Bahir Dar University Journal of Law

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The Editorial Board appeals to all members of the legal profession, both in academia and practitioners, to contribute scholarly manuscripts. The Editorial Board extends its gratitude to manuscript contributors, reviewers, and others who participated in different capacities.

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Legal History of Extractive Industry Governance in Ethiopia

Binnyam Ahmed[∂]

'The history of what the law has been is necessary to the knowledge of what the law is.'

Oliver Wendell Holmes

Abstract

Extractive Industries (EIs) are essential sources of economic and social development of a country. Current governance structures, extending from policies and laws pertaining to this sector are, in one way or another, the results of governance practices from the past. Even though the sector in Ethiopia has not grown to the expected level, the country had had a governance structure for this sector since the late 19th century. Over this stretch of time, there were governance systems regulating institutions engaged in mineral extraction activities. To fully understand the current governance structure, it is essential to analyse the sets of laws that were in place over that period. With this in view, the article evaluates the governance structure of extractive industries from the time of Emperor Menelik II to the time of the Derg. This is neither a denial of the existence of a governance framework in the pre-Menelik era nor a neglect of the developments in the governance of the sector after the Derg. Rather, this investigation is meant to draw insights from the extensive experience that could inform the current governance structure of extractive industries. By analyzing, through doctrinal legal analysis, the governance structures in place over those times, the article argues that since the inception of modern legal structures, the Ethiopian EI governance structure, though varied in depth, is informed by accumulated

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institutional experiences on the core issues related to EI governance. Accordingly, the paper further argues that an evaluation of the content of such historical legal documents is a first step to understanding the current institutional governance structure.

Keywords: *Extractive Industries; Governance; Historical Analysis*

1. Introduction

Extractive industries (EIs) are operations that harvest resources such as metals, minerals, aggregates and other items from the earth.[1] Its activities range from drilling to mining, and quarrying that require considerable investment on the part of a government, society or transnational companies. EIs are the backbones of some economies while they are paradoxically a curse for peaceful coexistence and growth in many parts of Africa. This difference in the contribution of EIs to socio-economic wellbeing across societies is mainly one of a difference in the quality of EIs governance in the respective societies or countries.

This article aims at assessing the historical background of the existing governance structure for extractive industry in Ethiopia.[2] The assessment places the governance frameworks at the center, which are references to all the policy and legal regimes regulating the rights and duties of active parties

[1]ExtractiveIndustryBusinesDictionary.com.WebFinance.Inc. available at http://www.buisnessdictionary.com/definition/extractive industry.html<accessed March 15,2022>

[2] Id. Note that the common distinction made among metallic and non-metallic minerals as well as mineral fuels are all the subject matters of extractive industry discourse.

in the extractive industry. Also these governance frameworks encompass domestic legislations that are meant to address the core issues of EIs.[3]

This article will draw a three-phase timeline to analyze the frameworks. The first phase covers the time of Emperor Menelik II, during which documented extractive industry-related activities clearly began. This is followed by the era of legislation when the Negarit Gazeta, the official newspaper for laws, was established, bringing all governance structures of the extractive industry under its ambit. This era covers three separate legislative frameworks. Finally, the legal frameworks of the Derg regime are closely examined.

In these three phases, facts and laws will be presented to uncover what governance of EIs constituted at different periods and how various issues arising therefrom were handled by the concerned organs. In the process, a reflection is made on the governing structure of the time and the core problems therein. It is the conviction of the author that a thorough analysis of these structures' sheds light on the journey of the institutions over those periods. This, in turn, would inform the current governance practice in the EIs.

2. EIs Governance Framework during Emperor Menilik II Regime

2.1. Emperor Menilik's Mining Letters

2.1.1 Letters to Foreigners

Richard Pankhurst, in one of his major works, "economic history of Ethiopia", provides a brief overview of ancient writers who have visited the old lands of Ethiopia and their account regarding the Mineral wealth of the

[3]Osisa, available at http://www.osisa.org/books/regional/what-laws-each-country-say, <accessed March 15,2022).

country.[4] It is safe to conclude, from that overview coupled with investigations made on ancient Ethiopia by other historians, that the country is endowed with a wealthy potential of mineral resources.[5]

Domestic and foreign historians concur in giving the credit to Emperor Menilik II for the creation of the modern Ethiopian empire state.[6] It is also during the time of his reign that most of the industry and technology advancement of the world reached the doorsteps of the Ethiopian Empire.[7]

Regarding extractive industries, although there was not a full-fledged governance structure in the form of the institutional establishment or legal framework, the emperor was considered as the center of the state's functions acting as the governance structure *per se*. Accordingly, the emperor had made various decisions on extractive resource governance.

[4] Richard Pankhurst, An Introduction to the Economic History of Ethiopia: From early times to 1800, Lalibela House (1961) pp. 224-231.

[5] Id. Professor Richard went on to mention the accounts of renowned travelers including Ibn fadl Allha, Brother Thomas of Angot, Alvares, Castanhoso, Bermudes, Almeida, Pero Pais, Barradas, Baratti, Puncet and Bruce, who in one voice register their account of mineral resources of the ancient Ethiopian lands and their use at the time, places as Gafat, Damot, Gojam, Axum, Enarea, Tselemt and Tambein were mentioned as having mineral resources or mineral resource potentials: For an exhaustive specific work on ancient Aksumite and Northern Ethiopia Civilization dating as far back as 1000BC wherein Various Mineral resources ranging from Gold, Silver, copper, zinc, Quarry and others were even used for industries of the time see David W Phillipson, Foundations of an African Civilization: Aksum & The Northern Horn 1000BC- AD 1300, James Curry & Addis Ababa University Press, (2012), pp. 159-180.

[6] Bahiru Zewde, A History of Modern Ethiopia 1855-1991, 2nd edition, James Currey Ltd, (2002), pp. 60-79.

[7] Paulos Ngongo, Atse Menelik, 2nd edition, Mankusa Printing, (1981), pp.236-338. Although the author is very fond of the emperor, his compilation of the technologies and advancements of the time after a careful evaluation of various sources supported by documents and photographic evidence is an important source to understand the developments of the time.

After a careful examination of more than sixty imperial letters addressed to foreign persons and companies[8] as well as local officials[9] about mining activity, it is argued that a de facto governance of extractive industry was in place with the sovereign Emperor acting as the sole regulatory authority and institution.

The ensuing paragraphs examine the core contents of the letters as a way to unravel the emperor's and his advisors' understanding of the governance structure of the extractive industry. It is to be noted that the reference to the extractive industry in these contexts includes all activities related to the available mineral resources.

It is widely noted that after the battle of Adwa whereby Ethiopian forces became victorious over Italian forces, Ethiopia was considered as a sovereign nation in the continent of Africa. As such Ethiopia was treated with equal footing of the diplomatic tie with the major forces of the world, forcing them to enter into negotiations of border treaties.[10] This justifies the reason why foreigners from all corners of Europe seek imperial permission to operate in the resources of an African country, a tale that seems fairy to the entire African continent of the time.

Of the seven letters issued by the emperor in the year 1901 five were initiated by individuals desirous of exploiting gold, silver, metallic and other minerals either by themselves or through a company.[11] The contents of these letters by the emperor follow a clear pattern. It usually starts with a mention of the

[8]Paulos Ngongo, 'Atse Menelik bewuchi hager yetesatsafuachew debdabewoch' Atse Menelik's Correspondences with Foreign countries, Aster Nega Publisher, (2010).

