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Original Article

Forex Regulation *vis-à-vis* Foreign Direct Investment in Ethiopia: An Appraisal of Previous Regulatory Trends vs. the New *Forex* Law

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Abstract

Ethiopia is a key foreign direct investment (FDI) hub in East Africa, consistently striving to boost the business environment with updated legal and institutional regimes. Yet, over the last three decades, foreign investors have been encountering significant investment risks, such as political, economic, and regulatory risks. Forex regulation was one of the regimes that posed a significant challenge to the establishment and operation of foreign investors. Previously, forex was governed by the NBE Establishment Proclamation No. 591/2008 and other subsequent regulations and directives. The forex regulatory trend was generally inconsistent and/or uncertain. In July 2024, Ethiopia adopted a New Monetary Policy Framework to support economic reforms. To implement the new policy, the National Bank of Ethiopia (NBE) enacted Foreign Exchange Directive No. FXD/01/2024. The Directive is the first comprehensive forex law that revises and repeals all the previous forex laws. It introduced substantial policy changes, such as shifting to a market-based exchange and eliminating various forex-related requirements, such as surrendering requirements. Besides, it mandates consultation with the NBE for foreign loan contracts and sets guidelines for forex account transactions in industry parks and special economic zones. On one hand, the rules in general aim to simplify and liberalize forex transactions, and they do have far-reaching repercussions on FDI in Ethiopia. This article, through textual

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analysis and/or doctrinal research methods, analyzes Ethiopia's previous forex regulations and compares them with the new law to evaluate their impact on FDI (if the regulatory trend supports or hinders FDI from the perspective of foreign investors). The findings of the work reveal that the previous forex regime was largely inconsistent with the state investment policy of attracting and protecting FDI. Neither did it resolve the country's currency shortage. Thus, it has been causing a substantial regulatory risk to FDI. The new forex law that repeals all the previous forex regime has incorporated significant changes that, on their faces, do potentially create a more favorable condition for the establishment and operation of FDI when compared to the previous regime. Yet, their practical repercussions on FDI in Ethiopia are to be seen.

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1. Introduction

Ethiopia has implemented several reforms to attract and protect foreign investors. It is a signatory state to many key international investment agreements, such as the Multilateral Investment Guarantee Agency (MIGA), and has signed bilateral investment promotion and protection treaties (BITs) with over 30 countries. At home, it has adopted a liberal investment law that incorporates important guarantees to foreign investors, such as full repatriation of profits in convertible currency, national treatment (NT), most-favored-nation treatment (MTN), and a fair and equitable treatment (FET) standard, among other things. However, for the last three decades, foreign investors have faced various investment risks, including economic, political, legal, and infrastructure risks.[1] In general, high state interference, poor infrastructure, land acquisition issues, strict foreign exchange controls, high transaction costs, and institutional weaknesses hinder Ethiopia's long-term economic development prospects.[2] In the field of foreign investment, regulatory risk is a significant factor that influences foreign investors' investment decisions. Countries with low regulatory risk are in general more likely to attract FDI.[3] In Ethiopia, foreign investors were facing regulatory risks mostly due to strict forex controls.[4] Forex regulation was one of the regimes that posed a significant challenge to the establishment and operation of foreign investors. Previously, forex was governed by the NBE Establishment Proclamation No. 591/2008 and other subsequent regulations and directives. The forex regulatory trend was generally inconsistent and/or uncertain.

[1] Lloyds Bank, Ethiopia: Investing in Ethiopia, April 2024, https://www.lloydsbanktrade.com/en/market-potential/ethiopia/investment
[2] Ibid
[3] Ibid
[4] Berihu Assefa, Mulu Gebreeyesus, and Alebel Bayrau, Chinese Investment in Ethiopia: Contribution, Challenges, Opportunities, and Policy Recommendations. PSI Research Report 34, Addis Ababa: Policy Studies Institute, 2020, p. 33, Available at https://mpra.ub.uni-muenchen.de/109166/1/MPRA_paper_109166.pdf Accessed on July 15, 2024

In July 2024, Ethiopia adopted a New Monetary Policy Framework to support economic reforms. With the aim of implementing the new policy, the NBE enacted Foreign Exchange Directive No. FXD/01/2024.[5] The Directive is the first comprehensive forex law that revises and repeals all the previous forex laws. The Directive addresses various activities such as banks, forex bureaus, and foreign currency accounts. The new law seeks to provide a unified framework for managing Ethiopia's foreign exchange market by replacing previous regulations.[6] It entails significant policy changes in various aspects of forex in Ethiopia. The Directive marks a transition to a market-based exchange regime, allowing banks to buy and sell foreign currencies at freely negotiated rates with limited NBE intervention. Besides, it removes several requirements in relation to forex embodied in previous regulations. The Directive removes surrender requirements to NBE and enhances retention rules, enabling exporters and banks to retain foreign exchange, converting 50% of export proceeds to Ethiopian Birr (ETB) immediately at a negotiated rate. The rules governing banks' allocation of foreign exchange and rules restricting imports are also the rules repealed by the Directive.[7]The Directive, for the first time, introduces non-bank foreign exchange bureaus, operating independently without bank affiliation. Restrictions on *franco-valuta* imports of goods not utilizing foreign exchange from the banking system are also lifted.

In sharp contrast to the previous forex regime, the Directive also establishes foreign currency saving accounts (FCY) for various entities and individuals, subject to specific requirements. A modest modification was made to the foreign loan contracts. Although the requirement of prior mandatory consultation with NBE before entering foreign loan contracts is maintained: interest rate ceiling for private sector borrowing from abroad is removed. The Directive also opens the securities market to foreign investors with detailed terms and conditions to follow. Lastly, it permits industry parks and Special Economic Zones (SEZs) to engage in various transactions, including the purchase and sale of raw materials in FCY, and explicitly provides guidelines for foreign currency cash notes for travelers, limiting cash to US$10,000 per trip for residents unless authorized otherwise. Overall, these changes aim to liberalize and streamline foreign exchange transactions and regulations in Ethiopia. These new regulations do have far-reaching repercussions on FDI in Ethiopia as well.

This article, through textual analysis and/or doctrinal research methods, critically analyzes the repercussions of Ethiopian forex regulations on FDI, comparing past trends with the new forex law. Along, it assesses the compliance of the past and present forex regimes with the state's goal of attracting and

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[5] The Foreign Exchange Directive No. FXD/01/2024 (referred to as 'FXD/01/2024' herein under). The NBE enacted this Directive in accordance with Article 18(6), Article 20, Article 21(5), and Article 27(2) of the National Bank of Ethiopia Establishment (as Amended) Proclamation No. 591/2008. The Directive is a lengthy text of 108 pages in total, containing 25 lengthy articles with many sub-provisions divided into seven parts and containing six annexes.

[6] FXD/01/2024, Art-25.2.1

[7] The new regime allows authorized banks to facilitate imports of goods for any value upon submission of required documents.

protecting FDI, or if they pose a risk to foreign investors.

2. Foreign Currency and Foreign Direct Investment: An Overview of Conceptual and Legal Backgrounds

2.1. Definition of Key Terms

Some concepts are referred to throughout the work, and it is imperative to briefly address them before delving into the main theme of the work. Thus, this section briefly discusses the key concepts of FDI, currency, foreign currency, foreign exchange, exchange market, foreign exchange rate, and foreign exchange regulation, respectively. The Organization for Economic Cooperation and Development (OECD) defines FDI as a type of investment where a resident enterprise in one economy establishes a lasting interest in an enterprise in another economy.[8] An establishment of a lasting interest often involves a foreign investor owning at least 10% of the voting power in an enterprise in a host state.[9] FDI is essential for integrating economies globally, and bringing capital, technology, and skills to foreign markets.[10] Effectively managed, it can be a significant source of capital inflows, especially for underdeveloped recipient states.[11] However, maximizing FDI benefits requires addressing challenges such as creating a transparent, investor-friendly environment and enhancing institutional capacity through international investment architecture and national policies.[12] This, inter alia, requires a host state to have effective, predictable legal frameworks in several fields of law that potentially affect the establishment and operation of FDI, including laws governing foreign currency.

