improve investment and productivity in Ethiopia. It also helps foreign investors by showing what they must consider when they decide to invest in Ethiopia. The finding of this research will help any interested parties by adding knowledge. It also will be used as a reference for further research undertakings in the area and serve as the basis for further study.

1.7. Scope of the Study

This study will focus on regulating domestic financing to Foreign Direct Investment and Foreign Portfolio Investment which are under the control of investment proclamations. It excludes investment areas reserved for joint investment with the Government and foreign state-owned enterprises. The study will focus only on foreign Private Limited Companies and Share Companies licensed under the Federal Government of Ethiopia.

1.8. Literature Review

There are several scholarly publications on the regulation of foreign investment in general in various legal jurisdictions, with a focus on foreign investors' entry and subsequent activities. In contrast, there is no considerable literature on the regulation of foreign investors' domestic sources of financing. In Ethiopia, there is no well-developed literature and jurisprudence on the matter at hand. Getahun Seifu, in his *"Regulatory Space" in the Treatment of Foreign Investment in Ethiopian Investment Laws,*[12] has attempted to show that the host state, while concluding BITs, should impose a regulatory space which allows them some degree of flexibility to protect local industry including important sectors. His article, however, did not address the regulation of local sources of financing for foreign investment in Ethiopia. The article simply indicates that BITs which Ethiopia concludes fail to give room for regulatory flexibility.[13]

Solomon Abay, in his *"Financial Market Development, Policy and Regulation: The International Experience and Ethiopia's Need for Further Reform"*[14] point out that the country's financial system is still undeveloped despite Ethiopia's government reintroducing market-led economic policies and implementing reform measures to stimulate the establishment of private firms in the

[12] Getahun Seifu. '"Regulatory Space" in the Treatment of Foreign Investment in Ethiopian Investment Laws' (2008) 9 The Journal of World Investment & Trade 405-426

[13] ibid

[14] Abay (n 6)

financial and non-financial sectors since 1991. [15] However, the work doesn't deal with regulating domestic sources of financing to a foreign investor in Ethiopia.

Zakariyas Berhanu in his article titled "*Foreign Capital Outflow Regulation under Ethiopian Bilateral Investment Treaties and Domestic Investment Laws*,"[16] articulates that Ethiopia's efforts to manage investment capital repatriation and returns through BITs and domestic investment law reveal that the majority of Ethiopian BITs completely liberalize investment capital repatriation. Furthermore, even while local investment rules permit the repatriation of current account transactions, they are unclear about whether they authorize the repatriation of foreign capital.[17] Still, since repatriation is about an outflow of capital and its return, the article focuses on regulating repatriation of capital only and disregards regulation of domestically financing foreign investments.

Lantera Nadew, in the work titled "Debenture as Alternate Scheme of Raising Investment Fund and Its Prospects under Ethiopian Company Law" tries to show the need to raise investment funds from the public by selling debenture bonds for public subscription, rather than relying solely on government subsidies or bank loans. However, it does not deal with how to regulate it.[18]

The above-mentioned works were found to be helpful in the consolidation of knowledge on the subject matter by the author of this study. The work's major focus, however, is not on regulating domestic sources of finance for foreign investors in Ethiopia. Rather, they just touched on the subject in passing as part of their respective core research.

Unlike the literature mentioned before, the primary goal of this research is to investigate how Ethiopia regulates domestic sources of finance for foreign investors. Especially, at this point when we are witnessing the demand to have foreign currency is skyrocket in the country.

1.9. Methodology of the Study

The study is a mixture of both doctrinal and empirical one. The doctrinal aspect applies to both primary and secondary sources. Regarding primary sources, I rely and focus on reading and analyzing investment legislations, commercial legislations, and financial legislations. Investigation on selected Bilateral Investment Treaties to which Ethiopia is a party is also conducted. Contextual interpretation of these binding sources will be used to determine whether they are adequate to regulate domestic financing to foreign investment and how financing

[15] Abay (n 5)

[16] Berhanu (n 7) 75,121

[17] ibid

[18] Lantera Anebo,'Debenture as Alternate Scheme of Raising Investment Fund and Its Prospects under Ethiopian Company Law' (2019) 13 Mizan Law Review 333

domestically to foreign investment is taking place in Ethiopia.

In addition, research findings in related subject matter, analysis of articles, books, and newspapers written in the subject matter are also to be considered. Best experience of other states is considered relating to regulatory and provision of finance to a foreign investor.

Official statistics, Reports, and consultation of the principles and standards from NBE, DBE, MoTI, Commercial Banks, Word Bank, IMF, and other institutions will be critically analyzed to explain the need to regulate domestic financing to foreign investment in Ethiopia.

Furthermore, interviews with pertinent government officials, experts and legal experts from financial and other relevant institutions is conducted to gather information relating to the domestic source of financing to foreign investors.

1.10. Limitation of the Study

Even though so much international literature and journals are available regarding the regulation of investment in general, there is a shortage of literature concerning regulating financing foreign investment domestically, especially literature written about regulating domestic financing to foreign investment in Ethiopia. As a result, great reliance is made on foreign literature.

The researcher also faces the problem of access to information. Since certain institutions refuse to provide information on loans made to foreign investors, findings and actions taken against state banks, and accesses to various internal circulars. The mere reason for such denial is its confidentiality due to its nature. Thus, some data gathering depends on the interview of a relevant person. The researcher is also unable to interview foreign investors.

1.11. Organization of the Study

The paper is divided into four sections. The first chapter contains introductory statements that describe the research proposal, while the second chapter is devoted to conceptualizing sources of financing and regulating its domestic sources including the meaning, types of financing, as well as various regulatory approaches with an examination of the experiences of selected Jurisdictions in regulating domestic sources of financing. Chapter three, the central theme of the paper, mainly examines the regulation of domestic sources of financing in Ethiopia. In the end, chapter four summarizes the study with concluding remarks and recommendations.

Chapter Two- Theoretical Framework of Foreign Investment, Financing and Experiences of Selected Countries In Its Regulation

2.1. Meaning and General Overview of Foreign Investment and Investment Financing

2.1.1. Foreign Investment

Direct investment and portfolio investment are the two types of foreign investment. In, a direct investment, investors put money into investments in return for a profit and the ability to participate in its management. In a portfolio investment, on the other hand, investors purchase securities (such as stocks and bonds) to earn a profit. FDI is distinguished from portfolio investment by its management, ownership, and control.[19] An investment that involves a long-term relationship and reflects a long-term interest and control (often greater than 10%) between an entity located in one economy and another is referred to as a foreign direct investment.[20]
Since the early 1980s, gross capital inflows to developing and emerging market economies have increased dramatically as a percentage of GDP, and FDI has become the most important and dependable source of funding for these countries.[21] However, still, FDI inflows and technology transfer are becoming increasingly concentrated in wealthy countries, while developing and least developed countries are being excluded, even if their investment legal regimes are liberalized.[22]
The Ethiopian investment proclamation defines a foreign investment as the expenditure of foreign capital by a foreign investor to establish a new enterprise or to acquire, expand or upgrade an existing enterprise, in any eligible area of investment.[23]

2.1.2. Investment Financing

Financing is the process of providing money to support a company's operational expenses, purchases, or investments. Banks, for example, are in the business of providing capital to firms,

[19] Donald Ball and others, *International Business: The Challenge of Global Competition* (McGraw-Hill/Irwin 2002) 69.

[20] Organization for Economic Co-Operation and Development, *Detailed Benchmark Definition of Foreign Direct Investment*, (3rd edn 1993)

[21] Georgios I Zekos, 'Finance and Investment in Globalization' (2003) 4 J World Investment 85

[22] Berhanu (n-6) 76.

[23] Investment Proclamation, (n 2), the cumulative readings of Sub-Articles 1,2 ,3 ,4, 6 & 8 of Article 2

consumers, and investors to help them to achieve their objectives.[24] Financial support is essential in any economic system, allowing firms to acquire items that are out of their immediate budget.[25] The long-term success of a firm is dependent on its ability to raise money and invest it.[26] The term "financing" will also be used in its broadest sense to include short-term as well as long-term borrowing, whether in the form of cash, leasing transactions, swaps, or supplier credit.[27] Firms to finance themselves, they may sell liability and equity securities, including bonds, stocks, mortgages, and loans.[28]

Blacks law defines "financing" as the act or process of raising or providing funds. Or Funds that are raised or provided.[29] And the word 'Fund' is also defined as to furnish money to (an individual, entity, or venture), especially, to finance a particular project, or to use resources in a manner that produces interest, or to convert (a debt, especially, an open account) into a long-term debt that bears interest at a fixed rate.[30]

Under the two commercial companies which got recognition under the Ethiopian Commercial Code[31] - private limited and Share company, financing is all about capital. Thus, it is worth defining what capital means. According to the Dictionary of Accounting, the term 'capital' refers to the financial resources available to firms to support their activities, such as cash, machinery, equipment, and other assets. These are the resources that allow the company to create a product or service that it can then market to customers.[32]

Even though the current commercial code doesn't define what capital means, the former commercial code defines capital as the original value of the items contributed to the undertaking by the owner or partners in cash or kind.[33] The Investment Proclamation, under Article 2 (3) also

[24] Adam Hayes, 'Investopedia' <https://www.investopedia.com/terms/f/financing.asp> accessed August 02 2021.

[25] ibid

[26] David Ingram, 'Financing & Investing Activities of a Business Entity' https://smallbusiness.chron.com/financing-investing-activities-business-entity-1884.html accessed August 04 2021.

[27] N A Bogdan, 'Private Sources for Foreign Investment and Financing' (1961) 1961 Proc Inst on Priv Inv Abroad 417,418

[28] Encyclopedia of Finance, (2nd edn, 2013) 83

[29] Bryan A. Garner, Black's Law Dictionary (9th edn. West Publishing Co 2004). 707

[30] ibid 744.

[31] Commercial Code Proclamation (n 3).

[32] Accounting Dictionary, https://www.myaccountingcourse.com/accounting-dictionary/capital 13Adam Barone, 'Capital Control' (Investopedia, 2 May 2019) https://www.investopedia.com/terms/c/capital_conrol.asp accessed 11 August 2021.

[33] Commercial Code of The Empire of Ethiopia Proclamation, 1960, Art 80(1) Proc. No 166, Neg. Gaz. Year 19,

defines capital as local or foreign currency, negotiable instrument, machinery or equipment, building, working capital, property right, intellectual property right, or other tangible or intangible business assets. In this study, the author use ‘finance’, ‘fund’, and ‘capital’ interchangeably.