[9]Paulos Ngongo, 'Atse Menelik behager wust yetesatsafuachew debdabewoch' Atse Menelik's Domestic correspondences, Aster Nega Publisher, (2010).

[10] Donald N. Levine, Greater Ethiopia: The Evolution of a Multiethnic Society, The University of Chicago Press, (1974) p. 12.

[11] Ngongo, *supra* note 7, pp. 144-156.

request made by the person/company to operate in mining activity. It then provides a clear authorization of operation. The authorization contains the type of minerals allowed to be exploited, the time limit for the permit and the area limit to which operation is allowed. Further, they take into account the rights and interests of local communities where the operation is to be carried out and the need to enter into a new mining contract with the emperor once preliminary exploration in the production of minerals bear fruits. The letters usually close with a guarantee from the emperor over the application of the existing tax or royalty rates from production and there will be no additional payment request from the side of the emperor.[12]

It is this content that leads one to conclude that the imperial letters are minimized versions of extractive resource governance. As such the traditional resource governance structure contains the scope of mining rights, type of minerals governed, fiscal regimes about mining operation, operational area community rights and the like which are all touched upon by the imperial letters examined. The remaining two letters at that point deal with the recognition made by the emperor for the establishment of an association of gold mine operators in Wollega[13] and a denial response for a request of permit extension for operation start.[14] Indicative of his desire to strengthen the operation of natural resource extraction, the emperor expressed his joy and full support for the establishment of the association. This can be taken as a historic move of the recognition by the government on the impact of operators functioning in harmony under a common institution to better protect their interest and rights. The same can be said regarding the easiness the controlling authority of the sector would have in following the execution of operations as per its rules and regulations.

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[12] Id.
[13] Ngongo, *supra* note 7, letter No. 360, p.154.
[14] Ngongo, *supra* note 7, Letter No.365, p. 156.

The second letter contains an explicit rejection of the request for extension of the start of operation time, which shows the serious application of terms of the permit. In this same letter, the request to explore gold in Kaffa was denied on the ground that another permit holder on the same location and operation is yet to start operation. The letter states the possibility of issuing the permit after proper evaluation of prior permit holder's operation and consultation. This is also a major governance guide of the time in recognizing the exclusive right of exploration which later era structures tend to endorse or amend, as mining rights start to be defined as a bundle of rights wherein certain rights are exclusive in nature to the right holder while other rights are shared among multiple operators at a time.

The year 1902 saw no unique imperial letter exchange in connection to mining operations. In fact, there was exchange of various letters made to the Wollega gold miners association in appreciation of their move in buying stocks from foreign markets in the name of the emperor and the country.[15] These stocks are bought using the payments agreed to be made to the government from the proceeding of sale of the production.[16] Claims of doubt as to how the emperor and his country were holding shares of global businesses over that period when all Africans were under the yolk of colonial brutality by many until this age can be answered by mentioning such acts of mine operators of the time.[17]

The other letter of that period worth discussing in this section is the one sent in April 11, 1902 to Alfred Ilg, the long-time trusted advisor of the emperor. The letter bore the name *Leontief as its source* and has a major goal of convincing investors in England and Belgium to spend their money in his

[15] Ngongo, *supra* note 5, Letter No.376-378 and 401, p. 161&169.
[16] Id.
[17] Baron de Jarlsburg, King Menelik Has Investments Here, NewYork Times, (Nov. 7, 1909).

Ethiopian gold operation under the false claim that the sender has secured the emperor's permission to operate in the area.[18]. The investor's woes of being swindled by the person had reached the emperor's castle hence he wrote a letter to Ilg in explaining the issue and the need to protect the acts of the individual from further damaging the interest of third parties.[19]This letter was indicative of the widespread practice by individuals of making the bogus claim as to their job in swindling clients to invest their money in the resources of the communities and people of the country at large while they are barely aware of it. In the contents of earlier letters, one can notice denial for extension of operation time by the Emperor. Yet this time, this is replaced by a positive response suggesting wider discretion of the emperor in handling similar questions from the operators on a case-by-case scenario. To this effect, the 1896 letter to a Moscow company engaged in gold mining extends the time of operation to further three years.[20] Two reasons were provided for such generosity: the geographical distance that poses challenge to investors and the bilateral tie between the governments of the two countries.[21] In sum, preferential treatment of operators from selected countries on basis of various considerations is seen as one character of the governance structure of the time.

The act of protecting the investor and facilitating the smooth operation of their work were taken care of, among others, by the issuance of imperial orders and letters explaining the duty of all citizens to cooperate with the permit holders in the provision of the right of way,[22] transportation service, provision of man power, shelter and the like.[23] On various occasions, those who plan to engage in the extractive industry are obliged to ensure they have the required

[18] Ngongo, *supra* note 5, Letter No.423 and 425, p. 174-176.
[19] Id.
[20]Ngongo, *supra* note 7, Letter No. 521, p. 201.
[21] Id.
[22] Ngongo,*supra* note 7, Letter No. 866/868/916/934, p. 306-322.
[23] Ngongo,*supra* note 7, Letter No.983, p. 324.

authorization from their respective countries of origin, authorization to operate to ensure their eligibility verified from their country of origin. This was reflected in the content of the 1904 letter requiring a person with interest to engage in the gold mining activity in Ethiopia. The letter specifically mentions the need to have authorization from the government of Germany, which at the time does not have a counsel in Ethiopia, making it difficult for the Ethiopian authorities to verify the claims of the investor. Accordingly, he was required to provide authorization from his country before putting forward a question for consideration.[24]

Of the five letters issued by the Emperor in 1905, one necessarily calls for due consideration. The remaining four letters of this year follow the pattern discussed above.[25] The letter issued to General Lishan on March 21, 1905 introduces various extractive resource governance concepts ranging from, technology transfer, and provision of mining infrastructure to the government to the utilization of resource produced to mining operation itself.[26]The letter claims the emperor's decision to transfer the gold mine originally intended to be exploited by the government to the permit seeking private operator.[27] This was also indicative of the government's participation in the extractive sector. The private parties: engineers from Moscow were allowed to operate for two years on the expectation that they are to plant required machinery for the operation. The cost was to be covered from the proceeds of future production of minerals in the area. The Emperor guarantees to assist in the provision of required manpower to the operation. After the expiry of the two years, the entire machinery would be submitted to the Emperor. The local people who

[24] Ngongo, *supra* note 7, Letter No. 857, p. 303.
[25] Ngongo, *supra* note 10.
[26] Ngongo, *supra* note 7, Letter No.580, p.220.
[27] Id.

were operating on the machine were allowed to continue to be responsible for the functioning of the machine.[28]

The contents of this letter can be considered to form the base for a governance structure that targets the mineral sector development by way of claiming ownership of required machinery and infrastructure from the operators. Further, it had the goal of transferring relevant technology, industrial expertise and skills. As such rules in place at that point, one would argue that, considerably contributed to the mineral development of the nation reaching its modern stage by now.