The next concept worth addressing here is the concept of 'currency' and/or 'foreign currency'**.** There is no universal definition of money or currency, and it is often defined as an economic unit that functions as a generally recognized medium of exchange for transactional purposes.[13] They are economic units that serve as mediums of exchange generally accepted for transactions and have recognized value.[14]While the terms money, currency, and legal tender are often used interchangeably, money is usually referred to as currency, a liquid asset used for transactions.[15] On the other hand, foreign currency is any currency other than the official currency in a country. The NBE Establishment

[8] OECD Benchmark Definition of Foreign Direct Investment 2008, 4th edition, p. 17. Available at https://www.oecd-ilibrary.org/docserver/9789264045743 Accessed on May 10, 2024

[9] Maitena Duce and Banco de España, Definitions of Foreign Direct Investment (FDI): A Methodological Note Final Draft, July 31, 2003, p. 2. Available at https://www.bis.org/publ/cgfS22BDe3.pdf Accessed on May 17, 2024

[10] OECD , International Investment Law: Understanding Concepts and Tracking Innovations, Companion Volume to International Investment Perspectives, 2008, p-46, Available at https://www.oecd.org/investment/internationalinvestmentagreements/40471468.pdf, accessed on March 20, 2024

[11] Ibid

[12] Muhammad Akram and Hassan Mobeen Alam, The Impact of Exchange Rate Movement on Foreign Direct Investment Inflows in Pakistan: An Empirical Assessment Using the ARDL Approach to Cointegration, Journal of the Punjab University Historical Society, Volume No-3, Issue No. 2, July-December 2017, p. 114, available at https://pu.edu.pk/images/journal/HistoryPStudies/PDF_Files/11_V-30-No2-Dec17.pdf Accessed on July 20, 2024

[13] Investopedia, Definition of Money, Currency, and Legal Tender, Available at https://www.investopedia.com Accessed on May 10, 2024

[14] Ibid

[15] Ibid

Proclamation No. 591/2008[16] and FXD/01/2024[17] define foreign currency as currencies accepted for payment in Ethiopia. However, the latter also adds the expression "foreign currency cash notes" in addition to 'foreign currency' and defines it as currencies, which are acceptable by banks and authorized foreign exchange dealers as listed by the NBE from time to time.[18] The expression 'other foreign currency'; i.e., 'foreign currency other than those listed as acceptable foreign currency by NBE' is also incorporated in the Directive.[19] The expression 'foreign exchange' represents money denominated in another country's currency or a group of countries. It also refers to claims on foreign currency payable abroad, including funds, bills, and checks.[20] The concept of foreign exchange often comes into play in the context of currency convertibility. Currency is considered convertible if the person holding it can freely convert it into any other currency.[21] The NBE Establishment Proclamation defines foreign exchange as;

Any foreign currency, checks, bills of exchange, promissory notes, drafts, securities, and other negotiable instruments, expressed in foreign currency, as well as bank balances in accounts held in foreign currency or assets in the form of foreign account crediting or set-off arrangements, expressed or payable in foreign currencies, provided they are acceptable by the NBE.[22]

The last group of concepts commonly raised in the discourse of forex is the 'foreign exchange market', the 'foreign exchange rate', and 'foreign currency regulation'. A foreign exchange market is a mechanism where currencies can be bought and sold, with pricing being a key component.[23] The Directive defines 'foreign exchange market" as a market where spot foreign exchange transactions are conducted at either the retail level (between bank and client or between forex bureau and client) or wholesale level (among banks).[24] It enumerates banks and authorized foreign exchange dealers as the key stakeholders in the foreign exchange market in Ethiopia.[25] FXD 01/2024 adopts a floating exchange rate system for the Ethiopian Birr, determined by the foreign exchange market based on supply and demand for other currencies.[26] On the other hand, 'regulation of foreign exchange' represents government-imposed limits on currency purchases to stabilize economies. Today, strict exchange controls are generally seen as undesirable, as they can discourage FDI.[27] Foreign investors prefer free convertibility and transfer of funds.

[16] The National Bank of Ethiopia Establishment (as Amended) Proclamation No. 591/2008, Federal *Negarit Gazetta*, 14th Year No. 50, Art-2.5

[17] FXD /01/2024, Art-2.35

[18] Id, Art. 2.36

[19] Id, Art-2.64

[20] James Sharpe, Foreign Exchange: The Complete Deal, A Comprehensive Guide to the Theory and Practice of the Forex Market, Harriman House Ltd, UK, 2012, p-37

[21] Ibid

[22] NBE Establishment Proc.No., 591/2008, Art-2(6). A verbatim copy of this definition is contained under Arts-2.37 of the FXD/01/2024. These definitional provisions indicate that foreign currency is an element of a broader foreign exchange.

[23] James Chen, Exchange Rates: What They Are, How They Work, and Why They Fluctuate, Updated July 23, 2024, Available at; https://www.investopedia.com/terms/e/exchangerate.asp Accessed on April 17, 2024

[24] FXD/01/2024, Art-2.38

[25] Id, Art-4

[26] Id, Art-5

[27] EMUI Euro-Mediterranean University Institute (2016), Country Risk in Foreign Direct Investment: Similarities and Differences with Country Risk in Exports, p. 4, available at http://dx.doi.org/10.5209/NOMA.53538 Accessed on July 20, 2024

28Restrictions on currency transfers can hinder foreign investors and lead to exchange rate risks that affect profits. 29Predictable regulations often positively impact FDI.30 Uncertainty in-laws, excessive regulations, government instability, and legal insecurity can deter FDI.31 In some transition economies, legal instability can lead to adverse selection of investors and lower FDI inflows.32

2.2. Foreign Direct Investment and Foreign Currency in Ethiopia: An Overview of the Policy and Law

2.2.1Foreign Direct Investment

In 1991, Ethiopia transitioned from a "command economy" to essentially forming 'the new market economy' which allowed FDI (mainly in the manufacturing sector) to enter into the country.[33] To attract foreign investment, Ethiopia has enacted laws, signed 34 Bilateral Investment Treaties (BITs) with 22 currently in effect and 12 pending, and joined the Multilateral Investment Guarantee Agency (MIGA) and the Common Market for Eastern and Southern Africa (COMESA).[34] While not ratifying the Convention on the Settlement of Investment Disputes, the country has committed to using the Additional Facility provided by an agency under the International Centre for Settlement of Investment Disputes (ICSID).[35] A 'Homegrown Economic Reform' was implemented in 2018 to enhance government efficiency and liberalize the economy, leading to the creation of new regulations and investment policies in 2020.[36] In terms of territorial sovereignty, governments have the option to either open their economy to foreign investors or close it partially or fully, which is an economic consideration.[37] In Ethiopia, the Investment Proclamation[38] and Regulation[39] define which parts of the economy are open or closed to foreign investors as part of their investment in Ethiopia. The sector is partially or entirely open to foreign investors, which means that in areas such as postal and air transport services, joint ventures with the government are now possible.[40] Some sectors permit foreign investors to invest, while others demand technology transfer and profit-sharing through joint ventures.