2.2. The Role of Private Foreign Capital Inflow in Developing Countries

Most early development plans focused almost entirely on the public sector of the economy when determining the quantity and composition of investment, with public sources of foreign capital serving as the only remaining means of finance. This early approach to development planning gave little consideration to the private sector of the economy and, for a strong reason, to private foreign capital: an exclusionary or restrictive attitude toward foreign investment was characteristic of the initial efforts at development planning in many countries.[34]

In pre-industrial countries, foreign capital was an essential requirement for economic growth.[35] Even though estimates of the magnitudes involved differ, any conceivable rate of domestic investment would have to be augmented by foreign investment if the population of the great majority of Asian, African, and Latin American nations were to raise their per capita income.[36]

Foreign capital inflows assist developing countries in achieving their development goals. The inflow of private capital helps the receiving country's development program in two ways: it helps to alleviate a domestic savings deficit and increases the supply of foreign exchange.[37] Foreign capital stimulates domestic investment if infrastructures are built by the foreign capital and linkages are created, other domestic investments in the supply chain would be established.[38] There is also a national economic benefit if the value-added to output by the foreign capital is greater than the amount appropriated by the investor: social returns exceed private investors' returns. By correcting the balance of payment problem or budget deficit, foreign capital helps them to meet their development plan.[39] Social impact or benefit can be accrued besides benefits to the investor, it has benefits that can accrue to domestic labor in the form of higher real wages, consumers by way of lower prices, and the government through expanded revenue. It increases

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no.13.

[34] Gerald M Meier, 'Legal-Economic Problems of Private Foreign Investment in Developing Countries' (1966) 33 U Chi L Rev 463,467

[35]Alec A. Rozental, ‘International Finance Corporation and Private Foreign Investments’ (1957) 5 Economic Development and Cultural Change 277

[36] ibid 277, 278

[37] Meier (n 34) 463, 471

[38] ibid

[39] ibid

the volume and productivity of the labor market of the populated developing countries. In this case, the marginal social net product of the foreign capital would be greater than its marginal private net product.[40]

Increasing money accessible in the local economy is one of the most straightforward ways that FDI may contribute to economic growth. By increasing the stock of domestic capital, both direct and portfolio investment tend to lower interest rates and promote internal borrowing.[41] In developing nations, where capital is generally limited compared to labor, policymakers frequently see potential capital injection as the most important advantage of FDI since it boosts investment and GDP in the host economy.[42]

Foreign direct investment may also benefit developing countries through the transfer of other nonmonetary resources such as technological knowledge, market information, managerial and supervisory personnel, organizational experience, and product and production technique innovations, all of which are in short supply in the recipient country. [43]

2.3. Source of Investment Financing

A financial system's main function is to connect economic agents with excess financial resources, such as households, to those with net financial needs, such as corporations and governments. In short, financial markets move money from people with extra funds to others who require it.[44]

2.3.1. Capital market

Capital markets are marketplaces where firms seeking long-term financing can meet investors with funds available. This funding can take the form of equity financing, which involves the issuance of new ordinary shares, or debt financing, which allows companies to choose from a variety of equity and debt securities. Investors purchase and sell corporate and government securities in capital markets.[45]

Capital markets provide two primary purposes. They are, first and foremost, a place where companies may raise long-term funds from investors with a fund to invest, such as financial

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[40] ibid 463, 475

[41] Rozental (n 35) 277,279

[42] Alfaro, Laura, and Jasmina Chauvin. 'Foreign Direct Investment, Finance and Economic Development' (2020) 1 Encyclopedia of International Economics and Global Trade 231

[43] Meier (n 34)

[44] Jeff Madura, *Financial Markets, and Institutions* (11th Edition, Cengage Learning 2015) 3

[45] Denzil Watson and Antony Head, *Corporate finance: principles and practice* (Pearson Education Limited 2010) 31

institutions and private investors. In fulfilling this function, they are the primary markets for new equity and debt issuance. Second, to expand their portfolios, investors might sell existing shares and bonds and acquire new ones on capital markets. In this case, capital markets serve as secondary markets for existing securities.[46]

2.3.2. Money markets

Money markets are used to ease the movement of short-term money from those with surplus funds to others with insufficient funds.[47] Money markets' primary function is to transfer money from those economic units in society that have a surplus to those that have a deficit.[48] Even investors who focus on long-term securities tend to hold some money market securities. Money markets enable financial market participants to maintain liquidity.[49]

Money market securities are debt securities having a one-year maturity or less. Treasury, companies, and financial intermediaries that need short-term funding issue them on the primary market using a telecommunications network. [50] The Treasury issues securities (T-bills) to cover the budget deficit. Money market securities are issued by corporations and the proceeds are used to support or expand their activities. Money market securities (B- bills) are issued by financial institutions and the revenues are pooled to make loans to individuals or businesses.

With the profits from issuing new money market securities, the Treasury and some companies pay down their maturing obligation on existing money market securities that have become due. As a result, even though money market instruments have short maturities, they may be used to fund long-term expenses.[51]

Debt and equity financing are the two most common types of financing available to the firm. Debt is a loan that must be returned with interest on a regular basis, although it is generally less expensive than borrowing money due to tax benefits.[52] Although equity does not need a return, it does give stockholders with ownership stakes. There are benefits and drawbacks to using loans and equity. For most businesses, a mix of these methods is used to raise money.[53]

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[46] ibid 34.

[47] Charles R. Geisst, *A Guide to The Financial Markets* (The Macmillan Press Ltd 1982) 42

[48] ibid 41.

[49] Madura (n 44) 135.

[50] ibid

[51] ibid

[52] Hayes (n 24).

[53] ibid

2.4. Major Types of Finance Markets and Institutions Which Provide Finance to Foreign Investment.

2.4.1. Equity Financing

Equity financing is the sale of specific shares to raise capital and reduce the risk of conducting business.[54] An equity investment gives the investor a share of the firm's profits. An equity investment is a long-term financial commitment to a firm that is not repaid by the it. As owners, equity investors are entitled to participate in the company's profits in the form of dividends, as well as participation in certain company activities such as voting for members of the board of directors.[55] There are both domestic and international equity financing. In the latter, international business firms operate in international equity markets by listing their shares on foreign stock exchanges and by selling new shares to foreigners.[56] Equity financing occurs in two conditions: the first is through an initial public offering (IPO), when a firm for the first time sells securities to the public and when the company raises substantial amounts of equity capital for the already established companies;[57] the second when the existing securities brought for market exchange.

2.4.2. Long-Term Debt Financing

A company will invariably fund itself not only via the issuing of shares (of various classes) but also through issuing of a bond.[58] Bonds are types of debt capital. So much like how a bank loan is a form of debt. Bonds, unlike bank loans, can be exchanged on a market. A bond is a debt capital market instrument issued by a borrower who must return the lender/investor the amount borrowed plus interest over a certain period.[59]

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[54] Geisst (n 47) 7.

[55] ibid 8.

[56] Imad A.Moosa, *International Financial Operations, Arbitrage, Hedging, Speculation, Financing, and Investment* (Palgrave Macmillan 2003) 277.

[57] Brown, B., Roe, C., and Jr. and Crooks, S., 'The Public Offering and a Quest for Alternatives' (1969-1970) 23 Vand. L. Rev.41

[58] Paul L. Davies and Sarah Worthington, *Principles of Modern Company Law* (9th edn Thomson Reuters 2012) 1179.

[59] *Moorad Choudhry, The Bond and Money Markets: Strategy, Trading, Analysis* (Butterworth-Heinemann 2001) 3.

Even if the firm is profitable, the board of directors (if such power is given to them) may decide not to pay any dividends and instead use the retained or undistributed profit to fund further expansion. In this case, capital gains tax is applied to capital gains. [60]

2.4.3. Bank loan

The company's money will come from someone else source, most likely in the form of a bank loan secured against the company's assets.[61] Although medium-term lending is becoming more frequent, bank lending remains mostly short-term. Banks may need collateral, which might be difficult to provide at times by foreign investors.

It is certainly the case that nominal interest rates in the transition economies were higher than corresponding rates in, say, the EU, and this might call into question the desirability of borrowing on the domestic market and moving money offshore where nominal interest rates were lower.[62] Furthermore, higher nominal interest rates paid on domestic loans may be tax-deductible, while taxes on money transferred to tax havens may be avoided, reducing the gap between nominal interest rates at home and abroad.[63]

2.4.4. Lease Financing

Leasing is a type of financing that is described as a contract between two parties in which one party (the lessor) delivers an asset for use by another party (the lessee) for a certain length of time in exchange for predetermined payments. In effect, leasing separates the legal ownership of an asset from its economic use.[64]

There are overall three main types of leasing: “operational lease”, finance lease”, and “hire purchase” lease. When it comes to ownership rights and asset control, they differ widely. Other differences include who is responsible for upkeep, damage, and insurance. Leasing is beneficial to a wide range of sectors and may be used on a variety of various types of equipment.

[60] Moosa (n 56) 300.

[61] Davies and Worthington (n 58) 855.

[62] Josef C. Brada, Ali M. Kutan & Goran Vuksˇic, ‘Capital Flight in The Presence of Domestic Borrowing: Evidence from Eastern European Economies’ (2013) 51 World Development 32,34

[63] ibid

[64] IFC, *Leasing in Development: Guidelines for Emerging Economies* (2nd edn 2009) 7

Under a capital goods leasing arrangement, the lessor provides finance in kind in exchange for the lessee's usage of certain capital assets. It's also a way of raising finance to pay for assets instead of paying rent.

2.5. Economic Regulation and Its Theory

In a free-market economy, the subject of regulation has been one of the most contentious, with opponents claiming that it impedes market efficiency and proponents claiming that well-designed rules not only make markets more effective but also assist assurance of more equitable market results.[65] According to proponents of free markets, if the government attempts to fix market failures, in most cases, it makes matters worse. They add that political processes are inherently inefficient.[66]

Generally, there are two theories of regulation which set of propositions or hypotheses about why regulation emerges. Public interest theories of regulation explain the emergence of regulation as a response to market failure; however, private interest theories explain the emergence of regulation because of the pressure of private interest groups seeking to secure benefits for themselves.[67] A substantial body of literature suggests that financial markets are most efficient when they are not regulated. However, all markets fail, and they fail for several reasons. They may fail for one or more of the following reasons, financial markets fail to produce efficient, competitive outcomes: Anticompetitive behavior, Market misconduct, Information asymmetry, and Systemic instability.[68] Thus, it assumed that Market failures can be addressed with the help of regulations.