The move of the emperor to realize his desire in securing mining infrastructure was not merely dictated by the moves and desires of the operators to invest. Rather, he also requires the purchased gold and silver mining machinery to be transported to him with engineers capable enough to operate the same. He has paid the required sum for the company and was requesting the transfer of the property to his possession.[29]

The letter issued in 1906 bearing an extractive sector issue sets out the duty of reporting on the side of the operator.[30] The emperor sounds frustrated by the failure of operators in Wollega for they did not report their work progress. He recalls it has been three years since the mining of gold had begun but no report of the findings was made until that point. Accordingly, he orders the reporting to be done. This is an aspect of governance expressed in the form of follow up after permit of issuing regarding work progress and a result of an operation that serves as a base for calculating tax, royalty and maintaining further conservation of the resources.

[28] Id.
[29] Ngongo, *supra* note 7, Letter No.665, p. 242.
[30] Ngongo, *supra* note 7, Letter No.643, p. 236.

In another disappointed tone in a letter of October 19, 1907 to Muse Jelardi, the Emperor responded to a request to ceasing operation by a permit holder, citing orders for same coming from his native country.[31]The emperor's response was almost a disapproval of the act of operation stoppage. He stated that the site is wanted by many for operation and endorsed the request. A letter issued days after this communication showcased the personal engagement of the emperor in convincing, and at times, offering to potential investors the benefit of engaging in mining operations of the country. Accordingly, the emperor offers some investor the possibility of operating in a rich area of gold reserve that is open for grasps.[32] Probably, he was referring to the area abandoned by Muse Jelardi. Governance of extractive industry in such a way that attracts local and foreign investment requires identifying resource wealth of a nation, accumulating sufficient data on the same, and inviting interested potential operators to engage in the sector. Thus, this letter can serve as a manifestation of the emperor's investment attraction strategy.

In 1908 Emperor Menilik's mining letters start to reflect the Emperor's power of revocation as operators are acting in defiance of the terms and conditions of a permit.[33] To this effect, the Emperor, in a letter to Muse Fred Markuat, accused operators of failure to start operating on agreed period, failure to provide documentation proving nationality, mistreatment of local employees and not respecting the orders of local officials.[34] These behaviors led to the writing of a letter warning revocation of permit and termination of contract if the operation does not resume within ten days with correction of all the behaviors leading to the accusations.[35] The emperor also made remarks as to a guarantee issued by the government to the sum of 7,500 Ethiopian birr which

[31] Ngongo, *supra* note 7, Letter No.667, p. 243.
[32] Ngongo, *supra* note 7, Letter No. 673, p.243.
[33] Ngongo, *supra* note 7, Letter No.767, p. 275-76.
[34] Id.
[35] Id.

the operator claims a right to collect same from an official in the place of operation.[36] Despite the faults, the investor was treated with good faith to build confidence in the industry.

This same year a letter was issued to the same person as to the notification of assignment of individuals responsible for controlling and recording the extraction of Gold.[37] It is presumed that the operator amended his way of operating and was saved from the revocation risk.

Now we turn to the contents of a mining contract signed in September16, 1904. An examination of the contents would shade light on general picture of what the content and structure of mining contracts of the time look like. The contract has a total of six terms that govern the relationship between the Emperor and Emmanuel Makres, a mining operator who planned to operate at Tegulet.[38] The first term narrates the background to the contract that Mr. Emmanuel has requested for a fifty-year contract of the mining right in Tegulet wherein he claimed to explore gold deposits. Article two stipulates the duty of the operator to secure the required machinery at his cost. The third term states the operator would hire employees necessary for the operation of the machine, pays their remuneration and, once the operation starts ,would secure a 50-year lease term on the area on the condition that the Ethiopian government takes 2/3 of the proceeding of the production. The rate is set at 1/3 to the government and 2/3 to Mr. Emmanuel until the machine is installed if a manual operation results in the production of gold under the fourth term. The duty of delivering equipment of operation including types of machinery upon expiry of the mining lease term is set under Article 3 of the contract. Article 4 reiterates the risk of operation about the cost of machinery or

[36] Id.
[37]Ngongo, *supra* note 7, Letter No.777, p.279.
[38]Ngongo, *supra* note 7, Letter No. 854, Article 1, p. 301-02.

operation, and stresses that the cost will be covered by the operator and the Ethiopian government will have no responsibility in this regard. The last provision is the termination clause which requires the operator to start work on the agreed date failure of which will result in termination of the contract.

2.1.2 Letters to Local Officials

More than 26 Imperial letters are registered with issues concerning the extractive sector operation for local officials. While the majority of the letters are orders to the officials to guarantee protection to the person and property of foreign operators authorized to operate in the locality of the officials as either study groups / associations concerned in map development[39] or mining operations,[40] some letters also deal with other specific matters including the chance discovery of previously unknown mineral resources.[41]

In a letter addressed to Dejazmach Gebregziahber, governor of Wollega in August 29/1906, the Emperor provides a direction on a matter of controversy as to whether the gold mine operators are duty bound to allow local officials to register the amount of gold mined on a daily basis or on a monthly one. The operators opted for the later one.[42] While the Emperor favors a daily register[43], he also warns the official to make sure of not being deceived by

[39] Ngongo, *supra* note 8, Letter No. 1931, 526: Letter No. 1962, p. 534:

[40] Ngongo, *supra* note 8, Letter No.335, p. 111: Letter No.418, p.133: Letter No. 483, p.148: Letter No. 599, p.175: Letter No. 922, p.255: Letter No.1468, p. 395: Letter No.1493, p. 402.

[41] Ngongo, *supra* note 8, Letter No. 2173, p. 599. The letter issued to 'Fitawrari' yebsa addresses the issue of chance discovery of silver in a gold mining site. The local official has send samples of the new discovery asking permission from the emperor to go to the site to further study the area. The emperor expresses his happiness for the discovery of silver as it is of the first time and confirms the mineral sent to him to be silver.

[42] Ngongo, *supra* note 8, Letter No. 275, p. 96.

[43] The Emperor is found appreciating another local official who asks his blessing to control mine production of English people operating in his area. The emperor accepts

acts of the operators who engage in the act of hiding or avoiding gold from the register. It is known that the amount of production is the basis of calculating tax or profit. The emphasis the Emperor rendered over this issue shows the seriousness of the problem at the time. Another letter issued for the same official clarifies the right of the miners to plant boundary marks in colors. The official seems confused as to the need of a flag for mining operation. It seemed a worry of territorial invasion was in the minds of the official who happen to spot foreigners demarking borders using flags. The letter clarifies the issue.[44]

Another letter under this category shows the role gold has at the time as monetary instrument. An official who explains the difficulty of securing ivory as tax to be paid to the Emperor has pleaded to pay in gold. While the Emperor clearly favors his taxes to be paid in ivory, taking in to account the problem at hand, he states his permission to be paid in gold. In a letter about local labor working on mining sites, the Emperor expressed his concern over the exploitation of the laborers by mine operators. Accordingly, the letter stresses the need to supervise the purpose for which the mine operators are using the local labor force provided by the government in the mining sites.[45]

The engagement of embassies and consular offices in the protection of the interest of their investors in Ethiopia was registered long before the concept of modern foreign investment protection was crafted. In a letter dated October 31, 1908, the Emperor mentioned a compliant reaching his courts from the Italian council regarding Muse Zapa who was prohibited by local officials

the request and orders the official to weigh and register the daily production, See Ngongo, *supra* note 8, Letter No.289, 100.

[44] Ngongo, *supra* note 8, Letter No. 276, p. 97.