A "negative list approach" was introduced by the Proclamation and Regulation to identify areas that foreign investors could explore for

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[28] Ibid

[29] Ibid

[30] Christian Daude and E. Stein, Quality of Institutions and Foreign Direct Investment, Vol. 19, No. 3, 2007, p. 324. Available at: https://ideas.repec.org/a/bla/ecopol/v19y2007i3p317-344.html Accessed on 23 April 2024

[31] Ibid

[32] Jacek Cukrowski, et al.,, Determinants of Foreign Direct Investments in Transition Economies, Problems of Economic Transition , Vol-48, No-2, 2003, Available at; https://www.researchgate.net/publication/5173292_On_the_Determinants_of_Foreign_Direct_Investment_in_Transition_Economies , Accessed on April 23, 2024

[33] Martha Belete Hailu and Zeray Yihdego, The Law and Policy of Foreign Investment Promotion and Protection in Ethiopia: An Appraisal of Theories, Practices and Challenges, Ethiopian Yearbook of International Law 2017, pp-13-14

[34] Bereket Alemayehu Hagos, Major Features of Ethiopia's New Investment Law: An Appraisal of their Policy Implications Transnational Corporations Journal, Vol. 29, No. 1, April 28, 2022, pp.137-138 Available at; https://ssrn.com/abstract=4096750 Accessed on Oct-15, 2024

[35] Ibid

[36] Ibid

[37] Id ,p-139

[38] Investment Proclamation No. 1180/2020, *Federal Negarit Gazette*, 26th Year No. 2, 2020, Addis Ababa

[39] Council of Ministers Investment Regulation No. 474/2020, *Federal Negarit Gazette*, 26th Year No. 78, 2020, Addis Ababa

[40] Art. 6(2), the Proclamation; Art. 3, the Regulation

investment purposes.[41] This method categorizes closed or restricted areas, while remaining open areas. The determination of prohibited or restricted investments becomes simpler with this. Nevertheless, certain countries employ the "positive list approach" to identify sectors that allow foreign investment, making it difficult to cover all fields and introduce new investment areas.[42]. The adoption of the negative list approach is anticipated to resolve administrative challenges and enhance the transparency and efficiency of an investment system. The objective of this change is to boost investment in Ethiopia. This proclamation outlines conditions for setting up and operating an investment in Ethiopia, including the allocation of minimum capital to foreign investors and the acquisition and maintenance of permit applications.[43] Regulations are also formulated to promote and facilitate investment, which include direct access to investors and the EIC's responsibility to simplify visa applications.[44] The Ethiopian Investment Board, EIC, Federal Government and Regional State Administrations Investment Council, and regional investment bodies are all part of the investment administration.[45] The Board, under the leadership of the Prime Minister, is accountable for establishing investment policies, managing EIC initiatives, and overseeing investments within its purview.[46] Industrial Parks Development Corporation of Ethiopia (IPDC) develops and operates industrial parks including textile and apparel production.

The Proclamation provides guarantees, protections, and obligations for investors, including allowing foreign investors to own immovable property, protect investment against unlawful expropriation, and allow foreign loans, foreign currency accounts, and repatriation of investment-related funds.[47]It also outlines obligations for investors, including providing investment information to government bodies and complying with social and environmental sustainability requirements.[48]

In March 2021, the Ethiopian Commercial Code was amended to regulate economic activities with more modern business structures and bankruptcy procedures. Despite these all legislative reforms; high state interference, poor infrastructure, land acquisition issues, strict foreign exchange controls with high transaction costs combined with institutional weaknesses make Ethiopia struggle to welcome foreign investment.[49]

2.2.1. Foreign Currency

The FDRE Constitution[50] establishes a federal parliamentary republic, with a bicameral parliament consisting of the House of Federation and the House of People's Representatives. It allocates law making power between the federal government and regional

[41] Bereket, p-149
[42] World Bank Group , Investment Law Reform: A Handbook for Development Practitioners, 2010, Washington, D.C., p-28
[43] Investment Proclamation No. 1180/2020, Arts. 9 and 10,
[44] Id, Arts- 24 and 23
[45] Id, Art. 29
[46] Id, Art. 31
[47] Id, Arts-18-21
[48] Id, Art. 14 and 54
[49]Llyods Bank, Foreign direct investment (FDI) in Ethiopia, April 2024, https://www.lloydsbanktrade.com/en/market-potential/ethiopia/investment
[50] Constitution of the Federal Democratic Republic of Ethiopia, 1995, *Federal Negarit Gazetta*, Proc. No. 1, 1st year, No. 1, Article 51(7)

states. The powers to administer the National Bank, print and borrow money, mint coins, and regulate foreign exchange and money in circulation belongs to the federal government.[51] Thus, the currency and currency exchange-related issues are the exclusive power of the federal government. The NBE is authorized to enforce currency exchange regulations under the supervision of the Council of Ministers.[52] It is responsible for formulating and implementing exchange rate policy, managing international reserves, setting limits on gold and silver bullion and foreign exchange assets, establishing payment systems, and monitoring foreign exchange transactions.[53] The NBE also acts as a banker, fiscal agent, and financial advisor to the government, modernizing payment systems and exercising other powers.[54] It controls foreign exchange transactions under the NBE Proclamation and related Directives, Guidelines, and Letters.[55] The NBE has issued several directives governing various aspects of foreign currency control, retentions, utilization, management, and operations of foreign currency, foreign currency transactions, and regulations of external loans.

The foreign exchange regime in Ethiopia has been liberalized gradually, with the delegation of management of foreign exchange operations to commercial banks under Directive FXD/07/1998. Over 60 directives, letters, and guidelines have been issued to regulate market activities and foreign direct investment. There was no comprehensive law that governs foreign currency exchange in Ethiopia until recently, and the sector used to be governed by the NBE Establishment Proclamation No. 591/2008[56] and several Directives and Regulations subsequently enacted by the same. These forex-related laws were subject to frequent amendment and were unpredictable and uncertain, thereby posing a problem for foreign investors. However, the Ethiopian state has made a sudden shift in its entire monetary policy recently.[57] As a part of an IMF-backed economic program, the new policy is believed to support the authorities' Homegrown Economic Reform Agenda, a comprehensive policy package to stimulate private sector activity and increase economic openness to promote higher and more inclusive growth.[58] Other development partners—notably the World Bank—are also providing substantial external financing, and the program provides a framework for the successful completion of the ongoing debt restructuring.[59]

In order to guide the implementation of the new policy, the NBE issued FXD/01/2024, a new law that consolidates and revises previous forex legislation. [60] The new law addresses several key forex-related activities. such as the role of banks and authorized dealers, exchange rate determination, foreign exchange retention,

[51] Id, Art- 55(10)

[52] Id, Art. 77(4) FDRE and NBE Establishment Proc.No., 591/2008

[53] NBE Establishment Proc.No., 591/2008, Art-5

[54] Ibid

[55] Ibid

[56] Id, Art-4

[57] National Bank of Ethiopia, Press Release, The National Bank of Ethiopia Announces A Reform Of The Foreign Exchange Regime With Immediate Effect 29 July 2024, Addis Ababa, Ethiopia, https://nbe.gov.et/wp-content/uploads/2024/07/FXD012024-FOREIGN-EXCHANGE-PR-English.pdf

[58] IMF, Key Questions on Ethiopia, July 29, 2024, https://www.imf.org/en/Countries/ETH/ethiopia-qandas#:~:text=A%20new% 20monetary% 20policy%20interest,prices% 20for% 20some% 20imported%20commodities.

[59] Ibid

[60] FXD /01/2024, Art-25.2.1

exports, imports, services, forex bureau operations, remittances, payment instruments, foreign currency accounts, capital account transactions, and other miscellaneous items.