2.5.1. Instruments of Regulation and Techniques

Scholars have structured or categorized regulatory instruments in several ways, using a range of tool dimensions as the foundation for categorization. Based on the underlying "modality" via which behavior is expected to be controlled the regulatory instrument is divides into five categories: command, competition, consensus, communication, and code (or architecture). [69]

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[65] Edward Balleisen and David Moss (ed), *Government and Markets: Toward a New Theory of Regulation* (Cambridge University Press 2009) 1

[66] ibid 4

[67] Anthony Ogus, *Regulation: Legal Form and Economic Theory* (Hart Publishing 2004) 3-4

[68] Jeffrey Carmichael, *The Development and Regulation of Non-Bank Financial Institutions* (world bank 2002) 24-25

[69] Bronwen Morgan and Karen Yeung, *An Introduction to Law and Regulation: Text and Materials* (Cambridge University Press 2007) 80

Command: These methods entail the state issuing legislative regulations forbidding certain behaviors, which are backed up by coercive consequences (civil or criminal) if the prohibition is broken.[70]

Competition: It is made an objective of regulation in developing market economies since the market has not yet been formed. It establishes a stable institutional framework that guarantees the freedom and security of market economic transactions.[71]

Consensus: The law's facilitative role also underpins those that rely on consensus and cooperation to control conduct. This category encompasses a remarkably diverse range of regulatory structures. It can range from regulatory methods and procedures that are commonly referred to as types of "self-regulation" to those that include different forms of cooperative partnerships between state and non-state entities to govern social behavior.[72]

Communication: There is a solid argument for disclosure regulations since market forces do not necessarily lead to full (or efficient) disclosure of information. Because markets cannot operate successfully with distorted and incomplete information, requirements that lead to better information can (by and large) lead to better resource allocations. [73] As a result, market operators may be compelled to notify the regulator of their operations. The public publication of information can also be utilized as a regulatory tool. Markets may be obliged to show or publish information about their activities to the public. In this mechanism members of the regulated community or those affected by the regulated activity are educated, to act in a manner that will facilitate the achievement of regulatory goals.[74]

Code (or architecture): While communication-based approaches rely on reasonable human thinking to effect behavioral change, code-based (or architecture-based) techniques work in the other direction, attempting to remove unwanted behavior by preventing it from happening in the first place.[75]

It's worth noting that categorization methods may not be perfect, and many instruments rely on several mechanisms to control their behavior. The borders of each type of instrument are also not well defined, and depending on the characteristics under consideration, it may be feasible to

[70] ibid

[71] ibid 91.

[72] ibid 92.

[73] Balleisen and Moss (n 65) 8

[74] Morgan and Yeung (n 69) 95.

[75] ibid 102.

classify any instrument in a variety of ways.[76] In addition, according to the circumstance, a combination of the instrument may also be applied.

2.6. The Rational to Regulate Domestic Financing to Foreign Investment.

Foreign investors , want to return their capital and investment earnings to a home country or a third country whenever they want. Host countries, on the other hand, need foreign capital to maintain a there healthy balance of payments and so must keep close control on capital outflows.[77] At the same time, governments, particularly emerging ones, seek foreign investment.[78] While some argue that FDI can benefit national development by providing capital, exports, training and managerial skills, and technology transfer, others focus on the risks, such as creating a balance of payments problems because of excessive capital outflows in the short term and when investors start repatriating profits in the medium term.[79]

As pointed out before, in developing nations, where capital is typically scarce, the most important benefit of FDI is capital injection. On another hand, if foreign businesses [Financed] significantly from local [source] such may worsen domestic firms' financing limitations by pushing them out of domestic capital markets.[80] This happens because foreign firms may simply be more profitable and/or have access to more collateral and thus be a better investment for lending institutions than the local investor.[81] Expanding domestic credit might be a substantial source of capital flight. Capital flight from transition economies is driven by differences in interest rates and investor evaluations of economic conditions in their countries, as well as the ease with which they may acquire funds that can be moved overseas via domestic loans and capital inflows.[82] Financial liberalization, rather than curbing capital flight, has fueled it by reducing costs and increasing the amount of money that may be moved outside.[83] According to the literature, foreign direct investment inflows into a nation often result in capital flight because the investments, particularly mergers and acquisitions, create liquid assets for local owners, which are subsequently shifted

[76] ibid 105.

[77] Berhanu (n 7) 75.

[78] ibid

[79] United Nations Conference on Trade and Development, 'Foreign Direct Investment and Performance Requirements: New Evidence from Selected Countries' (2003) 64

[80] Harrison, A. E., & M.S. McMillan, 'Does direct foreign investment affect domestic credit constraints?' (2003) 61 Journal of International Economics 73

[81] ibid 73,75.

[82] Brada, Kutan &Vuksˇic (n 62) 32

[83] ibid

outside.[84] As previously stated, loans from the local banking system are another source of assets that can be moved offshore.[85] To protect some sectors from full control by foreign investors, the government of the host state holds decisive voting power. In India for example, foreign ownership is allowed up to 26 percent through the Government approval route in the former media industry.[86]

The financial circumstances of the host nation may have an ambiguous impact on total FDI since they affect both the presence of foreign investment and the financing of that investment. On the one hand, good financial conditions attract investment to a host market in part because they allow foreign investors to finance an important share of their investment locally. On the other hand, because investors are likely to substitute FDI with local funds, in countries with good financial markets the total value of capital that foreign firms bring from aboard may be low.

Due to Financial Globalization, in certain developing market countries, such as Brazil, India, Indonesia, Israel, Korea, the Philippines, Turkey, and Uruguay, foreign purchases of stocks and domestic-currency debt have increased significantly in recent years, and foreign portfolio investments have surpassed direct investments.[87] The recent financial crises as well forced countries to reconsider the importance of capital control in assuring economic stability and caused the emergence of a protectionist approach.[88]

The guiding premise of financial regulation is that it should improve the efficiency of the financial system.[89] Thus, if the financial system can function efficiently on its own, there should be no need for regulatory interference.

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[84] ibid 36.

[85] ibid

[86] Ministry of Commerce & Industry, 'Clarification on FDI Policy for uploading/streaming of new and current affairs through Digital Media' <*https://dipp.gov.in/whats-new/clarification-fdi-policy-uploadingstreaming-news-and-current-affairs-through-digital-media*> accessed august 02 June 2021.

[87] Peter B Kenan, 'The Benefits and Risks of Financial Globalization' (2007) 27 Cato J 179,182

[88] Elo, Kinga Zsuzsanna, 'The Effect of Capital Controls on Foreign Direct Investment Decisions Under Country Risk with Intangible Assets' (April 2007). IMF Working Paper No. 07/79 3

[89]Carmichael (n 68)

2.7. Approaches to Regulate Domestic Source of Financing with Reference to Countries Experience

2.7.1. Minimum Capitalization requirement

States may compel a foreign investor seeking entry to bring all his capital in from abroad, or a specific percentage of it.[90] The state's interest in ensuring that the foreign investor brings capital from outside is to prevent them from raising capital on the local markets. The other reason for this is the country's wish to overcome its shortage of foreign currency through FDI.[91] If he is allowed to do so, local savings that could be used for home-grown projects would be diverted to servicing the interests of the foreign investor.[92] Some countries clearly state the minimum paid-up capital required, for instance, from April 2021 onwards in **Indonesia**, the government aiming to attract more great-value investments into the nation, foreign investment firms need to have paid-up capital of (US$696,565) now, up from (US$174,135). [93] In Africa also, Ghana and Tanzania demand minimum capital as a condition of entry.[94]

The argument for such minimum capital requirement is that if the investor raises his capital from the local markets, the expected benefit of foreign investment – which is capital flows from outside the host country – is nullified.[95] Thus, they impose the minimum capital requirement. Where a foreign investor agrees to capitalization requirements and later fails to comply, a right to terminate or otherwise interfere with the foreign investment arises in the host state.[96] However, in most host nations competing for FDI, a minimum investment requirement is not a common feature of investment regulatory regimes. Some counties use it with a combination of tax incentives to attract large investment projects**,** for instance, **Ukraine** investment legislation provides investors implementing large investments i.e., which envisage at least EUR 30,000 000

[90] Sherif H. Seid, *Global Regulation of Foreign Direct Investment* (Routledge 2018) 36

[91] John H. Dunning and Sarianna M. Lundan, Multinational *Enterprises and The Global Economy* (2nd edn, 2008 Edward Elgar Publishing) 559

[92] M. Sornarajah, *The International Law on Foreign Investment* (3rd edn , Cambridge University Press 2010) 108

[93] Asean Briefing, 'Indonesia Increases Paid-up Capital Requirements for Foreign Companies' <https://www.aseanbriefing.com/news/indonesia-increases-paid-up-capital-requirements-for-foreign-companies/> accessed 20 June 2021

[94] United Nations Conference on Trade and Development, Investment policy Hub, https://investmentpolicy.unctad.org/investment-policy-monitor accessed 28 august 2021.

[95] Sornarajah (n 92)

[96] ibid

of new investments, and which be implemented within 5 (five) years, under special investment agreements is entitled to certain tax incentives available until 1 January 2035 which include: 1) exemption from VAT and import duties on equipment and spare parts import; 2) exemption from corporate income tax for 5 years; 3) land tax breaks adopted by local governments. [97] In addition, foreign corporations wishing to do business in Texas must first demonstrate to the satisfaction of the Secretary of State that at least one hundred thousand dollars in cash of their authorized capital stock have been paid in, or that fifty percent of their authorized capital stock has been subscribed, and at least ten percent thereof has been paid in, or that fifty percent of their authorized capital stock has been subscribed, and at least ten percent thereof has been paid in, or that fifty percent of their authorized capital stock has been subscribed, and at least ten percent thereof.[98]

It is worth noting that, the minimum capital requirement to establish a limited company provided under the commercial law[99] is different from that which we have been discussing. The former fundamental function is the protection of creditors. The basic idea is that legal capital rules reduce the risk that the corporation will default on its debts.[100] while the latter is to protect domestic savings.

2.7.2. Requirements of Local Collaboration

Before the fall of communism, it was common practice in Eastern European nations, as well as many emerging countries, to allow foreign investment only in partnership with a governmental body of the host country.[101] Socialist nations saw the benefits of foreign investment to integrate socialist ideology with foreign investment admittance on the basis that ultimate control over the investment remained with the state.[102] The rationale was that the presence of nominees from the state entity on the joint venture ensured that state policy was reliably executed.[103] Even after communism fell apart and free-market economics took control in many Eastern European

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[97] CMS Legal, ‘Ukraine: Tax incentives for large investment projects enter into force’ < https://www.cms-lawnow.com/ealerts/2021/04/ukraine-tax-incentives-for-large-investment-projects-enters-into-force?cc_lang=en,> accessed 20 June 2021

[98] Amylee Travis, 'The Requirement of Minimum Paid-In Capital' (1947) 1 Tex L & Leg 259,260

[99] Commercial Code (n 3) see Art.247(1) which requires a minimum of 50,000 birr to form a share company and Art.496(1) requires 15, 000 birr as minimum capital for private limited company.