[45] Ngongo, *supra* note 6, Letter No. 1509, p. 406.

from gold mining operation. The Emperor orders the local official at the area to allow him in starting operation with proper follow up.[46]

3. Proclamation Era: The Beginning of Modern Governance of Extractive Industries

The year 1942 is historical in the legal development of Ethiopia. The *Negarit Gazeta*, the official news paper for legislations to this day(renamed as Federal *Negarit Gazeta* following the federal arrangement), was established at that point in history.[47] In its first act, named, Establishment of the *Negarit Gazeta* No.1 of 1942, it states that all proclamations, decrees, laws, rules, regulations, orders, notices and subsidiary legislation including notices of general information concerning matters of public interest are to be published under the responsibility of the ministry of the pen through the modality of the *Gazeta*.[48] The same law makes it a principle that courts and judicial organs take judicial notice of all that is to be published in the *Gazeta*.[49]

A year and half after the establishment of the *Gazeta*, the first legislation with a direct character of extractive resource governance, titled 'A Proclamation to Prohibit the Export of Gold, Silver and Platinum from Our Empire' was issued.[50] Though prohibitive in nature, the law was concerned about Gold, Silver and platinum as mineral resources. The absence of other types of minerals in the list may prohibit one from considering it as exhaustive governance and leads to contemplate the reason why these three resources were selected. In 1944, legislation was in place with a bit expanded content

[46] Ngongo, *supra* note 6, Letter No. 1840, p. 501.

[47] Establishment of the *Negarit Gazeta*, Proc.No.1/ 1942, *Negarit Gazeta*, (1942).

[48] Id., Article 2.

[49] Id., Article 5.

[50] A Proclamation to Prohibit the Export of Gold, Silver and Platinum from Our Empire Proclamation.No.43/, 1943, *Negarit Gazeta*, (1943), [herein after Proclamation to Prohibit].

meant to regulate only Gold and Platinum, titled 'A Proclamation to Control Transactions in and Concerning Gold and Platinum in Our Empire.'[51]

The 1943 legislation prohibits the export, sending or taking gold, silver and platinum out of the country in any form except with the terms and conditions of a license issued by the ministry of finance or an authorized person.[52] Failure to observe the restriction would result in monetary fine or imprisonment upon conviction.[53]A court is also authorized to order the forfeiture of the seized resource.[54]

From the title of the law and the content thereof, it is clear that the major purpose of the legislation was to regulate the export of mineral resources out of the country. Export was not prohibited but put under provisions to be issued by the Ministry of Finance. The lack of details in the legislation as to the terms and conditions of the license or how they are exercised leaves one to ponder over issues surrounding it. The Ministry, the organ responsible to issue a license and set the terms, can be taken as the major institution in place in the exercise of extractive resource governance at the time.

The 1944 legislation that follows the export restriction law is more detailed in scope. The opening statement to the proclamation serves as an essential source of mineral governance laws before the *Negarit Gazeta* days.[55] Apart from these regulative actions over foreign operators, imperial decrees as old as the 1928s have in essence tried to regulate mineral resources by

[51] A Proclamation to Control Transactions in and Concerning Gold and Platinum in Our Empire, Proclamation.No.67/1944, *Negarit Gazeta*,(1944),[hereinafter Transaction Control].
[52] Proclamation to Prohibit, *supra* note 50, Article 2.
[53] Proclamation to Prohibit, *supra* note 47, Article 3.
[54] Id.
[55] Transaction Control, *supra* note 51, Preamble.

determining issues on ownership of mineral resources of the country, rights of landowners upon which mineral resources are located, identifications of mineral resources eligible for private disposal, permit to exploit and to export mineral resources, institutional setups to regulate resources and many more.[56] It is to be noted that following the footsteps of the imperial letter exchanges in the era of Emperor Menilik, these decrees have for long served as governance structures. The preambles of the letters characteristically mention the need for the regular authorization of the department of mines for mining transactions. This, in effect, is a manifestation of an established governance structure.[57].

Looking into the 1951 legislation, one can see that it is dedicated to the regulation of Gold and Platinum transaction.[58]After declaring all gold and platinum in Ethiopia as the property of the empire wherever located, the legislation makes it an offence to possess, put in custody or conceal the raw or refined form of the minerals in an amount that exceeds ten ounces except under the authorization of the ministry of finance.[59] The ministry of finance

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[56] Id. Imperial Decree of 18th April 1928 provides all wealth of the subsoil of Ethiopia is state property and in consequence, beyond the power of disposal of the landowner and the exploration of minerals in their natural bed is permitted only to those persons or companies provided with a permit of exploration provided by the Ethiopian Government. Imperial Decree of the 29th prohibits the exploitation of minerals in the absence of authorization from the department of mines. Imperial Decree of the 5th December 1929 states the prospecting, search, excavating, extraction and collection of minerals prohibited unless a regular authorization is given from department of mines. Same authorization certificate is required from the department for export of minerals. Imperial Decree of the 7th November 1931 possession of minerals by persons without authorization from the department of mines raises the presumption that the minerals are products of illicit exploitation of the mineral wealth of the nation.

[57] A detail examination of institutional set ups at different regimes will be made on the chapter evaluating institutional structures in Extractive Industry Governance.

[58] See title of Transaction Control., *supra* note 48.

[59] Transaction Control., *supra* note 51, Article 1 and 3.

seems to take the regulatory power away from the department of mines as in the decree.[60]

The right to transport, import, export, trade or contracting gold and platinum is also allowed only under special authorization of the ministry of finance.[61] The term *special authorization* indicates the possible existence of two types of permits, one ordinary and another special. While the former regulates possession and custody of resources, the other is for the purpose of transacting in these minerals.[62]

Keeping in line with its predecessor, the 1951 legislation does not ban the right of persons to possess, buy or sale personal jewelry and articles of adornment made from gold and platinum.[63] It was clear from the start that the regulatory aspect of the law was not meant to infringe the personal liberty of individuals from utilizing these minerals as long as it has passed through a certain phase of value addition.

The act of concealing the minerals over the stated amount was labeled an offence, entailing seizure and confiscation/ forfeiture, apart from the monetary fine and imprisonment.[64] This legislation also introduced the concept of an incentive mechanism to control illegal acts associated with minerals in which any person who provides information is rewarded a share of the proceedings of the seized resource.[65] Finally, it is the proclamation that banned the age-old

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[60] Id., Article 4 and 7.
[61] Id.
[62] Transaction Control., *supra* note 51, Article 3 talks about authorization for possession and custody of the minerals while Article 4 talks about authorization of the transaction of the minerals.
[63] Proclamation to Prohibit, *supra* note 50, Art 2 and Transaction Control., *supra* note 451, Article 9.
[64] Transaction Control, *supra* note 51, Article 8.
[65] Id.

tradition of using gold as a legal tender among the society, ordering all people in possession of the same to surrender their possession to the government for a market price set as compensation.[66]

4. Mining Proclamation and Regulation of the Empire of Ethiopia

4.1. **The Government's Place in Resource Ownership**

In 1971 Ethiopia saw a comprehensive law intended to govern activities in the mining sector. [67] The law is established on the principle of deeming natural resources of the empire state domain and giving same a sacred trust for the benefit of its people. It also recognizes the role natural resources play to economic growth and welfare of Ethiopians. The preamble to the legislation states the need for employing sound principles of modern technology and resource conservation as well as a compilation of geological maps and statistics of Ethiopia.[68] Further, the preamble emphasizes the role of a clear law on mineral governance in encouraging foreign and domestic investment,[69] which in turn, is a key tool to realize developmental objectives.