This Directive is a comprehensive law that seeks to regulate all aspects of foreign currency. Its comprehensiveness can also be understood from its provision which determines the scope of its application.[61] Pursuant to Art-3.1, the directive applies to 'all transactions related to foreign exchange', an expression that is broad enough to accommodate several forex-related transactions. The provision enumerates a non-exhaustive list of the transactions, emphasizing the most frequently made transactions.[62]

In addition to the transactions, the directive is made applicable to 'the *conclusion of any contract, agreement, arrangement, or understanding, as a result of which any foreign exchange* is purchased, sold, transferred, borrowed, lent, assigned, exchanged, received, paid, or credited.[63] Thus, its scope of application extends to 'agreements' that lead to the purchase, sale, transfer, etc. of foreign exchange. Here the law apparently talks about agreements such as external loans, external loans in kind, supplier's credit, etc. All foreign exchange purchases and cross-border payments for current account transactions are in principle authorized.[64] Yet, the provision speculates exceptional circumstances where *foreign exchange purchases and cross-border payments for current account transactions* may be denied. Current account transactions, as defined by the Directive, are 'transactions involving visible trade (exports and imports of goods), invisible trade (exports and imports of services), transfers (either private or public), and factor income-related flows (from labor or capital).'[65] Unlike a general authorization for current account transactions, the Directive prescribes a general restriction on capital account transactions.[66] Capital account transactions stand for inflows and outflows of capital that directly affect a resident's foreign assets and/or liabilities position.[67] Thus, in principle, all inflows and outflows of capital that directly affect the foreign assets and/or liabilities positions of Ethiopian nationals or resident foreigners living and/or working in Ethiopia are restricted unless there is exceptional permission.

3. *Forex* Regulation vis-à-vis FDI in Ethiopia: An Appraisal of Previous Regulatory Trends vs. the New *Forex* Law of 2024

This section highlights important facets of the Ethiopian *forex* regime impacting FDI and carefully examines the substantive contents of Ethiopia's prior forex regulatory developments in comparison to the Forex Directive No. FXD/01/2024 in the context of their effects on FDI.

3.1 Forex Surrender and Retention

The main mechanism for managing forex in Ethiopia involves overseeing how businesses keep and use it. Forex retention is a mechanism that allows businesses, such as exporters and investors, to keep the amount of foreign currency they have earned from abroad. Ethiopian businesses are not permitted to keep all the foreign currency they have made due to policy reasons, which are often caused by a

[61] Id, Art-3
[62] Ibid
[63] Id, Art-3.1.2
[64] Id, Art-3.2
[65] Id, Art-2.16
[66] Id, Art-3.3
[67] Id, Art-2.11

scarcity of foreign currencies. Additionally, there are regulations that require foreign currency remittances to be deposited in a specific foreign exchange account at domestic banks.

The first law enacted to regulate forex retention and utilization was Directive No. FXD/02/1996.[68] It allowed exporters to retain a portion of their export proceeds in foreign currency. In 1998, the first law was replaced by Directive FXD/11/1998[69] that allowed exporters to retain 100% of their export earnings, distributed between two retention accounts A and B. The Directives that came immediately after Directive FXD/11/1998, i.e., Directive No. FXD/48/2017[70], adjusted the ratios to a 30:70 distribution. This ratio was maintained by a successor to Directive No. FXD/48/2017 (Directive No. FXD/66/2020).[71] Again, Directive No. FXD/66/2020 was repealed and replaced by Directive FXD/70/2021[72]in 2021. Directive FXD/70/2021 mandated a 30% surrender of earnings to the NBE, reduced the remaining currency to 45%, and required the immediate sale of 55% of earnings to banks. In the same year, Directive FXD/70/2021 was replaced by Directive No. FXD/73/2021[73] which was again replaced by Directive No. FXD/79/2021.[74] Directive No. FXD/73/2021, introduced a 50% - 40% - 10% allocation, requiring exporters and remittance earners to surrender 50% of their earnings, while allowing 40% indefinite retention. Directive No. FXD/79/2021 changed the allocation to 70% - 20% - 10% (70 percent to NBE, 20 percent to the retention account for the benefit of exporters and inward remittance earners and 10 percent to commercial banks). Yet, it was eventually replaced with Directive No. FXD/84/2023.[75]

As per FXD/84/2023, exporters of goods and services have the right to retain 40% of their export earnings, while recipients of inward remittances have the right to retain 20% in foreign currency transfers after deducting 50% and 70% of the surrender requirements from the total exports and remittance earnings, respectively. Directive No. FXD/84/2023 doubled the percentage of foreign currency that exporters were previously allowed under FXD/79/2022. Just like its predecessor, the Directive authorized banks to open 'forex retention accounts' for 'eligible businesses'. Although FXD/84/2023 aimed to reduce Ethiopia's inflation rate, forex issues persisted, with exporters required to surrender up to 80% of earnings, causing reduced production capacity and job losses. As a result, the NBE has issued Directive No. FXD/86/2023[76] in

[68] Procedures for the Retention and Utilization of. Export Earnings Directive No. FXD/02/1996.

[69] Retention and Utilization of Export Earnings and Inward. Remittance Directive No. FXD 11/1998

[70] Directive for Amendment of Retention and Utilization of Export Earnings and Inward Remittance Directive No. FXD 11/1998, or simply Retention and Utilization of Export Earnings and Inward Remittance Directive No. FXD 48/2017.

[71] Retention and Utilization of Export Earnings and Inward Remittances, Directive No. FXD/66/2020

[72] FXD/73/2021, Directive for Amendment of Retention and Utilization of Export Earnings and Inward Remittance, Directive No. FXD/70/2021

[73] FXD/73/2021, Directive for Amendment of Retention and Utilization of Export Earnings and Inward Remittance, Directive No. FXD/70/2021

[74] The Retention and Utilization of Export Earnings and Inward. Remittances Directives No." FXD/79/2022

[75] The Retention and Utilization of Export Earnings and Inward. Remittances Directives No." **FXD**/**84**/2023

[76] Off-shore Account Opening and Operations for Strategic Foreign Direct Investment Projects Directive No. FXD/86/2023

order to tackle the problem to some extent. The law was meant mainly to help foreign investors in key sectors access more forex. It made an exception to the general prohibition of having offshore forex accounts, allowing businesses investing in strategic areas to use offshore bank accounts.[77] Yet, the use of offshore accounts is restricted to specific payments, such as external debt service, insurance claims, capital or investment expenses, and maintenance and operation costs.[78] In addition, the Directive ensures foreign currency convertibility[79] for dividend repatriation and loan repayments for strategic PPP power and mining projects when they exhaust options for purchasing foreign exchange from banks.[80] The Directive was augmented by the relevant provisions of the External Loan and Supplier's Credit (as amended) Directive No. FXD/82/2022 for matters it has not covered.[81]

As pointed out above one the fundamental policy change introduced by Directive No. FXD/01/2024 is the removal of surrender requirements to the NBE and improvement of forex retention rules. Pursuant to Art-6.1 of the Directive, exporting goods requires approval from an Authorized Bank and payment instruments to secure payment.[82] Exporters must repatriate sales proceeds in foreign exchange to an authorized bank before, during, or within three months, or as prescribed by the NBE for specific export classes or exports.[83] Payment instruments are required for exports. Exporters must convert 50% of their export proceeds into Birr at a freely negotiated rate for the Bank used in processing their foreign exchange transaction, while keeping the remaining 50% in their Foreign Exchange Retention Account.[84]

Art-6.2 states that;

After fulfilling the repatriation requirement set out in sub-article 6.1, *exporters of goods and services shall immediately convert into Birr, at a freely negotiated rate, 50 percent (50%) of their export proceeds to the Bank used in processing their foreign exchange transaction, while keeping the remaining 50 percent (50%) in their Foreign Exchange Retention Account.*[85]

To support the interbank foreign exchange market, foreign earners can use their Foreign Exchange Retention Account for different payments, with funds required to be sold to a transacting bank after 30 days. It is possible to convert leftover earnings into Birr at any time, and it can also be sold at a fixed exchange rate. However, half of the export proceeds will be retained in EBT at a negotiated rate by exporters and banks, while the remaining portion is held in the Foreign Exchange Retention Account. Some foreign exchange inflows do not have to be converted. Changes in the share of foreign exchange earnings and duration may be made by the NBE. Different account types are specified in the directive, which includes accounts for foreign entities, Ethiopian residents and non-residents, and

[77] Eligible projects include PPPs in power generation and infrastructure, large mining projects with export potential, and FDI projects.