[100] Wolfgang Schon, ‘The Future of Legal Capital’ (2004) 5 European Business Organization Law Review 429,437

[101] Sornarajah (n 92) 106

[102] ibid

[103] ibid 106-107.

countries, this strategy remained. The concept expanded to Asia's communist states, where it is still the primary means of attracting foreign investment in these countries.[104] Such strategy can also be seen in Latin American countries as well. In Brazil, for example, no foreign company may engage in the utilization of natural resources unless 51% of its capital is owned locally.[105]

In Africa, once Algeria also with the objective of '…producing positive foreign exchange surplus balance in [favor] of Algeria for the entire duration **...** of its existence' impose local collaboration which demand companies which invest directly in Algeria to transfer 51% of their stock to local partners.[106]

A joint venture arrangement between local and foreign businesses is not generally required in developed countries. Joint ventures, however, can be utilized for a variety of reasons, including to pool resources and technology or the need to diversify the venture's risks of failure.[107] Whereas, restriction on joint ventures in the United States is being seriously considered in order to avoid losing control of the nation's economy and destiny. The Defense Department was given significant powers as a watchdog over foreign acquisitions of American companies in the 1988 trade bill. [108]

Foreign investors may favor joint ventures in developing nations because they diversify risk, reduce visibility, and provide them with a local partner who can frequently serve as an efficient mediator with the local government.[109]

To fill the lack of sufficient capital by foreign investors collaborating with local investors would be a solution. However, local investors' desire to participate in shares in a project with a large foreign firm will drain funds that could otherwise be used to finance local enterprises.[110]

One of the advantages of local partnership for developing host countries is that it bears the advantages to the host country through reducing the profit that could be repatriated abroad.[111]

Such local collaboration requirements should be imposed with prudence since foreign investors dislike being forced to look for local partners. Thus, rather than imposing local collaboration

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[104] ibid 107

[105] NwOgugu, E. I, *The Legal Problems of Foreign Investment in Developing Countries,* (Manchester University Pres 1965) 11

[106] Omar T Mohammedi, 'International Trade and Investment in Algeria: An Overview' (2010) 18 Mich St U Coll L J Int'l L 375,387

[107] Sornarajah (n 92) 107.

[108] Paula Stern, 'Regulating U.S. Trade and Foreign Investment' (1989) 21 U Miami Inter-Am L Rev 1,14

[109] Sornarajah (n 92) 107.

[110] ibid 108

[111] Seid (n 90) 37.

outright, it is better to incentivizing local partnerships, which have a positive impact to attract foreign investors from abroad and retaining capital that could repatriate.

2.7.3. Restricting Access to Local Financing

Because of their stronger collateral capacities, foreign firms may have easier access to local funding and may receive state support for initiatives deemed essential to the national development strategy. In order to reduce such risk, South Africa for instance has implemented rules limiting non-residents' access to domestic loans, and Tanzania has also had the practice of limiting foreigners' access to local finances.[112] Further in Kenya, in order to safeguard the public interest and enable local Kenyan ownership, every business registered on the Kenyan Securities Exchange or a public offering of securities must reserve at least 25% of its ordinary shares for local investors.[113] A minimum of 40% of the ordinary shares that are up for sale in an IPO must be set aside for investment by locals. The company may, however, transfer any unsold shares to foreign investors after getting written approval from the Capital Markets Authority if the share part intended for local investors is not fully subscribed.[114] There is a market reservation in Egypt also, for those companies formed by public subscription, at least 49% of the shares must be offered to the Egyptian public for one month unless such percentage of shares is already paid up by the Egyptian founding shareholders before the public offering.[115]

2.7.4. Providing Tax Incentive

As a result of the development planning process, the host nations' policies on private foreign investment now reveal a mixed picture of both restrictions and incentives. Regarding the situation when the incentive should be provided to have the effective result there is some evidence that tax exemption has been a significant motivator for existing businesses to expand.[116] Tax incentives are a good method to ensure that a foreign investor behaves in the way that the host government wants.[117] Thus, the host country's grant of investment incentives may be conditional on the

[112] OECD, 'Regulatory Environment for Foreign Direct Investment: Preliminary Inventory for Selected African Countries' (2005) 7

[113] Foreign Direct Investment: An Overview of Policy and Regulatory Developments in East and Southern Africa, https://iclg.com/practice-areas/foreign-direct-investment-regimes-laws-and-regulations/5-foreign-directinvestment-an-overview-of-policy-and-regulatory-developments-in-east-and-southern-africa accessed 01 September 2021

[114] ibid

[115] Becker McKenzie, Doing Business in Egypt, 2016, 10

[116] Milton C. Taylor, 'Industrial Tax Exemption in Puerto Rico' (1954) 7 National Tax Journal 359-362

[117] Sornarajah (n 92) 103.

achievement of certain performance goals. These are conditions put on investors that require them to meet particular goals while operating in the host nations.[118] For example, as stated before, in order to be benefited from the incentive scheme, **Ukraine** investment legislation provides the implementation of large investments.

However, crafting incentives should be done carefully as it may divert financial resources that could otherwise be more effectively used for development purposes.[119]

2.7.5. The Use of Criminal Law as Regulatory Approaches

There is a perceived distinction between *mala in se*, an activity that is "wrongful in itself" and therefore considered as "criminal" in societies with quite diverse social and economic norms, and *mala prohibita*, conduct that cannot be characterized and is the subject of special prescription. [120]

For conviction of a regulatory offense, the traditional sanction is a fine of a specified maximum amount, the amount of which is assumed to represent the gravity of the offense. Although imprisonment is a common alternative, it is rarely used for regulatory offenses, especially those involving strict liability, and it cannot be used where a company is a defendant. [121]

Even if older versions of regulatory legislation typically imposed, or was interpreted as imposing, strict liability, there has recently been a reaction to this traditional approach, possibly motivated by a concern that imposing responsibility on those who had no knowledge of the act or could not have avoided it is inconsistent with the moral basis of criminal law.[122]

The broad employment of other enforcement mechanisms differentiates regulatory offenses from those relating to conventional criminal law. These are divided into two groups. the first consists of administrative measures taken prior to, and often in substitution for, the criminal process. The second category consists of additional instruments accessible to the court. [123] Unfair or fraudulent behaviors by market players and poor disclosure of information on which to make investment choices are the two most prevalent types of misconduct in financial markets.[124] Some states clearly provide what constitutes infringements of investment law. For example, Angola

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[118] UNCTAD, Investment Promotion Provisions, (2008) UNCTAD Series on International Investment Policies for Development 36

[119] UNCTAD, International Investment Key Issues II, (2004). United Nations Publication.49

[120] Ogus (n 67) 79.

[121] ibid 87.

[122] ibid 84.

[123] ibid 87-89.

[124] Carmichael (n 68) 26.

investment law[125] article 47 provides the following considered as infringements in connection to foreign investment:

“The use of resources from abroad for purposes different from those for which they were declared and registered; Practicing invoicing that allows the illicit exit of capitals or the misrepresenting of obligations to which the company or association are subjected to, mainly the fiscal nature ones; … The lack of unjustified execution of the investment within the registered deadlines; The lack of information transmitted to the competent fiscal bodies, under the terms to be regulated; The falsification of goods and providing of false declarations; The over-invoicing of imported machinery and equipment…; The carrying out of commercial activity outside the declared commercial scope.”

Article 48 of the same law provides the consequences of such infringements. Mainly, Impositions of a fine, loss of benefits and other concessions granted, Cancelling of the private investment’s registration and imprisonment.[126]

[125] United Nations Conference on Trade and Development, (n 94) Private Investment Law of Angola, Law No. 10/18 of June 26th

[126] ibid

Chapter Three - Regulating domestic source of financing in Ethiopia

3.1. The Major Bottlenecks of Domestic Sources of Financing to Foreign Investment

In Ethiopia, unlike the Anglo-American system, a company cannot retain shares for a future offer. There is no distinction between authorized, issued, and subscribed capital in Ethiopian company law. Thus, all of the shares have to be offered for public subscription, and no share shall be outstanding, meaning, all the shares have to be issued and subscribed.[127] As a result, the company will need additional authorization to issue new shares to the public, which will need a broad discussion at an extraordinary general meeting.[128] After passing over a range of procedures, The company can offer shares after passing through a series of procedures, but it's a time-consuming process that can't keep up with the needs of today's fast-paced business environment.

In Ethiopia, only companies that can issue transferrable securities can offer debentures for public subscriptions. Other business organization including sole proprietors, partnerships, joint ventures, and a private limited company cannot issue debenture/bond.[129] The private limited company also may not issue bond/debenture.[130] However, even if the law provides the requirement and procedures to issue debenture by share company, this type of source of financing investment has never been tested in practice in Ethiopia.[131] Debentures, like stocks, can be traded on the stock exchange market.

There is a belief that maintaining an open and free capital market may encourage and promote foreign investment inflows by lowering the cost of capital.[132] But, as indicated above the inexistence formal stock market may be considered as the bottleneck of a domestic source of financing for foreign investment. Recently the government enacted the capital market proclamation.[133] However, the enactment of such proclamation alone doesn't guarantee the

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[127] Commercial Code (n 3) Art. 245 (1)(a).

[128] ibid Art. 442

[129] ibid Art. 180

[130] ibid Art 495(5)

[131] Anebo (n 18) 333,339.

[132] UNCTAD, Investment Promotion Provisions, (n 118) 41.

[133] Capital Market Proclamation (n 9).

immediate establishment of the market. There is a fear that there may be a lack of potential private investors to build the market itself. This worry is demonstrated in the capital market proclamation itself by stating: "…if there is no interest at all from the private sector, including from foreign investors, the Exchange shall be established as a fully Government owned public enterprise by regulation of the Council of Ministers." [134] Moreover, after the successful establishment of the market, there may be a few savers who will be accustomed to using the institution for investment purposes as the case happened in South Korea, in which the government introduced a tax and financial incentive system to encourage companies to list their shares on the stock exchange market.[135]

Regarding lease financing, one study[136] indicates that Ethiopia's Lease Finance Sector has several key problems, including a lack of low-cost and sustainable funding, weak supply chain connections, and a shortage of domestic suppliers. Currently, there are Six Capital Goods Finance Companies in the counties.[137] In addition, five of them are MFI-affiliated leasing firms that specialize in the industrial manufacturing industry.[138] Leasing objects are too regulated. Rather than allowing the market to determine what may be leased, the law allows leasing of goods that the Ministry of Trade and Industry has designated as "Capital goods." [139]

Many banks have little liquidity, and commercial banks often need more than 100 percent collateral, making credit one of the most significant barriers to investors.[140] Even if article 8(4) Rural Land Administration[141] and article 24(1) of Urban Lands Lease Holding Proclamation[142]

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[134] Capital Market Proclamation (n 10) Art 31(4).

[135] Chung (n 5).