The proclamation embarks by a clear repeal of the previous laws in place.[70] It further goes to state all rules, written or customary, in place regarding minerals are to be replaced by this law.[71] A recognition as to the existence of various customary practices governing the operation of mining activities is clear from the tone of these repealing provisions. In its long years of mining

[66] Transaction Control, *supra* note 51, Article 5.
[67] A Proclamation to Promote the Development of Mineral Resources of the Empire of Ethiopia, Proclamation No. 282/1971, *Negarit Gazeta*, (1972) [hereinafter Proclamation No. 282/1971].
[68] Id., Preamble.
[69] Id.
[70] Proclamation to promote, *supra* note 67, Article 2. i.e. Proclamation to Prohibit., *supra* note 47 and Transaction Control., *supra* note 48.
[71] Id.

activities, it is impossible to imagine the governance structure was limited to two piecemeal legislations whose scope merely concentrates on a limited area. The repeal thus comes in time as the legislation under discussion is comprehensive both in terms of its scope and the types of minerals and mining operation it purports to administer.

Accordingly, all activities of mining within the boundaries of Ethiopia were made as per the set rules and regulations of this legislation. These activities cover prospecting, exploring, mining, storing, processing, transporting, and disposal of mineral wealth within the boundaries of the country.[72] The regulatory aspect of the proclamation is manifests in the requirement set for a permit, license, certificate and a lease for acts of mineral prospecting, mineral exploration, mineral discovery and mining operation respectively.[73]

An eligibility provision in the proclamation requires a person or an operator to have sufficient working capital and technical knowledge to explore, exploit and market minerals, consistent with pertinent stipulations under the commercial code of Ethiopia.[74] The 1960 commercial code of Ethiopia has set exploitation of mines, including prospecting for and working of mineral oils and exploitation of quarries as acts of trade.[75]Also, the various privileges the then investment law extend to traders are also applicable to those in the mining sector.[76]

[72] Proclamation No. 282/1971, *supra* note 67, Article 5.
[73] Id., Article 7.
[74] Id., Article 9.
[75] Commercial Code of the Empire of Ethiopia, Proclamation No.166/1960, *Negarit Gazeta*, (1960), Article 5(4)(5)(6).
[76] Proclamation No. 282/1971, *supra* note 67, Article 17.

The law allows the government to participate in mining activities through its agencies or via a commercial enterprise it establishes for such a purpose.[77] The government, as the custodian of sacred resources, is also entitled to require traders in the sector to establish a processing and refining plant in mining areas.[78] It can require the sale of the agreed percentage of equity of foreign investments to Ethiopian nationals and companies planning to operate in the sector.[79] The government has also given itself the pre-emptive right of all or a portion of produced minerals.[80]As such it can order to whom sale of the produced minerals is to be made on the condition of respecting free-market prices.[81]

Where the mining operation ceases, it is the right of the government to take over, without payment of compensation, the land and immovable on the mining area constructed.[82] It can also acquire at a set price all the movables of the lessee at the site after informing the same to the right holder.[83] Taking into account the huge investment mining operations call for both in cash and equipment, the right given to the government in taking over same ensures the transfer of technology to the domestic need as well as enables society at large to benefit from the infrastructure in place.

4.2 **Mining Rights and Duties**

The overall structure set by the legislature in connection with mining operation is of a two-tier arrangement, i.e., preliminary development rights

[77] Id., Article 10 a (1).
[78] Id., Article 10 a (2).
[79] Id., Article 10 a (3) and (4).
[80] Id., Article 30(1).
[81] Id.
[82] Proclamation No. 282/1971, *supra* note 67, Article 32(b) 2.
[83] Id., Article 32(c).

and development rights.[84]The first category of rights are largely concerned with prospecting, exploration and discovery while the latter is about mining lease. The regulation devotes a vast share of provisions detailing what the respective rights, obligations and limitation in connection to all these various classifications.

The proclamation, under specific provisions, defines minerals as any substance of economic value incorporating petroleum, natural gas, quarry substance and thermal powers on top of the common metallic and non-metallic mineral classification.[85]The provision which classifies minerals replicates this wider classification.[86] Over that period, there was no separate legal regime applicable for selected types of minerals, making the proclamation the sole and exclusive regime with applicability on all operations in connection to minerals.[87]This is why the proclamation states all the rules set to have applicability on petroleum and natural gases.[88]

Preliminary development rights are concerned with the stages that need to be passed before the actual task of producing minerals. Prospecting permit is one of these stages. This stage, which the law expresses as limited or unlimited both in terms of areas or type of minerals, confers a non-exclusive right.[89] As such it entitles the permit holder to a period of one year[90] with a chance for an

[84] PArt 2 of Proclamation 282/1972 has five chapters. The first chapter deals with mining rights in general. The second chapter is entitled Preliminary Development Rights. Under this chapter three sections deal with prospecting permit, exploration license and Discovery. The third chapter is titled Development rights. Mining lease and quarry substances are the two sections of this chapter.

[85] Proclamation to promote, *supra* note 667, Article 3(m).

[86]Id., Article 6.

[87] Id., Article 38.

[88] Id.

[89] Proclamation No. 282/1971, *supra* note 67,Article 18(b).

[90] Mining Regulation, Legal Notice 396/1971, *Negarit Gazeta*,(1971), Article 6(b),[hereinafter Mining Regulation].

indefinite number of renewals of a similar one year period[91] to determine whether the areas contain minerals in a payable quantity, i.e., economically/ commercially viable amount.

The rights conferred to a permit holder as expanded by the regulation are all meant to effectively achieve this purpose. By stipulating the limit and obligation of permit holders, it sets a clear stand as to the seriousness of the controlling office in seeing to it that the resources of the nation are effectively utilized.[92]

Evidencing this, the proclamation states:

> "…[T]*he holder of the permit is not prosecuting the prospecting operation, with all reasonable diligence, skill, exactness in accordance with the provisions of the proclamation and the present regulation and the requirements of the controller or the director"*[93]

A prospecting permit is a precondition for the entitlement of application of exploration license.[94] Exploration under the law refers to all operations concerned with the search and prospecting of minerals.[95] It is a step next to prospecting which was concerned solely with the conduct of mineral exploration to ascertain the presence or absence of minerals and mining information.[96] Prospecting permit and exploration license are two highly interlinked mining rights paving the way for the final act of mining operation.

[91] Id., Article 7(d).
[92] Mining Regulation, *supra* note 90, Article 8 a-c.
[93] Id., Article 10(c).
[94] Proclamation No. 282/1971, *supra* note 67, Article 19(b).
[95] Id., Article 3(e).
[96] Id., Article 3(x).