[78] Art. 4, FXD/86/2023

[79] Art. 2.4 defines a convertibility guarantee as 'a guarantee providing assurance that local currency funds can be converted into foreign currency funds at the prevailing exchange rate'

[80] Art. 6.1. FXD/86/2023, Art. 2.2 defines a bank as 'a company licensed by the National Bank to undertake banking business or a bank owned by the government.

[81] Id, Art-9

[82] Id, Art-6.1

[83] Ibid

[84] Id, Art-6.2

[85] Ibid

exporters.[86] Merchants and entities can be included in the Retention Accounts Scheme to hold onto foreign exchange, provided that they have written permission to do so before funds are credited to their account.[87]

Despite Ethiopia's previous restrictions on forex retention, surrender, and utilization, the country hasn't been successful in attracting foreign investment or resolving currency shortages. The state asserts that there has been a surge in FDI arrivals, but there is no concrete proof to support this assertion. It is clear that the NBE has issued several guidelines on how to retain and use forex, indicating government interest in the matter. The laws have been repealed or modified several times, indicating their inability to tackle forex shortages. It is worth mentioning that the country essentially endorses international investment laws that permit the complete return of profits, dividends and interest payments in convertible currency, as well as upholding FET standards to safeguard investors from arbitrary actions by host states.

3.2. *Forex* Allocation

In countries that face foreign currency shortages, it is not uncommon to control and allocate the available foreign currency to certain priority sectors. Ethiopia has been facing a foreign currency shortage, with decades-old *forex* allocation laws in place. In 2021, the NBE enacted Directive No. FXD/77/2021.[88] that prioritized allocation of foreign currency to products and services based on first-come, first-served principles in order to promote effective and transparent foreign exchange distribution.[89] The Directive outlines the powers and functions of different organs, requiring banks to have clear guidelines for foreign currency allocation and management. The executive management board of the NBE was authorized to review the bank's foreign exchange exposure monthly to maintain prudent levels and resources.[90] The directive also requires daily records of foreign exchange business closures, proper reporting procedures between head offices and branches, monthly reconciliation of transaction accounts, and effective internal controls to monitor and control foreign exchange operations.[91]

The Directive outlines foreign exchange allocations and priorities in three categories: pharmaceutical items, medicine, and pharmaceutical manufacturing inputs; agricultural and manufacturing inputs; and motor oil, agricultural inputs, and pharmaceutical products.[92] Nonetheless, ***in practice,*** FXD/77/2021 has led to a lack of transparency and procedural requirements for accessing foreign exchange exchanges.[93] It also reduced the amount of foreign currency allocated for third-priority imports and payments to 40%, resulting in limited funds for these transactions. This has led to a risk of FDI, which is crucial for economic growth.[94] *Above all,* the forex regime governing allocation was

[86] Id, Art-15.1
[87] Id, Arts-5 and Art-12.13
[88] Transparency in Foreign Currency Allocation and Foreign Exchange Management (As Amended) Directive No. FXD/77/2021
[89] Id, the preamble, and Art. 6
[90] I d, Art- 4
[91] Id., Art-3
[92] Id, Art-6
[93] The *Legatum* Institute Foundation, Global Index of Economic Openness, Pathway to Prosperity Ethiopia Case Study 2021, p. 59, Available at https://li.com/wp-content/uploads/2021/09/GIEO-Ethiopia-Case-Study-Web.pdf Accessed on May 7, 2024
[94] WFP, Market Watch Ethiopia, March 2022, Retrieved from file:///C:/Users/en/Downloads/WFP-0000138505.pdf, < accessed on May 7, 2022.

inconsistent with the government's investment policies, limiting the privileges for companies engaging in FDI and import substitution. The regime did not differentiate between different types of companies, causing foreign companies to be disproportionately affected by forex shortages. Access to forex remained a risk, limiting growth, interfering with maintenance and spare parts replacement, and impeded imports of raw materials.[95] FXD/01/2024 repeals all previous foreign exchange directives and circulars, including Directive No. FXD/77/2021. Thus, the significant policy change in this area is the removal of rules governing banks allocation of forex and/or imports based on a waiting-list system for different categories based on priority.

3.3. Repatriation of Funds Off-Shore

Ethiopia regulates foreign exchange inflow and outflow, requiring effective repatriation of funds for foreign investors. A quick perusal of most Ethiopian BITs reveals that it fully liberalizes investment capital repatriation.[96] Capital inflows from foreign investors are generally registered at the Ethiopian Investment Commission (EIC) at the initial stage of investment, and subsequent requests for repatriation depend on compliance with EIC and NBE requirements.[97] On the other hand, Investment Proclamation No. 1180/2020 guarantees capital repatriation and remittance of dividends and interest.[98] All registered foreign investors to remit profits and dividends, principal and interest on foreign loans, and fees related to technology transfer in convertible foreign currency at the prevailing exchange rate.[99] The general rule stated under Art-20/1 of the Investment Proclamation under the title 'Remittance of Funds' is:

Any foreign investor shall have the right, in respect of his investment, to remit the following payments and earnings out of Ethiopia *in convertible foreign currency at the prevailing exchange rate on the date of transfer:*

1. *Profits and dividends* accruing from his investment;
2. *Principal and interest payments* on external loans;
3. Payment related to a technology transfer agreement registered by Article 15 of this Proclamation;
4. Payments related to collaboration agreements registered in accordance with Article 16 of this Proclamation;
5. Proceeds from *the transfer of shares or conferral of partial or total ownership of an enterprise to another investor;*
6. Proceeds from *the sale, capital reduction, or liquidation of an enterprise*; and
7. *Compensation* paid to an investor pursuant to Sub-article (2) of Article 19 of this Proclamation.[100] (Emphasis Added)

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[95] IMF Staff Report for the 2019 Article IV Consultation and Request for Three-Year Arrangement under the Extended Fund Facility: Press Release and Staff Report IMF Country Report No. 20/29, Ethiopia, p. 24 Available at: https://www.imf.org/-/media/Files/Publications/CR/2020/English/1ETHEA2020001.ashx <Accessed on May 5

[96] Zakariyas Berhanu, Foreign Capital Outflow Regulation under Ethiopian Bilateral Investment Treaties and Domestic Investment Laws, Haramaya Law Review, *Vol. 7*, 2018, p. 78. Available at: https://www.ajol.info/index.php/hlr/article/view/184423 Accessed on July 20, 2024

[97] Ibid

[98] Investment Proclamation No. 1180/2020, Article 20

[99] Ibid

[100] Id, Art-20/1

The Proclamation outlines the permissible funds for offshore repatriation, but it is unclear if foreign investors can relocate their investments before liquidation or repatriate capital in kind.[101] It restricts offshore remittance only to foreign investors and denies that domestic investors investing jointly with foreign investors cannot remit funds.[102] However, expats employed for investments outside Ethiopia can remit salaries in convertible foreign currency at the prevailing exchange rate.[103] FXD Directive No. 01/2014 has contained a more detailed concern concerning the repatriation of funds offshore. The general principle under the Directive is that, 'unless explicitly authorized by NBE, capital account transactions by residents shall not be permitted, and banks shall not effect such capital transfers except under the specific exceptions and requirements'.[104]—–The subsequent provisions of the Directive address the requirements for each element of repatriation of funds, *i.e.*, remittance of registered foreign investments.[105]transfers of profits and dividends.[106]-The transfer of profits and dividend wing has contained many lists that include net profit/dividend[107] , remittance of proceeds from liquidation[108] , and remittance of proceeds from sales of shares.[109] The Directive allows registered foreign investments, approved by the National Bank or Ethiopia Investment Commission, to repatriate profit and dividends, proceeds from liquidation, share transfers, return of investment if unable to start operation, and profits from portfolio investments in equity or debt securities.[110]