[136] Asfaw Abera, 'Lease Financing in Ethiopia: An Assessment of Five Regulated Lease Financing Companies' (MA thesis, Addis Ababa University 2016) 55-56

[137] NBE,https://nbebank.com/capital-goods-finance-companies/ accessed 02 September 202.

[138] Currently out of Six capital goods financing companies five of them are MFI-affiliated leasing companies. See https://nbebank.com/capital-goods-finance-companies/ for detail.

[139] United States Agency for International Development, 'Ethiopia Commercial Law & Institutional Reform and Trade Diagnostic' (2007) 45

[140] United States of America Department of State, 'Ethiopia Investment Climate Statement' https://www.state.gov/reports/2020-investment-climate-statements/ethiopia/ accessed 06 August 2009.

[141] Federal Democratic Republic of Ethiopia Rural Land Administration and Land Use Proclamation, 2005, Proc. No 456, Neg. Gaz. Year 11, no. 44.

[142] Urban Lands Lease Holding Proclamation, 2011, Proc. No 721, Neg. Gaz. Year 18, no. 4.

allow the usage of land use right as collateral, private commercial banks hesitate to provide loans to a foreign investor using such land as collateral.[143]

The other bottleneck of domestic sources of financing for foreign investors in Ethiopia is that the prevalence of corruption. The problem of corruption in Ethiopia is pervasive though there are legal and administrative mechanisms to combat it.[144] Thus, as corruption increases cost of foreign investment, which includes the process of capital increment, may also increase in a given country. Even though one of the goals of investment is to boost the country's foreign exchange profits by promoting the development of export volumes, diversity, and quality,[145] because of foreign exchange deficit, exporting investors may have to wait six months to two years to get the foreign currency they need to carry out their business. Even because of foreign exchange constraints, industrial halts are widespread.[146]

3.2. The Contemporary Overall Financial Condition of Ethiopia

Savings and Investment: Domestic savings have increased in line with the growth in capital creation as a percentage of GDP. This suggests that domestic saving has been playing important role in driving GDP growth during the previous two decades, but the disparity between investment and domestic saving also suggests that foreign capital inflows in the form of loans and grants have played a major role.[147] The country's low level of investment is financed by foreign sources, resulting in growing debt loads, owing to the country's inability to create enough hard currency to fund its developmental efforts while also servicing its loans.[148] Domestic savings are insufficient to meet domestic investment demand, resulting in a significant investment-savings mismatch.[149] The county experienced a consecutive negative gap of saving -investment for a long time.[150]

[143] Interview with W/ro Meseret Alemayehu, Manager, Credit Underwriting Directorate, Buna International Bank (Addis Ababa, Ethiopia, 02 September 2021).

[144] Freedom House report, Countries at the Crossroads 2011 - Ethiopia, 10 November 2011, available at: http://www.unhcr.org/refworld/docid/4ecba64d32.html , accessed 08 April 2020).

[145] Investment Proclamation (n 2) Art 5.

[146] United States of America Department of State (n 140).

[147] Mengistu Ketema and Getachew Diriba, 'State of the Ethiopian Economy 2020/21' Ethiopian Economics Association 37

[148]ibid

[149] FDRE Plan and Development Commission (n 1) 5.

[150] National Bank of Ethiopia, 'The Relationship Between Saving, Investment and Economic Growth in Ethiopia: ARDL and VECM Approach' (2013) 130 Birritu 9

Balance of Trade: Like some developing countries, Ethiopia faces the problem of financing imports through export earnings. As a result of its low exportable products output and logistical challenges, Ethiopia has a chronic trade imbalance. Gold, coffee, live animals, and oilseeds are the most important exports. Ethiopia is a net importer of gasoline, food, and textiles.[151] Ethiopia, for example, had a trade imbalance of 337,948,871Br in 2019/20.[152]

Government Revenue and Expenditure: like saving and investment gap Ethiopia face a budget deficit for consecutive time. For instance, Ethiopia's 2019 government budget deficit was 2.50 percent of the country's GDP.[153]

Currently, even though the government is doing its due diligence to place the country among the world's top 50 business-friendly nations in order to aid its drive toward industrialization,[154] according to the World Bank's Doing Business 2020 report, on "Ease of Doing Business", Ethiopia comes in at number 159 out of 190 nations, which is the same ranking from 2018 and 2019. Ethiopia's low ranking is due to low scores in three sub-indices: "starting a business," "getting credit," and "protecting minority investors"[155]

Aside from attracting new investment, the government's plan aims to increase current firms' production and production capacity. The government is focusing heavily on growing investments to boost export revenue.[156] As stated under HGER, the promotion of quality FDI is also taken as vital not just for the inflow of foreign currencies but also for technological transfer and for the creation of job opportunities.[157]

Generally, Ethiopia, as a developing country, has very huge gaps between its development plan and the available capital to finance these development goals. Ethiopia is aiming to become a middle-income carbon-neutral economy by 2025.[158] As Krishna Ahooja pointed out by stating

[151] Ethiopia Balance of Trade, https://tradingeconomics.com/ethiopia/balance-of-trade accessed 02 September 2021

[152] Source, NBE

[153]Ethiopia Government Budget, https://tradingeconomics.com/ethiopia/government-budget, accessed 02 September 2021

[154] See the statement of Tadesse Kassa /PhD/, legal advisor of the EIC, at Capital Newspaper, January 4, 2021 https://www.capitalethiopia.com/capital/ministry-of-finance-revises-investment-incentives/ accessed, 17 August 2021

[155] World Bank Group, 'Economy Profile of Ethiopia' (Doing Business 2020) 30.

[156] Kassa (n 154)

[157] FDRE Plan and Development Commission (n 1) 9-10.

[158] IMF, 'Country Report No. 20/29' The Federal Democratic Republic of Ethiopia, (January 2020) 22

"Liberal clauses mean a loss of capital; restrictions mean less investment." [159] Ethiopia should also need to regulate its domestic financing while maintaining the balance of attracting foreign investment.

3.3. The Legal Framework of Regulating Domestic Financing of Foreign Investment

Developing countries consider FDI as a remedy for overcoming foreign exchange shortages, low investment, and tax revenue deficits, among others, and hence offer a variety of incentives to attract FDI inflows. Since 1992, Ethiopia has provided tax incentives to encourage private investment and boost foreign capital inflows. Tax holidays, exemptions from import charges on raw materials and machinery, and exemptions from export duties on most export goods are among the incentives provided in Ethiopia.[160] However, some findings suggest that this kind of initiative resulted in more revenue losses than economic gains.[161] Thus, in addition to the need to carefully assess and monitor the provision of tax incentives to attract FDI in Ethiopia, the proper regulating domestic sources of financing to foreign investment is required.

3.3.1. Regulating Domestic Source of Financing Through Investment Law

Ethiopian investment laws are aimed at bringing foreign capital to the country by making it easier to transfer funds out of the country, but the Investment Proclamation contains very limited rules that are meant to regulate the domestic source of financing foreign Investment.

A. The Minimum Initial Capital Requirement

Some countries require foreign investors to bring in all or a specific percentage of their money from outside to gain the perceived benefit of alleviating domestic capital shortages.[162] Similarly, according to Mr. Ahmed Nur,[163] MCR is incorporated in the investment proclamation to fill the

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[159] Krishna Ahooja, 'Investment Laws and Regulations in Africa' (1964) 2 The Journal of Modern African Studies 300,302

[160] Million Timer Jeza, Azime A. Hassen and Gollagari Ramakrishna, 'The Impact of FDI Flows on Aggregate and Disaggregate Tax Revenues In Ethiopia: A Bounds Test With A Structural Break' (2016) Asian-African Journal of Economics and Econometrics, Vol. 16, No. 2, 172

[161] IMF, 'Kenya, Uganda, and United Republic of Tanzania: Selected Issues' (Country Report No. 08/353, October 2008) 11

[162] Ahooja (n 159) 504.

[163] Interview with Mr. Ahmed Nur, Director, Licensing and Registration Directorate, Ethiopian Investment Commission, (Addis Ababa, Ethiopia, 09 September 2021).

capital gap of the county in addition to the screening out purpose. Under the current investment proclamation, [164] foreign investors must contribute a minimum amount of foreign capital ranging from 50,000 USD to 200,000 USD, depending on the industry and whether they are collaborating with domestic investors.[165] Such MCR is the same as that of the previous 2012 investment proclamation,[166] At this juncture, it is important to raises the issue of whether such amount is set taking into consideration the economic change that happened within nine years. In addition, such MCR does not consider whether the project is capital intensive or not. Almost the same amount of MCR is required for all types of investment projects. According to article 9 of such proclamation, the reduction of MCR is considered only for the investment of architectural or engineering works or related technical consultancy services, technical testing, and analysis or publishing works.

Alternatively, there is against argument on MCR, which says that the requirement of a minimum capital as a precondition for entrance may be seen as a prevention of attracting foreign investors.[167] The opponents of MCR add that there are areas of investment that need very little startup capital, like areas where technological innovation is their main activity.[168]

However, there is neither theoretical discourses nor empirical evidence which supports the elimination of minimum capital requirements alone attracts foreign investment. Hence, because not all types of investment projects require the same amount of capital, for example, cement and brewery companies are among capital intensive industries, providing MCR based on the investment sector and providing incentives for those who brought a large amount of foreign capital may be a better way out to attract foreign investment.

Under the very old Ethiopian investment law, for the encouragement of foreign capital investment in Ethiopia, it offers exemption from income tax for five years for certain kinds of enterprises that invest more than 200,000 Br.[169] The current law,[170] in this regard, for a company which engaged in the agricultural or industrial sector and that has invested 200,000 USD or its

[164] Investment Proclamation (n 2) Art 9(1), (2), (3) & (4).

[165] ibid Art 9

[166] Investment Proclamation, 2012, Art 11, Proc. No. 769, Fed.Neg. Gaz, Year 18 No. 63.

[167] ዳንኤል በሀይሉ ገብረአማኑኤል, 'የቻይና ኢንቨስትመንት አንድምታ በአፍሪካ፤ኢትዮጵያን እንደ ማሳያ' (2018) 7 Haramaya Law Review 110,121

[168] Interview with Mr Eemiyas Birru, Attorney at law, (Addis Ababa, Ethiopia, 08 September 2021).

[169] Investment Proclamation, 1966, Proc. No. 242, Neg. Gaz, Year 26 No. 2.

[170] Investment Incentives and Investment Areas Reserved for Domestic Investors Council of Ministers (Amendement) ,2014, Art 12 (5) (b) Reg No. 312, Fed.Neg. Gaz. Year 9, no. 29.

equivalence in Birr and has created permanent employment opportunity for at least 50 permanent employees are entitled to import duty-free capital goods necessary for the existing enterprise up to 5 years from the date of acquiring a business license or other appropriate license.[171] But, this incentive, in addition to its limitation as it exempts payment of customs duty only, is given per se since the highest MCR for any foreign investor is 200,000 USD, and creating permanent employment opportunities for at least 50 is easily attenable.