Unlike the prospecting permit, the law makes exploration license an exclusive right of the licensee.[97]

After the proper filing of an application for an exploration license, the regulator mandates a publication of the application with sufficient detail for third parties in a newspaper of general circulation enabling them to provide an opinion on the application to the extent of an objection.[98] This is a transparency requirement set by the legislator to protect the interest of third parties in general and parties with a particular interest in connection to the application as in the case of avoiding issues associated with or likely to arise with superimposition of mineral rights. If the application meets the requirements and in line with the regulation, a license, which is valid for two years with the likelihood of renewal as of right for the same two years time for three successive periods, can be issued.[99] The holder of an exploration license, in addition to the rights and duties as a prospecting permit holder, has the right to explore the area of license.[100]

A licensee must also renounce every year a stated percentage of the exploration area.[101] The exploration area may extend from one square kilometer to one hundred square kilometers.[102] The obligation of renunciation –except in situations where an agreement between the ministry and the licensee is in tune with ensuring the area eligible for interested third parties –allows no exclusiveness to the extent of the renounced area. Further, where there is no motivation to renounce the exploration area, such undertaking is understood as a mechanism set by the legislator to take away

[97] Id., Article 19(a).
[98] Mining Regulation, *supra* note 90, Article 13(d) and 14.
[99] Id., Article 18(a).
[100] Id., Article 19.
[101] Id., Article 20(b).
[102] Id., Article 11(b) 2.

areas covered in the license. This ensures the due diligence duty extended to all exploration areas.

The last predevelopment right discussed by the law is discovery. This right entitles a person to a certificate of discovery[103] and a special certificate of discovery.[104] The certificates are evidences of discovery of mineral deposits. Both the acts of prospecting and exploring may lead to economically viable mineral deposit discovery. Yet, at times a person may also discover minerals while not being a holder of either a prospecting permit or an exploration license. This entitles the discovering party to special certificates of discovery.

It is important to note that the law does not out rightly disregard coincidental discovery. It has rather formulated a mechanism to legalize it and make it eligible to be governed by the existing structure. This applies only in a non-exploration license area.[105] In both cases of certificate of discovery, the holder of the certificate is given the exclusive right to explore the discovery and has a preferential right for grant of mining lease.[106]

In the predevelopment mining right category the law has established a non-exclusive right of prospecting and an exclusive right of exploration and discovery. Except for scenarios where a person applies for an exploration license and a mining lease at similar time creating a combined mining right[107], development rights for minerals flow directly from the issuance of a certificate of discovery. After a mutual agreement on the work program and minimum expenditure to be spent on the operation is set between the ministry and the certificate holder, a mining lease will be issued.[108] The law takes the

[103] Proclamation No. 282/1971, *supra* note 67, Article 21(b).
[104] Id., Article 22.
[105] Id.
[106] Proclamation No. 282/1971, *supra* note 67, Article 21(d).
[107] Id., Article 25.
[108] Id., Article 23(a).

public interest and existing mining rights holder's interest as factors of consideration before issuing a mining lease.[109]As the term public interest is prone to interpretation and not defined even in indicative terms, it gives a wider discretion to the regulating authority to deny or allow mining lease. This may be viewed negatively from the perspective of investment attraction and a negation of the objectives set at the preamble of the proclamation.

Once a mining lease is issued, it confers a variety of rights to the lessee. To this effect, Article 23(b) of the proclamation states:

> *(....).mining lease shall confer the right to possession of the surface and subsoil of the mining area and subject to the prescribed conditions, the exclusive right to mine, remove and dispose minerals specified in the lease, including all rights deemed necessary by the minister to ensure the successful and efficient operation of the mine.*

The law further lists the following as the rights of a lease holder[110]

1. Right to enter upon the lands subject to mining lease
2. The exclusive right to mine, store, remove, export and sell the exploited minerals
3. Right to occupy land within or adjacent to the mining area
4. Right to request land expropriation, if negotiation to land acquisition fails
5. Right to construct, operate, maintain all mines and other facilities necessary or convenient for the performance of purposes listed in the mining lease
6. Right to construct a house and other facilities for employees
7. Right to use water from water bodies within and with a reasonable distance from place fop operation

[109] Id.
[110] Mining Regulation, *supra* note 90, Article 34(a) (b).

8. Right to remove and move earth, wood, store and such other materials in the mining area with the agreement of owners or through ministry approval

Mining lease right may range from five to thirty years, with a preferential renewal right.[111] Similar to the rights, whose survival depends on the special formality of registration, a mining lease shall be entered into a register of an immovable property that is open to the public at large.[112]The proclamation extends this obligation to all mining rights on the pain of making the right null and void.[113] In fact the proclamation introduced a new system of registering all mining rights except those traditionally engaged in mining and obtains their livelihood from same, as it requires even those rights formed prior to the legislation to be registered or risk being extinguished.[114]

The controller is duty bound to notify the third parties about the pending application[115] together with the publication of same in a newspaper.[116] These obligations are clear manifestations of the fact that ensuring the rights to be assigned to the lessee are unassailable rights. Such obligation further protects the infringement of lease area by third parties who failed to object and state their interest during the time framework.

A mining leaseholder is entitled to a surface lease right for mining operation outside his lease area.[117] This right comes into effect upon payment of service fee and compensation in a form of rent.[118] The law goes to the extent of expropriating private holdings if the holding is needed for a mining

[111] Proclamation No. 282/1971, *supra* note 67, Article 23(c).
[112] Id., Article 23(d).
[113] Id., Article 44(a).
[114] Id., Article 46(a).
[115] Mining Regulation, *supra* note 90, Article 26 (d) (e).
[116] Id.
[117] Proclamation No. 282/1971, *supra* note 67, Article 24(a).
[118] Id.

operation.[119] The proclamation has already labeled mining purpose a public purpose[120] under the meanings of the civil code of Ethiopia, thereby setting the platform for expropriation with ease. Mining purpose is defined as any work necessary for or incidental to the mining operation.[121]

The position of the law in connection to surface lease is a positive one, fostering the confidence of the investor and showcasing the commitment of the government in ensuring the smooth running of mining operations. This being said, the government reserves the ownership of such area and the acts of prospecting, exploring or mining is prohibited as a matter of principle.[122] The surface can provide only an auxiliary service for the operation on the area indicated on the lease.

The proclamation envisages a situation whereby the ministry might vary or suspend the terms of the mining lease[123] with the consent of the lessee and the terms applied thereupon.[124] The motivation for same emanates from the evaluation made by the ministry that it would be impossible to perform the lease terms and undue hardship will be inflicted on the lessee.[125] In a move to accommodate the interest of the license holder, prior consent implying negotiation on terms of variation and suspension are put in place.

[119] Proclamation to promote, *supra* note 67, Article 24(b).
[120] See Id., Article 16.
[121] Id., Article 3.
[122] Mining Regulation, *supra* note 90, Article 35(d).
[123] Proclamation to promote, *supra* note 67, Article 26(b).
[124] Id.
[125] Id.

Mining rights and obligations under the law take express and implied forms.[126] The proclamation does not refer to express rights and obligations. Yet an express reference is made under Article 14 of the proclamation about implied rights and obligations. In connection to the variation and suspension arising from performance, it is important to make mention of one implied obligation stated by the law; the undertaking on the part of the lessee to perform obligations with promptness and all diligence.[127]

The term diligence is essential that it is even provided with a definition under the proclamation. It constitutes skill, efficiency, prudence, and foresight employed by the right holder while operating and utilizing the modern techniques of operation.[128] This clearly shows the high level of professionalism the government expects from operators. It further suggests the logic behind an inclusion of the exception to the application of the administrative contract provisions on mining rights.[129] Noting the high level of professionalism and cumbersome responsibility, parties with an administrative contract type are expected to act in accordance with the stipulations in such contracts which explicitly expect the contracting parties to perform their duties 'diligently'.[130] It is important to note that the exclusion of mining-related contracts from the ambit of administrative contracts is a clear indicative of the desire of the legislator in contemplating a much higher duty on the lease or right holder.