Investors earning profits or dividends from foreign investments can remit their net profit or dividend abroad with certain documents. These include authenticated minutes of the Board of Directors, a copy of closing financial documents audited by an independent third party, a capital registration letter from the National Bank or Investment Authority, tax receipts, a memorandum and article of association, a valid business license, an application letter, and any other necessary documents required by the National Bank.[111] As a wing of transfer of profits and dividends, the new law permits branch offices of foreign companies operating in Ethiopia desirous of repatriating foreign exchange.[112]–The NBE shall not deny the repatriation of profits from dividends so long as the documentary requirements are satisfied.[113]-As an exceptional treatment for any profit and dividend amounts that may be outstanding as of the issuance of this Directive (involving dividend repatriations approved by NBE but for which payment has not been effected by banks), the NBE *shall stipulate a special repayment schedule to be applied to address the backlog of such dividend cases*. Such a repayment schedule will not apply to any new dividend repatriation requests that are initiated after the issuance of this

[101] Zakariyas Berhanu, Foreign Capital Outflow Regulation under Ethiopian Bilateral Investment Treaties and Domestic Investment Laws, Haramaya Law Review, *Vol. 7*, 2018, p. 78, available at: https://www.ajol.info/index.php/hlr/article/view/184423 . Accessed on July 20, 2024
[102] Investment Proclamation No. 1180/2020, Art-20/2
[103] Id, Art 20/3
[104] FXD/ 01/2024, Art-16
[105] Id, Art-16.2.1
[106] Id, Art-16.3
[107] Id, Art-16.3.1
[108] Id, Art-16.3.5
[109] Id, Art-16.3.6
[110] Id, Art-16.2.1
[111] Id, Art-16.3.1
[112] Id, Art-16.3.2
[113] Id, Art-16.3.3

Directive, which shall—for such new cases—be accepted and settled by banks upon demand.[114]

Investors closing their businesses must provide certain documents to transfer the capital offshore.[115] These include shareholder/partner decisions, a declaration letter, a liquidation report, a letter from the ministry of trade, an audited balance sheet and income statement, a foreign capital registration letter, tax clearance from the relevant government authority, and any other necessary documents required by the National Bank. Foreign investors can apply for remittance of share sales proceeds to Ethiopian nationals or foreign investors by presenting updated foreign capital registration certificates, bank credit advice, authenticated sales agreements, and tax clearance from relevant government organizations, confirming receipt of foreign currency value, and confirming sales agreement authenticity.[116]

The forex laws governing repatriation of funds on FDI in Ethiopia have repercussions for both the government and foreign investors. The regime aims to attract FDI and reduce currency shortages. Compliance with these laws aligns with Ethiopia's commitments under the relevant BITs and international investment law obligations. The laws adequately guarantee foreign investors' right to repatriate funds offshore, but other economic factors may impact the effective enjoyment of these rights. Most commentaries on the subject published prior to the coming into force of FXD 01/2024 argue that Ethiopia has strict forex-related regulatory requirements for foreign investors, including private equity investors, to repatriate forex from the country.[117] Contrastingly, other sources indicate that the repatriation of funds offshore by foreign investors is being eased significantly. For instance, Dangote Cement from Nigeria was reportedly able to repatriate USD 70 million to Zenith Bank in Nigeria from its birr account in Ethiopia recently, and it is preparing to repatriate another substantial sum through a local private bank.[118]

Yet, other sources argue that foreign companies and individuals have experienced difficulties obtaining foreign currency to remit dividends, profits, or salaries.[119] The 2020 Investment Proclamation allows foreign investors to remit profits, dividends, principal and interest on loans, and fees related to technology transfer.[120] However, due to a critical shortage of foreign currency, foreign companies and individuals have faced difficulties in obtaining foreign currency to remit dividends, profits, or salaries.[121] It adds, 'an acute foreign exchange shortage (the Ethiopian birr is not a freely convertible

[114] Id, Art-16.3.4

[115] Id, Art-16.3.5

[116] Id, Art-16.3.6

[117] Getu Shiferaw, Foreign investment and forex regulation in Ethiopia, Return to Africa Connected: Issue 2, DLA Piper Africa, Ethiopia (Mehrteab Leul & Associates), 17 April 2019, available at: https://www.dlapiper.com/en/uk/insights/publications/2019/04/africa-connected-issue-2/foreign-investment-and-forex-regulation-in-ethiopia/, accessed on May 10, 2024

[118] Repatriation of Dividends and Capitals in Ethiopia: Perception vs. Reality, Ethiopian Business Review, 6th Year. January 16–February 15, 2018. No.57, available at: https://ethiopianbusinessreview.net/repatriation-of-dividends-capitals-in-ethiopia-perception-vs-reality/#:~:text=According%20to%20the%20investment%20proclamation,or%20liquidation%20of%20an%20enterprise. Accessed on July 19, 2024

[119] US Department of State, 2020 Investment Climate Statements: Ethiopia. Available at: https://www.state.gov/reports/2020-investment-climate-statements/ethiopia/ Accessed on May 10, 2024

[120] Ibid

[121] Ibid

currency) impedes companies' ability to repatriate profits and obtain investment inputs.[122], Another source argues that Forex access for foreign loan repayment and benefit repatriation can take months or years, depending on factors like a company's priority sector status and experience in the Ethiopian business context.[123] Yet, it remains to be seen if the practical problems concerning the repatriation of funds identified in the previous commentaries will be resolved or remain after the country has enacted FXD/01/2024, following the adoption of a New Monetary Policy Framework in July 2024. In fact, the new Directive offers much more comprehensive guidelines for the repatriation of funds offshore.

4.4. External Loan, Supplier's Credit and *Franco-Valuta* Imports

Another forex regulation that potentially impacts FDI is the one governing external loans, supplier's credit and *franco valuta* imports. External loan is a loan acquired from an eligible foreign lender and approved and registered by the NBE[124] and it can be made either in cash or in kind.[125] Supplier credit is a commercial agreement where an exporter agrees to provide goods or services to a foreign buyer on credit. Exporters provide short-term loans to importers, with importers expected to repay after the loan period. The credit is collateralized by a usage letter and is used for inventory, raw materials, equipment, machinery, and working capital needs. Supplier's credit is 'a source of financing provided by a foreign supplier with a future repayment date.'[126] Ethiopia is concerned with external loan and supplier credit, as payment of principal and interest on foreign loans is made through foreign currency provision.