Any foreign investor who brings foreign capital into the nation must register and get a registration certificate from the EIC. The proclamation further provides that such capital is required to be registered within one year.[172] The effect of non-registration at all and after the expiration of such period is neither found in such proclamation nor under the NBE regulatory laws. Nevertheless, practically, if the investors fail to register, they might lose their right to repatriate the proceeds of the investment in convertible foreign currency.[173] On other hand, the proclamation provides that "any foreign investor shall have the right… to remit the …payments and earnings out of Ethiopia in convertible foreign currency at the prevailing exchange rate on the date of transfer."[174]

Hence, in the absence of a clear legislative provision limiting such remittance rights, the practice of NBE's is against the law and as noted by NBE's legal officer [175]as a result of such denial there is a threat that the denied investor would engage in illicit activities to repatriate his money.

B. Local Collaboration Requirement

The investment regulation provides areas of investment designated for joint ventures with the government [176] and investment areas designated for participation by both domestic and foreign investors.[177] Collaboration with local investor requirements befits the host country by reducing the profit that could be repatriated abroad. However, as stated in chapter two, foreign investors hate being obliged to seek local partners. Thus, to hold foreign investment capital and its proceeds from being repatriated, incentivizing partnership is a good mechanism. However, the Investment Incentives and Investment Areas Reserved for Domestic Investors Council of Ministers

[171] ibid

[172] Investment Proclamation (n 2) Art 9(5).

[173] Interview with Mr. Efream Baraki, acting Chief Legal Officer, National Bank of Ethiopia, (Addis Ababa, Ethiopia, 07 September 2021).

[174] Investment Proclamation (n 2) Art 20(1)

[175] Interview with Efream Baraki, (n 173)

[176] Investment Regulation, 2020, Art 3, Reg. No 474, Fed.Neg. Gaz. Year 26, no. 78.

[177] ibid Art 5.

Regulation[178] doesn't give any incentive on the ground of joint investment. The incentive scheme is mainly designed on a sectoral base and localization orientation.[179]

3.3.2. Regulating Domestic Financing Under BITs and other BTs

BITs are made with the express purpose of safeguarding foreign investment,[180] and the promotion and protection of foreign investment, including the ease of the free transfer of capital, are at the heart of their aims.[181] BITs were developed to safeguard investments against political and other dangers in the host nation.[182] Almost all of the bilateral investment treaties that Ethiopia signs with other nations do not include the execution of Ethiopian court judgments against foreign investors in their home countries. In fact, as BITs are designed to protect and promote foreign investment between contracting parties through providing foreign investors several rights,[183] it is not expected to do so.

One of the major problems DBE faces is the inability to recover its loans from a foreign investor. The absence of a bilateral treaty with the home country for mutual recognition and enforcement of one another's judgments in relation to the subject of foreign investment, which allows the bank with the help of the foreign court to attach and sell the property of a default foreign investor to satisfy his obligation, is considered as one of the reasons why the bank remains unable to collect some of its loans.[184] Treaties are made before the occurrence of the disputed fact and entertained in absence of case-by-case consideration. Thus, it cerate the certainty on the fate of the subject matter. In addition, some states require the existence of such kind of treaty for recognition and enforcement of civil judgments. For instance, in Vietnam before 2004 the only basis for recognizing foreign judgments was the existence of legal assistance agreement in the matter.[185]

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[178] Investment Incentives and Investment Areas Reserved for Domestic Investors Council of Ministers regulation (n 170)

[179] ibid see Art 5, 7 and 13.

[180] Sornarajah (n 88) 172.

[181] ibid

[182] ibid

[183] Stephan W. Schill, 'Mulitilateralizing Investment Treaties through Most Favored-Nation Clauses' (2009) 27 Berkeley J. Int'l Law 496,498

[184] Interview with Mr. Aklilu Tesfaye, Team Manager, Legal Affairs Department, Development Bank of Ethiopia, (Addis Ababa, Ethiopia, 10 September 2021).

[185] Ngoc Bich Du, 'Cross-Border Recognition and Enforcement of Foreign Judgments in Vietnam' (2008) 4 Journal of Private International Law 479, 483-484.

Similarly, until 2004, foreign judgments could only be recognized in Ukraine if an international treaty provided for it.[186]

The responsibility to undertake international relations and cooperation in criminal and civil matters is given to FDRE Attorney General Office.[187] However, except for the treaty that Ethiopia concluded with China, there is no other treaty concluded with other states. Thus, such Treaty is the only Treaty of its kind.[188] Such Treaty under its Article 2(1)(c) gives the recognition and enforcement of Ethiopian court decisions and arbitral awards in China and vis-vera.[189]

Therefore, to minimize the risk of non-returnable loans granted to foreign investors, it needs to conclude such kind of treaty between Ethiopia and major FDI exporting countries to Ethiopia.

In terms of foreign debt payments, some of Ethiopia's BITs include provisions that require a guarantee to the repayment of a foreign loan agreement in conjunction with investments.[190] They demand the repayment to be made without delay.[191] Having regard to the shortage of foreign currency in the country, as stated before, foreign investors are basically forced to wait a lengthy period for the return of their foreign loan, obtaining foreign exchange might take from six months to two years. [192] As a result, the issue of such a long wait, as well as the lack of exceptional conditions in BITs that allow Ethiopia to limit the repayment of the loan, could have negative consequences. For instance, investors may sue the country for non-compliance with BIT provisions.[193] However, some BITs have exceptional restrictions that limit or prohibit the complete liberalization of outflows of foreign capital for debt repayment.[194] These exceptions are intended to provide parties with a safety valve in the event of a financial crisis or the threat of a

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[186] Béligh Elbalti, 'Reciprocity and the recognition and enforcement of foreign judgments: a lot of bark but not much bite' (2017) 13 Journal of Private International Law 184,200.

[187] Federal Attorney General Establishment Proclamation, 2016, Art 6(12), Proc. No 943, Fed, Neg. Gaz. Year 22, no. 62.

[188] Interview with Mr. Gebru Mahitem, Public Prosecutor, International Cooperation on Legal Affairs Directorate, FDRE Attorney General Office (Addis Ababa, Ethiopia, 18 September 2021.

[189] Treaty between the People's Republic of China and The Federal Democratic Republic of Ethiopia on Judicial Assistance in Civil and Commercial Matter, 4th May 2014, Addis Ababa.

[190] See Art 6 of Ethiopia-Russia BIT, Ethiopia-China BIT and Ethiopia-France BIT, Art 7 of Ethiopia-Austria BIT and Ethiopia-Kuwait BIT, Art 5 of Ethiopia-Turkey BIT

[191] See Art 6 of Ethiopia-Russia BIT, Art 7 of Ethiopia-Austria BIT and Ethiopia-Denmark BIT, Art 5 of Ethiopia-Turkey BIT

[192]United States of America Department of State, (n 140)

[193] Berhanu (n 7) 75,88.

[194] Ethiopia- France BIT, Ethiopia- Austria BIT

balance of payment problem. In addition, even if some BITs incorporate the phrase "*subject to the laws and regulation of contracting parties*" such referred Investment Proclamation allows all foreign investors to remit … "*principal, and interest on foreign loans*."[195]

3.3.3. Export-Import Regulation in the Context of Foreign Exchange Control

To process foreign currency payments, banks require proforma invoices of imported goods. In such case, Importers present fake under-invoiced pro forma invoices that imply a less price than the true pricing.[196] Because they obtain hard currency through illicit remittances or the parallel market.[197] To control such malpractice, NBE issue a directive which sets an indicative minimum price for selected import items.[198] Such directive forces the importer to get a letter of credit equal to the price of the selected imported products, and it authorizes banks to examine and approve the pricing of those items using the Harmonized System of Commodity Pricing Description.

The directive aimed to monitor '*under invoicing'* of some import items and take a preventive measure from those who attempt to be involved in such malpractice by setting a minimum price for selected import items.[199] However, the directive is not compressively enough to be utilized as a national price index that banks use to cross-check the credibility of the price provided to them. Thus, banks make only a rudimentary effort to verify the accuracy of such prices.[200] In addition, such an incomplete directive is not updated with the rapidly changing economic circumstances of the world. The last revision of the price was made on 26 Jan 2018.[201] The bank rather than amending the directive and updating the price of imported goods, it authorizes private banks through a letter to deviate from the directive regarding some items.[202] On the other hand, there is no directive which controls the under-invoicing in the case of export.[203]

[195] Investment Proclamation (n 2) Art 20.

[196] Interview with Mr Samuel Demsew, Manager, Trade service and Correspond Banking Directorate, Buna Bank, (Adiss Ababa, Ethiopia, 10 September 2021)

[197] Interview with Yenehasab Tadese, Director, Foreign Exchange Monitoring and Reserve management Directoreate,NBE, (Adiss Ababa, Ethiopia, 13 September 2021)

[198] Setting of Indicative minimum price for selected import items Directive (n 9)

[199] ibid, See the preamble (emphasize added)

[200] Interview with Samuel (n 195)

[201] Letter from NBE to all Banks, ቁጥር የው.ኢ.ት.ዓ.ግ.ዳ/014/2018 ቀን፡ጥር 18 2010

[202] Letter from **NBE** to all Banks, Ref: FEMRD/0579/2020 dated June 08,2020

[203] Interview with Yenehasab (n 197)

3.3.4. Regulating Domestic Equity and Debt Financing

Companies already in business may decide to increase their capital. In such case, the issuance of new stock is the one possible way to make the increment. The other remedy to increase the capital is by increasing of par value of shares. [204] As per Art. 442(4) of the Commercial Code, an increase in capital by raising the par value of company shares must pass by an extraordinary general meeting. The capital of companies may also be increased through contributions in kind.[205]

Share companies may for the betterment of the company, also issue debt securities i.e., debentures/bonds as per Articles 407 and the following of the Commercial Code. The law requires publicly traded security to be registered, before the offer or placement by Capital Market Authority. [206]

Mr. Ahmed[207] states that in order to buy an existing firm or to buy its shares a foreign investor must receive prior authorization from EIC before making a purchase. This is done to determine whether the foreign investor has brought the required minimum capital and whether the investment area is open to foreign investors. In such case of a joint venture, the law puts a limitation on such foreign investors not to hold more than 49% of the share of the enterprise in the area reserved for joint investment with domestic and foreign investors.[208] As a result, it is feasible to argue that there is a market reserve for the domestic investor in the secondary market in such a situation. However, in the primary market, there is no market reservation made to the domestic investor to protect the public interest and facilitate local Ethiopian equity ownership. In this regard, neither the recent capital market proclamation[209] nor the new commercial code[210] provides market reservation in the primary and secondary market for the domestic investors.