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[126] Proclamation No. 282/1971, *supra* note 67, Article 14. Also See Article 3(p) of this proclamation which defines mining rights to constitute prospecting permit, exploration license and mining lease.

[127] Id., Article 14(d).

[128] Id., Article 3(d).

[129] Id., Article 8.

[130] Civil Code of the Empire of Ethiopia, Proclamation No. 165/1960, *Negarit Gazeta*,(1960) Article 3172(3). See also Article 3177 entitled Exceptio Non Adimpleti Contractus, a principle enshrining the idea as failure in the side of the administrative organ in fulfilling its contractual obligation cannot be a ground to suspend performance by the non-administrative organ.

The following provision sums up the narration made so far:

> [T]*he lessee of a mining lease shall promptly and thoroughly carry out all obligations under the lease in a proper and workmanlike manner, developing and maintaining the production of all the exploitable minerals in accordance with the most modern techniques and methods in the industry, at the optimum rate consistent with the extent of the mineral deposits within the mining area, current market conditions and all relevant orders and regulations issued hereunder.* [131]

The law has provided four mechanisms whereby the mining lease and rights emerging from such can be terminated in connection to the right holder. As such, it can be terminated through transfer, surrender, revocation or expiry of due date.

The mining lease right can be transferred to third parties in writing with the written approval of the ministry through amalgamation, mortgage, assignment, inheritance or any other cause.[132]The transfer does not automatically absolve the transferor from the performance of its obligation under the lease.[133] It shall also not divide the leased land.[134]

Further, there is an obligation of registering the transfer in the register of immovable.[135] Hence, once the lease is transferred to a third party, the benefit emanating from it ceases to exist and they are not available for the third party. The legislator's tendency in allowing right transfer is largely taken as an

[131] Proclamation No. 282/1971, *supra* note 67, Article 26(a).
[132] Id., Article 31(a).
[133] Mining Regulation, *supra* note 90, Article 38(c).
[134] See *supra* note 148.
[135] Mining Regulation, *supra* note 90, Article 38(b).

investment attracting strategy. Investors will be encouraged to risk investing in mining operations if they are guaranteed that the possibility to transfer their investment to third parties is respected as a matter of principle. The strategy is balanced in that the ministry will have the power to critically appraise a transfer request and has the final say in allowing the same.

A lessee is also entitled to an act of surrendering his lease right by providing a one-year prior notice to the same effect to the ministry.[136] Approval of the request will be made by taking due consideration of the right of persons under the lease.[137] To protect the act of abandoning obligations under the guise of surrender, the proclamation makes it a pre-condition that any liability of the leaseholder is performed before validating surrender.[138] Surrender will ensure the reduction of illegal behaviors whereby right holders may simply abandon places of operation due to various reasons. A person or a company unable to proceed with operation can lawfully surrender and exit his investment.

Expiry of contractual duties and obligations is an obvious way of ending a mining lease if renewal is not sought with the period provided by the law.[139] Revocation, on the other hand, covers those situations arising from breach of provisions of the proclamation or regulation or breach of the conditions associated with the mining lease.[140] While the proclamation explicitly states two of these later conditions for revocation, i.e. failure to mine in a reasonable time after discovery and mining contrary to conservation.[141] There are other

[136] Proclamation No.282/1971, supra note 67, Article 28(a).
[137] Id.
[138] Id., Article 28(b).
[139] Id., Article 32(a).
[140] Id., Article 27(a).
[141] Id.

conditions implied across the provisions. The contents of the conditions are summarized below.[142]

1. Failure to pay rent/royalty/any sum required from right holder after six months of the due date or failure to discharge any liability due to the government for more than a year of the due date.
2. Wasteful mining activity.
3. Failure to commence operation or suspend or restrain the operation.
4. Failure to meet performance obligation.
5. Failure to improve working conditions impearling or tending to imperil the health and safety of employees while being notified of the same.
6. Making an intentionally false or misleading statement in the process and during operation.
7. Failure to prosecute the operation with all reasonable diligence and skill as set by law or requirements of the controller/director.

It is important to note at this point that the publicity of these items in news article serves as conclusive evidence of revocation.[143] Yet before the act of revocation, the ministry may provide a grace period for the lessee to amend and remedy the gaps.[144] In this regard, the ministry is authorized to shorten or extend the time set to perform acts under the law for good cause.[145] Revocation is also open for appeal both to the revoking authority[146] and the court of appropriate jurisdiction.[147]

4.3 **Fiscal Regimes of EIs Governance**

[142] Mining Regulation, *supra* note 90, Article 39(a) 1-10.
[143] Id., Article 39(b).
[144] Id., Article 39 (c).
[145] Id., Article 39(d) and Article 45.
[146] Id., Article 39(f).
[147] Id., Article 39(g).

As one of the major contents of a governance structure for extractive resources, high emphasis is rendered to the financial related schemes. The high-hope and expectation these resources will bring to the overall development and economic progress of a nation mandate a governance structure to carefully design the rules meant to control the management of revenues generated from the operation of extractive resources. In this regard, the proclamation has stipulated royalty, income tax and rent as major mechanisms of benefiting from the proceedings of the resource operation.

A royalty at different rates as to categories of minerals collected every 6 months is set by the proclamation.[148] Royalty for petroleum and natural gas is set at 12.5% of the wellhead value of the crude product extracted by the lessee.[149] Metalliferous and non-metallic minerals operators are to pay a maximum rate of 10% of the gross sale[150] while for precious minerals the rate is higher (15%)[151]. Mineral waters and thermal water require a 5% royalty[152] while for quarry substance a 3% rate is set.[153]All the royalty payments are calculated from the gross sale based on the highest price obtainable at the time of sale.[154]

It is also stated that the rate is set under the term "maximum rate"[155] the exact percentage of royalty will take into account for the economic value of the minerals.[156] Such provision tells us that the higher the economic value of the mineral in the market, the higher the possibility of applying the maximum rate

[148] Mining Regulation., *supra* note 90, Article 44(b).
[149] Proclamation No. 282/1971, *supra* note 67, Article 40(a).
[150] Mining Regulation., *supra* note 90, Schedule x (a) 1.
[151] Id., Schedule x (a) 2.
[152] Id., Schedule x (a)3.
[153] Id., Schedule x (a) 4.
[154] Id., Schedule x(a) 1-4.
[155] Id.
[156] Mining Regulation., *supra* note 90, Schedule x(b).

of royalty, and the lower the economic value of the mineral in the market, the lower the possibility of requiring a maximum rate of royalty. Although this can be viewed as encouraging to the investor, the room for improper determination of royalty among various operators as a result of gaps in the institution responsible for controlling the activities is also a major threat of unjustified discrimination.

The governance structure seems generous and encouraging to leaseholders about other considerations it sets regarding royalty. The ministry is with the power to remit royalty payment in part or in whole.[157] This act of grace stands for 5 years.[158]With the approval of the council of ministers, the period can even extend to additional years.[159] Taking into account the high-cost investment put in place and the time required to return on investment, such provisions would enable investors to engage in the extractive resource sector easily. Finally, under all these scenarios, remittance of royalty requires the presentation of a good cause.[160] Yet with proper and convincing reason, the lessee is entitled to invoke an exemption request.