In 2022, the NBE issued a Directive[127] that allows eligible borrowers to take external loans, including exporters, foreign investors, and domestic manufacturers, if they meet specific requirements.[128] Exporters must have a valid export license, foreign investors must have a debt-to-equity ratio of 60:40, and manufacturers must have a business license.[129] All borrowers must submit loan agreements, capital documents, and repayment plans to the NBE before taking on external debt.[130] Banks are exempt from seeking approval, but individuals or companies can register for external loans or suppliers' credit upon prior approval.[131] The NBE must approve loans before interest and principal payments can be made. Approval requirements include an application letter, valid export license, investment or business license, draft loan agreement, supplier's credit pro forma invoice,

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[122] Ibid
[123] TRAIDE, Forex Guide for Incoming Investors (to Ethiopia) by the Kingdom of Netherlands in October 2023, p. 5; available at: https://traide.org/wp-content/uploads/FOREX-Guide-for-Incoming-Investors-TRAIDE-foundation.pdf Accessed on July 10, 2024
[124] FXD No. 01/2024, Art. 2.29
[125] Id. Art. 2.30 defines 'external loan in kind' as the acquisition of capital goods from an eligible foreign lender in the form of a sale with deferred payments, a lease agreement, or any other legal arrangement that may be approved by the NBE.
[126] Id, Art. 2.83
[127]Directive No. FXD/82/2022 Amendment to External Loan and Supplier's Credit
[128] The Preamble of the Directive states that the NBE is vested with the power to issue this Directive in accordance with Articles 20 and 27(2) of the National Bank of Ethiopia Establishment Proclamation No. 591/2008 and Investment Proclamation No. 1180/2020 to regulate forcing exchange and determining registration procedures for external loans.
[129] Art. 4.2 of Directive No. FXD/82/2022
[130] Id., Art. 3.2
[131] Ibid

capacity to repay the loan, and foreign capital registration certificate.[132] Repayment requires an application letter, a copy of the credit registration letter, and a loan repayment schedule. Governments or banks are prohibited from acting as guarantors or entering guarantee agreements for private loans.[133]

The FXD/01/2024 has chosen to maintain the rigorous procedures in the previous Directive when it comes to foreign currency administration from external loans and supplier's credit. Foreign loan contracts must be approved by the NBE for government-issued contracts without fulfilling certain requirements.[134] External loans guaranteed by the Federal Government of Ethiopia must be registered by the NBE.[135] However, other eligible borrowers must first obtain approval from the NBE before entering into external loan and supplier's credit agreements.[136] Foreign loans remitted must be registered in cash or in kind, and no repayment in foreign currency is allowed without registration.[137] Authorized banks can open usance letters of credit for exporters importing equipment, raw materials, machinery, and accessories for future exports.[138]

In general, before entering into an external loan or supplier's credit agreement, borrowers must seek approval from the NBE. Similar to its predecessor, the current Directive also identifies eligible borrowers and the respective requirements they should satisfy. Accordingly, exporters and foreign investors are the major eligible borrowers.[139] Exporters and domestic investors can acquire external loans or supplier's credits for export-oriented investments that generate foreign currency.[140] To obtain approval and registration from the NBE, exporters must provide an application letter, a valid export license, a draft loan agreement with detailed terms, a pro forma invoice for suppliers, and a document justifying the capacity to repay the loan.[141] Where a loan contract is entered into without fulfilling the requirements of this article, foreign exchange for the repayment of the loan may be denied. [142] Another group of eligible borrowers, foreign investors, are permitted to acquire external loans if they meet certain requirements, such as a debt-to-equity ratio of 60:40 and a valid investment or business license.[143] To obtain approval from the NBE, they must provide an application letter, a foreign capital registration certificate, a draft loan agreement with detailed terms, and a pro-forma invoice with a repayment period and term for the supplier's credit.[144]

The state's forex regulations aim to attract FDI and alleviate forex shortages. However, the current forex laws governing external loans and suppliers' credit primarily combat foreign currency shortages rather than attracting FDI. Both previous and new forex laws require strict registration and approval by the NBE for businesses to utilize these financing vehicles. This has led to acute foreign currency shortages, indicating that the previous forex

[132] Id., Art. 3.4
[133] Id., Art. 3.1
[134] FXD/ 01/2024, Art-17.1.1.
[135] Ibid
[136] Ibid
[137] Ibid
[138] Ibid
[139] Id, Art-17.2
[140] Id., Art. 3.1.
[141] Id, Art. 17.2
[142] Ibid
[143] Ibid
[144] Ibid

regime was not effective in alleviating the issue. Foreign investors find these strict regulatory requirements challenging to use for funding operations. The practical effects of the new forex law on these issues are yet to be seen. Pursuant to the new forex law; no person or entity may enter into a foreign loan contract[145] without first consulting with the NBE (in the case of the Government) and obtaining the NBE's approval (in all other cases). If a loan contract is entered into without fulfilling these requirements, foreign exchange for the repayment of the loan may be denied. Thus, from the investors perspective there is no much change regarding the regulation of external loan and supplier's credit. Hence, the problems encountered because of these regulations previously seem to persist.

Franco-valuta imports involve any imports of goods that do not utilize foreign exchange resources from the banking system and hence do not require the use of letters of credit, cash against deposits, advance payments, or other payment modalities. The privilege was first introduced during the imperial regime and has been governed by several regulations since then.[146] Franco Valuta, in Ethiopia, refers to a license to import goods on which no foreign currency is payable from the banking system and is governed by Council of Ministers Regulation No. 88/2006 (ERCA 2006). The privilege is intended for Ethiopian investors or foreign nationals of Ethiopian origin for investment activities, including capital goods and raw materials.[147] Foreign investors in the manufacturing sector can also benefit from this privilege by importing certain goods. The importation of goods on a *franco valuta* basis is restricted to use by (a) diplomatic missions and (b) businesses that are 100% foreign owned. The broader use of *franco valuta* may clash with ERCA tax requirements. Many of the businesses using *franco valuta* benefit from long corporate tax holidays as they export 100% of their production. The supplier credit scheme allows importers to receive goods from suppliers on short-term credit terms provided the business is either a domestic business which is both an exporter and the loan is going to finance an exporter or a 100% foreign-owned entity with a debt-equity ratio of no more than 60:40, with clear loan repayment arrangements and purpose.

The initiation of FXD/01/2024 involves one of the crucial policy changes, which involves abolishing the ban on *franco-valuta* imports. This policy was introduced to address inflation, foreign exchange shortages, and debt issues. Yet, all customs, taxes, health, and regulatory regulations will be applied to the *franco valuta* imported into the country, with implementation determined by the relevant authorities or regulations.[148] "

4.5.Offshore and Domestic Forex Accounts

The last segment of forex regulation having repercussions on FDI in Ethiopia is the regulations pertaining to foreign currency

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[145] Note, however, that the NBE has removed the interest rate ceiling that previously applied to private sector companies and banks when borrowing from abroad.

[146] Capital Increases and Franco Valuta Under Ethiopian Law, 09 January 2017, https://www.simmons-simmons.com/en/publications/ck0amp33mdiss0b595ilnw4wc/090117-capital-increases-under-ethiopian-law-4fr1ca

[147] Ibid

[148] Ethiopia Removes Foreign Exchange Permit Requirements, Retaining Only Two Exceptions, Shega News, August 19, 2024 https://shega.co/news/ethiopia-removes-foreign-exchange-permit-requirements-retaining-only-two-exceptions

accounts (in authorized domestic banks) and offshore forex accounts.

4.5.1. Offshore Accounts For Strategic FDI Investments

Ethiopia's strict currency controls have historically hindered foreign businesses from using foreign bank accounts for foreign currency payments, limiting foreign investment, exchange inflows, and purchasing from overseas. Thus, with the aim of tackling this problem, the NBE issued Directive No. FXD/86/2023 that granted businesses in strategic areas the right to use offshore bank accounts for payments on capital, insurance, contractors, maintenance, and external debt services. This directive aimed to attract high-potential investors for public goods, generate foreign exchange inflows, and create a favorable environment for opening offshore accounts with guaranteed currency convertibility and modified debt-to-equity ratios.[149] Eligible projects include PPP projects in power generation and infrastructure, large-scale mining projects with significant export earnings, or any other FDI project approved by the NBE.[150] A balance sheet is created with a debt-to-equity ratio of 80:20 using foreign capital.[151] The NBE monitors quarterly financial statements for strategic FDI project owners to track offshore account inflows and outflows.[152].