3.3.5. Regulating the Provision of Domestic Loan to Foreign Investor

In Ethiopia, foreign firms that are legally incorporated have the same access to domestic bank loans as domestic investors.[211] However, if projects are to be financed using domestic loans,

[204] Commercial Code (n 3) See Art. 442(2).

[205] ibid Art 458.

[206] Capital Market Proclamation, 2021, Art 75, Proc. No 1248, Fed.Neg. Gaz. Year 27, no. 33.

[207] Interview with Mr Ahmed (n 161)

[208] Investment Regulation (n 174) Art 5(2).

[209] Capital Market Proclamation (n 10)

[210] Commercial Code Proclamation (n 3)

[211] Interview with Mr. Sibhat Meskelu, Principal Bank Examiner, Bank Supervision Directorate, NBE, (Addis

domestic banks must be certain that the projects are feasible before granting credit.[212] There are two principal sources of bank loans in Ethiopia: Development Bank Lending and Commercial Bank Lending. DBE is entrusted with the task of providing investment credits including short-term loans to viable projects that will contribute to the country's economic development.[213] The Bank relies primarily on the financial viability of the project it finances.[214]

The DBE has been providing loans especially for Investors who are engaged in the agriculture and the manufacturing sector for years. The Bank carefully selects and prepares projects that are properly examined, carefully assessed, and systematically evaluated.[215] Currently, for new projects, foreign investors are required to cover at least 50% of the total project cost. To cover the remaining amount, the Bank can lend up to 50% of the project's total cost. [216]

In terms of capital provision, foreign investors dominate the loan provided by the bank.[217] This may worsen domestic firm credit constraints by preventing them from accessing domestic bank loans. Thus, through conducting empirical research, it needs to make reservations for the domestic investor.

There were times where the bank is said to have been unable to collect back the loans it provided to foreign investors. In 2019 the bank was grappling with 40 % non-performing loans.[218] Such circumstances occurred mainly because of the poor due-diligence assessments of the borrower, the utilization of used machinery and equipment, and inappropriate interference made by government officials.[219] Accordingly, billions of birr went uncollected and some were declared

Ababa, Ethiopia, 13 September 2021).

[212] FDRE Plan and Development Commission (n 1)

[213] Development Bank of Ethiopia Re-establishment Council of Ministers Regulations, Art 6(1), 2003, Regu. No 83, Fde. Neg. Gaz. Year 9, no. 28.

[214] Credit Policy of Development Bank of Ethiopia No. CP 001/2017, Section 10.5.1, December 2017 , 15

[215] Development Bank OF Ethiopia, https://www.dbe.com.et/index.php/credit-service accessed 11 September 11 2021

[216] Credit Policy of Development Bank of Ethiopia (n 214) 11

[217] Interview with Mr Adane Mehari, Vice President, Customer Relation Division, DBE, (Addis Ababa, Ethiopia, 14 September 2021).

[218] Birhanu Fikade, 'Ayka Addis to fetch 2 bln birr in foreclosure' *The Reporter* (Addis Ababa, 29 June 2019) https://www.thereporterethiopia.com/article/ayka-addis-fetch-2-bln-birr-foreclosure accessed 11 September 2021.

[219] Interview with Mr Adane (n 217)

uncollectible from a foreign investor, such as Ayka Addis Textile Investment Group, Else Addis Industrial PLC, Angel Cotton Production PLC, Omo valley Farm Cooperation PLC.[220]

Currently, except for used vehicles, used machineries and equipment are not eligible for in-kind equity contributions to get a loan from the bank. [221] However, though institutional independence has shown progress meticulous assessment of due diligence of foreign investors before granting the loan needs attention to avoid the repentance of the bank's history. Because such assessment is made through the Ethiopian embassy situated at the home county of the investor, and it lacks the detailed loan track record and personal character, which is the base to provide the loan.[222]

In order to collect foreign currency. Private Commercial banks provide loans for a foreign investor at an interest rate which is very low when we compare with the borrowing interest rate for domestic investors.[223] In such case, Domestic investors may also be pushed out of domestic loans provided by private commercial banks.

3.3.6. Regulating domestic Leasing for Foreign Investment

In 1998, Ethiopia enacted a leasing proclamation.[224] According to such proclamation and its amendment,[225] there are three types of leasing namely financial, operational and hire-for-purchase. As stated in the preamble of the Leasing Proclamation three reasons necessitated its enactment. These are: To create an enabling environment for the establishment of *alternative sources of financing* for investors who have the desire, knowledge, and profession to participate in various investment activities but *could not act due to lack of capital*; Lessors of capital goods are assumed to fill a gap that is not addressed by the existing financial institutions, and Existing laws concerning capital goods leasing business are found to be incomplete.[226]

These two proclamations are the principal piece of law that control leasing. Some aspects of the leasing business are also regulated by the Investment Proclamation No. 1180/2020 and the

[220] Interview with Mr Habtamu Taye, Loan Officer, Project Rehabilitation and Loan Recovery Directorate, DBE, (Addis Ababa, Ethiopia, 14 September 2021).

[221] Credit Policy of Development Bank of Ethiopia (n 214) 11

[222] Interview with Mr Habtamu (n 220)

[223] Interview with Mr Yenenehe Tadesse, Senior Credit Analyst, Credit Underwriting Directorate, Buna International Bank (Addis Ababa, Ethiopia, 02 September 2021).

[224] Capital Goods Leasing Business Proclamation, 1998, Pro. No 103, Fed. Neg. Gaz. Year 4, no. 27.

[225] Capital Goods Leasing Business (Amendment) Proclamation, 2013, Pro. No 807, Fed. Neg. Gaz. Year 19, no. 60.

[226] Capital Goods Leasing Business Proclamation, (n 224), see the Preamble. (Emphasize added)

Investment Incentives and Investment Areas Reserved for Domestic Investors. Furthermore, the Proclamation on Registration and Control of Construction Machinery[227] governs issues relating to construction machinery registration and control. In addition, the relevant provisions of the Ethiopian Civil Code and the Ethiopian Commercial Code apply to subjects not covered by the above-mentioned capital goods lease legislations.[228] NBE is authorized to regulate financial Lease and hire-for-purchase agreements while MoTI is empowered to regulate Operating Lease.[229]

Although NBE officer[230] says that capital goods financing companies do not provide capital goods finance services to foreign investors, there is no law that puts such restrictions rather than providing that SME and Manufacturing Sector should be the primary focus.[231] The practice also shows that they provide the service to a foreign investor.[232]

The rent paid by the lessee shall be treated as an operating expense of the lessee and it is deductible from his income for the purpose of taxation. [233] The income tax proclamation also considers such as detectable expense.[234] On other hand, according to the investment proclamation,[235] the equipment gained through lease became a capital of a given foreign investor and they can repatriate it at any time. Thus, as the provision of capital goods is intended for those who lack capital, the law should have a limitation as to the provision of capital good service to foreign investors.

[227] Proclamation on Registration and Control of Construction Machinery Proclamation, 199, Pro. No 177, Fed. Neg. Gaz. Year 5, no. 61

[228] Capital Goods Leasing Business Proclamation, (n 224) Art 18.

[229] Capital Goods Leasing Business (Amendment) Proclamation, (n 254) Art 3 and 4.

[230] Interview with Mr Abrham Girma, Senior lease Finance Examining Officer, Micro Finance Supervision Directorate, NBE (Addis Ababa, Ethiopia, 08 September 2021).

[231] Capital Goods Finance Operational Modality Directives No. CGFB/10/2019, Article 4.

[232] For example Ethio-lease company provides capital goodes for foreign investor as long as they fulfilled the requremnt under the directive and the company provide.

[233] Capital Goods Leasing Business Proclamation (n 223) Art 16(3).

[234] Federal Income Tax Proclamation, 2016, Art 22(1)(a), Pro. No 979, Fed. Neg. Gaz. Year 22, no. 64.

[235] Investment Proclamation (n 2) Art 2(3).

3.4. Institutional Setup

A. Ethiopian Investment Commission

The EIC is the principal government organ responsible for promoting, coordinating, and enhancing foreign investment in Ethiopia.[236] It is accountable to the Prime Minister.[237] It registers capital brought into the country by foreign investors.[238] The investment proclamation recognizes machinery or equipment to be considered as capital.[239] In an interview with Mr. Ahmed Nur,[240] practically the EIC does not allow the in-kind contribution at the entry stage of the foreign investor. However, since capital includes machineries or equipment such practice is not in line with the law. As a matter of fact, when the foreign investors bring their initial foreign capital to the country, there may be a possibility that they can import used machinery or equipment. Such importation of used machinery or equipment may create a problem as their valuation to some extent depends on subjective criteria. To avoid the importation of outdated machinery or equipment from developed countries, it is possible to require the production of a chartered engineer's appraisal report issued at the load port from the investor. Moreover, the EIC should organize a team or department with coordination with Custom Authority and/or with other relevant organs which revise the valuation made abroad and make inspect the condition of such machinery.

The power to initiate policy and implementation measures required to create a conducive and competitive investment climate and follow up the execution of same upon approval is vested on the EIC.[241] Thus, the EIC should develop a policy that regulates outdated equipment from being dumped in Ethiopia which produces inferior quality products. However, such a policy needs to incorporate the possibility of importing used equipment or machinery after obtaining special approval for a justified reason like if new machinery of the same type is not available or if the machinery is being leased for free.

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[236] ibid Art. 38(2).

[237] ibid Art 35.

[238] ibid Art 38(13).

[239] ibid Art 2(3).

[240] Interview with Mr. Ahmed (n 163)

[241] Investment Proclamation (n 2) Art 38(3.

B. National Bank of Ethiopia

According to articles 20(3), and 27(2) of the National Bank of Ethiopia Establishment Proclamation[242] the bank is responsible to set a directive to determine foreign exchange that results from the export or import of goods. To obtain extra foreign currency from banks, importers may present fake contracts that imply a greater price than the true pricing. In contrast, in countries where there is a foreign currency control because of the shortage of foreign exchange, they may also present fake under-invoiced pro forma invoices that imply a less price than the true pricing. Further, they may do the same for tax evasion purposes. On other hand, the exporter may produce an under- invoice which is used for transferring money abroad.[243]
However, as stated before the NBE directive[244] is not compressively enough to be utilized as a national price index and it is not updated with the rapidly changing economic circumstances of the world and further there is no directive which controls the under-invoicing in the case of export.[245]

Previously, under NBE there was a team called "*Market intelligence"* which have the duty to regularly assess and make the update the price index.[246] Hence, to incorporate a similar organ, there should be an organizational structure reform that enables the regulation of such illicit outflows of capital. The bank should also implement an updated database system that is accessible to the concerned body.

According to Sintayew Desalegn, there is a circular which prohibits commercial banks' Non-Performed Loan (NPL) not to pass 5% of the overall loan they granted. For DBE the limit is much greater than the commercial bank, which is 15%.[247] (the author unable to access such circular) However, in the exitance of such circular, as stated before, in 2019 the DBE was fighting with

[242] National Bank of Ethiopia Establishment (as Amended) Proclamation 2008, Pro. No 591, Fed. Neg. Gaz. Year 14, no. 50.

[243] Interview with Samuel (n 196)

[244] Setting of Indicative minimum price for selected import items (n 9).

[245] Interview with W/ro Yenehasab (n 197).

[246] ibid

[247] Interview with Sintayew Desalegn, Principal Bank Examiner, Bank Supervision Directorate, NBE, (Addis Ababa, Ethiopia, 20 September 2021).

40% non-performing loans.[248] The reason for such is the unwillingness of higher government officials to implement the finding and recommendations of the supervisory experts of NBE.[249]

The bank also according to Articles 4 (4) and 18 (4) of Capital Goods Leasing Business Proclamation[250] issue: Capital Adequacy Ratio Requirement of Capital Goods Finance Business Directives No. CGFB/04/2016", Requirements for Licensing of Capital Goods Finance Business Directives No. CGFB/02/2013" (with its amendment), Capital Goods Finance Operational Modality Directives No. CGFB/10/2019" (with its amendment), Minimum Paid Up Capital Requirement Directives No. CGFB/07/2017 (2nd replacement), Limit on Capital Goods Finance Exposure to a Single Lessee Directives No. CGFB/09/2019" (3rd replacement), Manner of Financial and Operational Information Reporting Directives No. CGFB/03/2016, Penalty for Failure to Comply with Regulatory Requirements of Capital Goods Finance Business Directives No. CGFB/06/2017" enables the bank to control and monitor the business of financing capital goods. However, as the supervision is undertaken through on-site examination it is difficult to conduct such supervision with only one team and five officers because the lessees are situated all over the county.[251] Thus it needs to fulfill the required experts.

C. Development Bank of Ethiopia

The Bank is established to accelerate the Country's development through the provision of development credit.[252] DBE shall be governed by monetary and banking laws and Public Enterprise Proclamation.[253] However, even if the bank is under the umbrella of such banking supervisory laws, it experiences the inability to collect back the loans it provided to foreign investors, especially loans provided to garment factories.[254] As stated above, such circumstances occurred mainly because of the poor due-diligence assessments of the borrower, the utilization of used machinery and equipment, and inappropriate interface made by government officials.[255]

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[248] Birhanu Fikade, (n 218)

[249] Interview with Koricha Anisa, Principal Bank Examiner, Bank Supervision Directorate, NBE, (Addis Ababa, Ethiopia, 20 September 2021).

[250] Capital Goods Leasing Business (Amendment) Proclamation (n 225).

[251] Interview with Mr Abrham (n 230)

[252] Development Bank of Ethiopia Re-establishment Council of Ministers Regulations (n 213) Art 5.

[253] ibid Art 2(2).

[254] Interview with Mr Aklilu (n 184)

[255] Interview with Mr Adane (n 217)

Thus, the bank needs to maintain its institutional independence, and similarly, the NBE who supervises all bakes including the development bank should also perform its proper supervisory role on the bank.

As indicated above, from a loan granted to a foreign investor, there are several billion Br went uncollected and some were declared uncollectible. The bank, however, rather than seeking to collect its loan from the property situated in Ethiopia, never tries such from their asset located in their home countries of the investors.[256]

In addition, the bank did not try to sue them by presenting such cases to the FDRE Attorney General,[257] which vested the power to institute civil suits on behalf of the federal government office and represent them in civil litigation where they sue or sued. [258] The bank is included under the definition of "federal government office".[259] Hence, to recover its loan, the bank should bring the case to the FDRE Attorney General Office before the laps of the period of limitation.

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[256] ibid

[257] Interview with Mr Henok Tesfaye, Director General, Civil Justice Administration Directorate General, FDRE Attorney General, (Addis Ababa, Ethiopia, 15 September 2021).

[258] Federal Attorney General Establishment Proclamation (n 187) Art 6(4)(c).

[259] ibid Art 2(2).

Chapter Four: Conclusions and Recommendations

4.1. Concluding Remarks

In Ethiopia, when foreign PLC or Sh. Co needs capital for their business, they face some problem. Co to issue new share by established Sh it needs extraordinary general meeting. So, such mechanism is not suitable for the fast need of the company. On othe hand, PLC cannot issue debenture/bond however the practice never allows Sh. Co also to issues too. There is no institutional and legal frameworks that regulate the capital market. The lack of such market may force the foreign investor to rely significantly on other domestic sources.

In addition to their limited exitance, lease financing companies are forced by law to provide limited types of capital goods to an investor. Moreover, practically private banks do not grant loans to foreign investor through attaching land use rights. Besides, corruption and foreign exchange deficit are the major bottlenecks that foreign investors may face while they try to finance themself from domestic sources.

On other hand, even if the domestic savings is insufficient to meet domestic investment demand and there is a consecutive budget deficit and negative trade balance, the country focuses mainly on attracting foreign investment while insignificant attention is given on regulating domestic sources of financing foreign investment. As repatriation is fully liberalized, consequently foreign investors may repatriate their capital including capitals they gained from the domestic sources of financing.

The initial MCR is not enough to start a business in some sectors especially in capital-intensive sectors. Further, there is no incentive scheme avilable for those who brought a large amount of foreign capital. Even if the law is silent as to the effects of the non-registration of imported foreign capital, the practice of NBE entails the denial of the right to repatriate it. The law does not prevent the importation of used machinery and equipment, and there is no organizational setup available to value such imported machinery properly.

Although incentivizing partnership is the finest vehicle for holding foreign capital and its proceeds from repatriation, there is no law that encourages the local collaboration of foreign investors with domestic ones.

All most all BITs that Ethiopia concludes with other states is intended at promoting and protecting foreign investment, including the free flow of capital, among other things. In addition, including domestic investment law BITs do not take the time of repatriation critically, which is something that should be addressed since foreign investors may complain if there is a delay.

There is a limited no of bilateral treaties with other countries for the recognition and enforcement of judicial decisions and arbitral awards in civil and commercial matters. Which may help the facilitation of the return loan granted to foreign investors.

There is no compressively enough directive or manuals which enables to regulate under and over-pricing of export and import of goods. In addition, such an incomplete directive which regulate only the under-pricing of import is not updated with the rapidly changing economic circumstances of the world. This is because there is no responsible department which regularly assesses and makes updates to the price index.

In the primary market, there is no market reservation made to the domestic investor to protect the public interest and facilitate Ethiopian ownership of equity, while there is an incidental reservation to some degree in the secondary market i.e when foreign investors want to buy an existing firm or to buy its shares. As a result, the domestic investors may be forced to leave the capital market to foreign investors.

In terms of capital provision, foreign investors dominate the loan provided by the DBE. This may worsen domestic firm credit constraints by preventing them from accessing domestic bank loans.

Because of the poor due-diligence assessments of the borrower, the utilization of used machinery and equipment, and inappropriate interface made by government officials, loans grated in billions of Birr by DBE for foreign investors remain uncollected. NBE also did not exert its strong regulatory hand like which it does on private commercial banks. In addition, the bank did not try to sue them on its own or by presenting such cases to the FDRE Attorney General.

There is no clear legal stipulation which forbids foreign investors from being acquiring capital goods from a capital good financing company. The same is true for hire purchase and operating lease finance. In addition, there is a shortage of experts who supervise the leasing business at NBE.

4.2. Recommendations

Given the foregoing findings of the research work, the following recommendations are forwarded to ensure the adequate regulation of domestic financing for foreign investment while maintaining the balance of attracting foreign investment.

- To improve the domestic means of financing for foreign investment while maintaining its proper regulation; it needs to accelerate the establishment of a capital market, to effectively fight corruption, expand goods that are subject to leasing, and granting lease financing companies to provide such goods to a foreign investor provides that the lease company is financed itself from oversees.
- The initial MCR should be set based on sector and it should be higher for some sectors especially for the capital intensive sector. Taking into account the fast-changing circumstance of the world's economy it is better if the determination of MCR is given to the investment board. In addition to the mandatory MCR, the law should incorporate non-mandatory capital requirements which entitle certain advantages, such as tax exemptions for a limited period, for an investor who brings and invest huge amounts of foreign capital.
- In addition, through conducting further research on the investment incentives scheme, it needs incentivizing partnerships of foreign investors with domestic investors.
- The effect of non-registration of foreign capital should be incorporated expressly under the investment law. In addition, as a principle, the importation of used machinery should be prohibited with exaption, and the investment law should be amended to such effect. If not or until then there should be a team or department which revises valuation made abroad by foreign expert and inspect the condition of such used machinery or equipment.
- In addition to concluding BITs, in order to facilitate the enforcement of Ethiopians judicial judgment on foreign investors, Ethiopia needs to enter into bilateral treaties with major FDI Exporting countries to Ethiopia on mutual recognition and enforcement of judgments in civil and commercial matters. Furthermore, BITs which Ethiopia concludes should take into consideration the time of repatriation seriously, since foreign investors may complain about the delay.
- To regulate illicit outflows and inflow of capital concerning under and over-pricing of export and import of goods, there should be a compressive and updated Price index. Further, for its ease of accessibility, such an updated price index needs to be established on database system-oriented. To such effect, there should also be a responsible department under NBE which regularly assesses and makes updates such price.
- In the capital market, there should be market reservations made to the domestic investor to protect the public interest and facilitate ownership of equity for Ethiopian, however, if the proportion designated for domestic investors is not completely subscribed for, it should be allowed the remaining shares to distributed for foreign investors. Hence, the capital market

proclamation should be amended to incorporate such issues or it needs to incorporate in the regulation enacted in the future.

- To prevent the dominance of foreign investors on the loans provided by DBE, it is necessary to make a loan reservation for the domestic investor through conducting an empirical study. DBE should perform its borrowing activity based on banking rules and principles without any improper interference from government officials.
- In addition, to recover its debt that was given to the foreign investor, the bank must bring the case to the FDRE Attorney General's Office before the expiration of the period of limitation.
- NBE who is empowered to supervises all bakes including the development bank should also perform its proper supervisory role on the DBE.
- As the provision of capital goods is intended for those who lack capital, there should be a law that limits the provision of capital good service to foreign investors unless the financing company itself generates such source finance from overseas. On other hand, to undertake the proper supervision of leasing businesses company, the NBE should be equipped with sufficient experts. Hence, the shortage of expertise it needs to fulfill.

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