Similar to Directive No. FXD/86/2023 (that is now repealed), FXD/ 01/2024 has introduced special allowances for offshore accounts for strategic foreign direct investment projects.[153] These include large capital investment PPP projects in power generation and infrastructure, large mining projects with substantial export potential, and any other project deemed eligible by the NBE's Executive Management.[154] Eligible payments covered from the offshore account include external debt service, insurance claims in foreign exchange, capital or investment expenses, and maintenance and operation expenses.[155] The debt-to-equity ratio must not exceed 80:20 of the foreign capital.[156] The Foreign Currency Convertibility Guarantee applies to strategic PPP energy and mining sector projects for loan repayment and dividend repatriation after the project owner has exhausted all means to purchase foreign exchange from banks.[157] For the sake of effective implementation, the law requires transparency and reporting requirements. The law authorizes the NBE the right to monitor any contracts associated with offshore accounts to ensure there are no malpractices involved.[158] It also mandates quarterly financial statements for strategic FDI project owners, showing inflows and outflows of the offshore account and annual projections of expected foreign exchange inflows and outflows.[159]

4.5.2. Domestic Forex Saving Accounts for Ethiopian and Foreign Entities

The establishment and management of forex saving accounts in Ethiopian banks were first addressed by the NBE's Directive No. FXD/68/2020.[160] This Directive allowed the

[149] Preamble, Directive No. FXD/86/2023
[150] Id, art -3
[151] Id, art-5
[152] Id, arts-7-8
[153] FXD/ 01/2024, Art. 19
[154] Id, Art-19.1.1
[155] Id, Art. 19.2.1
[156] Id, Art. 19.3.1
[157] Id, Art-19.4
[158] Id, Art-Art-7
[159] Id, Art-Art-8.2
[160] Establishment and Operation of Foreign Currency Saving Account for Residents of Ethiopia, Non-Resident

establishment and operation of foreign currency saving accounts for residents of Ethiopia, non-resident Ethiopians, and non-resident Ethiopians of Ethiopian origin.[161] The Directive's main objectives were to create incentives and encourage the inflow of new exchange with funds, maintain the international foreign exchange reserve, reduce the burden on the economy, as well as promote savings and investment. To open an account, a minimum of USD 50 or its equivalent in other currencies such as US dollar, Pound Sterling, or Euro is required. Other convertible currencies may be accepted at spot exchange rates. The Directive established provisions for foreign currency saving accounts, allowing those savings to be used for education, medical expenses, and international travel with proper documentation. However, withdrawals were only allowed in Birr and approved transactions by the NBE. Deposits from foreign currency cash notes and illegal sources are not allowed to credit or open a foreign currency savings account. The opening bank is responsible for maintaining account confidentiality and reporting the number of accounts opened and balance to the NBE. Violations may result in a penalty of Birr 10,000 and account suspension. Other transactions approved by the NBE may also be allowed.

In contrast to Directive FXD/68/2020 which allowed only residents of Ethiopia, non-resident Ethiopians, and non-residents of Ethiopian origin to establish and operate foreign currency accounts, FXD/01/2024 has broadened the list of eligible individuals and entities who can establish FCY deposit accounts upon fulfilling the requirements applicable for specific accounts. The FXD/01/2024 recognizes three categories of FCY accounts authorized by the NBE, and additional types of accounts may be permitted from time to time.[162]These are FCY Accounts for Foreign Entities, including FDI Companies, International Organizations, Embassies, and Foreign Nongovernmental Organizations (NGOs); FCY Accounts for Resident and Nonresident Ethiopians, including Nonresident Foreign Nationals of Ethiopian Origin; and Retention Accounts for Exporters of Goods and Services.[163] Obviously, companies that engage in FDI are one of the eligible businesses in the list of FXD/01/2024.

Foreign companies (FDI) require documentation of the application letter, foreign investment license, TIN certificate, NBE approval letter, and other requirements as requested by the opening bank.[164] Holders of FCY accounts for foreign companies, international organizations, embassies, and foreign NGOs may use the account for all foreign payments without any restriction.[165] In addition to foreign currency account rights, FDI companies engaging in exporters of goods and services have retention rights as specified in Article 6 of this Directive, and they are entitled to open forex retention accounts in licensed domestic banks.[166] There are differences between these two accounts, while foreign companies are free to use the account for all foreign payments without any restriction.[167] However, foreign exchange

Ethiopian, and Non-Resident Ethiopian Origin Direc11ve No. FXD/68 720

[161] Id, Art-3

[162] Part-V of the Directive

[163] FXD/ 01/2024 , Arts-13,14, and 15 respectively

[164] Id, Art-13.5.1.

[165]Id, Art- 13.6

[166] Id, Art-15.2

[167] Id, Art-13.6

earners can use their foreign exchange retention account balance for their own use, including payments for imports, dividends, and external debt service repayments. To support the development of an interbank foreign exchange market, earnings must be sold to a transacting bank after 30 calendar days. Unutilized earnings can be converted into Birr at a freely negotiated rate. The NBE can modify the percent share of foreign exchange proceeds and the conversion period.[168] Art-6.2 of FXD/01/2024 states that;

> After fulfilling the repatriation requirement set out in sub-article 6.1, exporters of goods and services shall immediately convert into Birr, at a freely negotiated rate, 50 percent (50%) of their export proceeds to the bank used in processing their foreign exchange transaction, while keeping the remaining 50 percent (50%) in their foreign exchange retention account.[169]

The other important development by FXD/01/2024 is a special privilege conferred on industry parks and special economic zones (SEZs) regarding the utilization of foreign currency accounts. Industry parks not designated as SEZs may: buy, in FCY, raw materials or inputs manufactured by another investor within the same industrial park or across another industrial park from its FYC and/or retention account, Sell its manufactured product within the industrial park as an input to another investor within the same industrial park or across another industrial park in FCY via credits to its retention account. Open an FCY account for a foreign employee of an industrial park and Issue export and import permits for trade within and between industrial parks. Besides, authorized banks may open and maintain 'non-resident foreign currency accounts' in the name of persons, corporate bodies, institutions, and diplomatic organizations such as FDI companies, international organizations, foreign embassies and consulates, and foreign non-government organizations.[170] Also, foreign individual employees of the above companies are entitled to open foreign currency accounts as per Article 14 of this Directive.[171] Regarding the uses of the account, holders of FCY accounts for foreign companies, international organizations, embassies, and foreign NGOs may use the account for all foreign payments without any restriction.[172] The legal restriction imposed on the utilization of foreign currency accounts by exporters of goods and services is not applicable to non-resident foreign currency accounts.

5. Concluding Remarks

In recent years, Ethiopia has struggled with its forex regulatory regime. The fluctuating and uncertain regulatory landscape presented a significant risk to FDI. Ethiopia's previous forex system has been criticized for not following government investment policies to encourage FDI and address the country's foreign currency deficit. In July 2024, Ethiopia adopted a New Monetary Policy Framework, enacting Foreign Exchange Directive No. FXD/01/2024, which is the first comprehensive forex law to revise and repeal all previous forex laws. The Directive aims to provide a unified framework for managing Ethiopia's foreign

[168] Id, Art-6.3-6.8
[169] Id, Art-6.2
[170] Id Id, Art-13.1.2,
[171] Id, Art-13.1.1
[172] Id, Art-13.6

exchange market by replacing previous regulations. It marks a transition to a market-based exchange regime, allowing banks to buy and sell foreign currencies at freely negotiated rates with limited NBE intervention. The Directive also removes several requirements related to forex, including surrender requirements to NBE and enhancements in retention rules. It introduces non-bank foreign exchange bureaus and lifts restrictions on franco-valuta imports of goods not utilizing foreign exchange from the banking system.

The Directive also establishes foreign currency saving accounts (FCY) for various entities and individuals, opens the securities market to foreign investors, and permits industry parks and Special Economic Zones to engage in transactions. Overall, these changes aim to liberalize and streamline foreign exchange transactions and regulations in Ethiopia. Looking at their contents and the amount of modifications they have made to the previous forex regime, these new regulations do have far-reaching repercussions on FDI in Ethiopia. Yet the practical effects of the new law on FDI are yet to be seen.

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