Another important point to note about the mining lease is that such exemption is not allowed for petroleum and natural gas operations. A lessee for petroleum and gas is exempted only from a royalty pay for resources used by it in the course of operation under the lease or while reintroducing such deposit or if petroleum or gas is lost or not used.[161]The lessee has also the option of paying royalty in cash or kind, i.e., in petroleum or gas for part of or

[157] Proclamation No. 282/1971, *supra* note 67, Article 34(b).
[158] Id.
[159] Id.
[160] Id. The term good cause is not defined in the law leaving the room wide open for the discretion of the regulatory authority.
[161] Proclamation No. 282/1971, *supra* note 67, Article 40(c).

the whole production.[162] In the case of royalty payment in kind, the acts of preliminary treatment, transportation and storage of production will be done by the lessee upon payment of the cost for doing the same by the government.[163]

The other major financial aspect of the governance structure is income tax. Without disregarding the income tax applicable for all activities in place at the time, the proclamation goes to state the particulars of extractive resource operations to be taxed.[164] In principle, a flat business income tax rate of 51% is provided both for mining and petroleum and natural gas operating business.[165] The determination of taxable income is set to be made after the deduction of royalty and other eligible taxes due and payable in a fiscal year.[166]

In an illustrative effort of how deductions are made for purpose of calculating income tax, Article 43 of the proclamation explicitly categorized discovery, depreciation, capital allowance and income from different mining activities as costs to be deducted from the income before determining the taxable income.

The legislator has provided two options for mining income tax payment. The lessee can either pay the 51% income tax or enter into a profit-sharing arrangement with the government to provide an agreed percentage of its profits instead of income tax.[167] The profit-sharing arrangement does not only relieve the lessee from its tax obligations, but it extends to relive it from royalty and other eligible taxes required by pertinent laws.[168] A further

[162] Id., Article 40(d).
[163] Id., Article 40(e).
[164] Id., Article 34(c).
[165] Id., Article 34 (c) 1 and Article 41(b).
[166] Id.
[167] Proclamation to promote, *supra* note 67, Article 34(c)1 -2.
[168] Id.

safeguard for the lessee of petroleum and natural gas is in place such that if in a fiscal year the amount of income tax and other payments required from him exceed 51% of his profits, the income tax will either be reduced or remitted to ensure that excess is avoided.[169] When even complete remission does not bring the excess down, the excess amount can be carried forward and deducted in subsequent years.[170]

Although at face value a 51% income tax on top of royalty, rent and other payments is cumbersome leading to investment decline, the various arrangements discussed above show the intention of the lawmaker to remedy the gap of in the same. The legislator is caught between finding the balance between ensuring investors attraction towards the sector while at the same time bringing the maximum benefit to the public at large.

Finally, the wide discretion left for the ministry/controller may be taken as a positive attribute for the law governing the sector. Yet the application of the same on fiscal matters calls for a very strict approach. Failure to treat all actors operating in the sector under similar footing and application of varying rules under the justification of national interest may have opened the door for corruption and wastage of resource gain leading to the resource curse.

5. Mining Governance in the 'Derg'[171] Era

The mining proclamation and regulation of the empire of Ethiopia, as discussed in the prior sections, were in full force as a principle even when the country saw a regime change that purports to follow socio-economic and

[169] Proclamation No. 282/1971, *supra* note 67, Article 41(c) 1.
[170] Id., Article 41 (c) 2.
[171] Meaning 'committee' in the ancient Ethiopic language 'Geez', 'Derg' refers to the military regime which overthrown Emperor Hailesellasie I and reigns in Ethiopia for seventeen years.

political path far different from its predecessor.[172] The provisional Military administration council seemed to have been convinced to avoid double effort by developing a new governance structure for the extractive sector. With a wider recognition of the strategy, the Dergue regime maintained used the contents of the structure with limited amendments. The amendments were demonstrative of the political reality of the time and the winning ideology of the day to which the government in power subscribes.

It is claimed that the 'hibretesebawinet'[173] principle which the military administration staunchly adhere to eradication of personal gain by providing priority to the community's interest is prioritized.[174] It seeks to fulfill the same among others, by transferring resources it identified crucial for the economic development from the private sector to the ownership of the government after payment of "fair" compensation.[175]Where such total transfer cannot be realized for various reasons, the government considers it as its responsibility to share in the equity of the private sector to ensure the public interest.[176] The room for private sector ownership of resources and activities is availed after the consideration that such will not harm the interest of the society.[177] All this narrative is set in clear term to the preamble of the law that declares the government ownership and control of means of production. The law sets this means of production into three categories; activities undertook exclusively by

[172]Government Control of Mineral Prospecting, Exploration and Mining Activities Proclamation, Proclamation No. 39/1975, *Negarit Gazeta*, (1975), Article 5(2), [hereinafter Government Control].

[173] Amharic word for socialism.

[174]Government Ownership and Control of the Means of Production Proclamation, Proclamation No. 26/1975 *Negarit Gazeta*, (1975), Preamble,[hereinafter Government Ownership].

[175] Id.

[176] Id.

[177] Id.

the government[178], activities that may be undertaken jointly by the government and foreign capital,[179] and activities which may be undertaken by the private sector.[180]

The prior governance structure for mining operations is left untouched in connection to their substantive content. The shift is primarily concerned with ensuring the activities henceforth labeled as government-owned, joint or private. The change also seeks to ensure the ownership of those activities by governmental pursuant to legislative rules of nationalization that require private actors operating at the time to either surrender their full control or enable the government to have an equity interest, with fair compensation payment, in their operation as the case may be.

The legislation has put the following extractive resource operations under the ambit of exclusive ownership of the government:

1. Exploration and extraction of precious metals (such as gold and silver), large scale mining of salt pans, and radioactive and nuclear minerals[181].
2. Petroleum refining and extraction of natural gas[182]

In the second category of joint undertaking by the government and foreign capital on terms to be agreed with the condition of a minimum of 51% equity for the government[183], the following activities are listed:

1. Exploration and extraction of carbons and hydrocarbons such as petroleum and coal[184]

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[178] Government Ownership, *supra* note 174, Article 2.
[179] Id., Article 3.
[180] Id., Article 4.
[181] Id., Article 2(1) a.
[182] Id., Article 2(1) d.
[183] Id., Article 3(1) and (2).

2. Mining of ferrous and non-ferrous metals[185]
3. Mining of chemicals and fertilizer materials such as potash, phosphate and Sulphur[186]

On the final list of private sector engagement open areas for individuals or business organizations, quarrying[187] is mentioned. Although the fields as import-export trade and wholesale and retail trade[188]are mentioned in generic terms, it is possible to understand the same to apply for trade in connection to mineral products. The final list under this category also bears the term 'others not elsewhere classified',[189] enabling one to find room for an activity in the mining sector if not specifically listed by the other two categories.

Barely three months after the coming to effect of this general law was a specific legislation meant to expand the contents of the general declaration to the extractive sector in particular in place. Proclamation 39/1975, government control of mineral prospecting, exploration and mining activities proclamation recognizes the need to issue a separate law that provides direction to the new economic policy in connection with mineral activities.[190] Affirming the long-standing claim over all mineral wealth of the state domain, it provides a slight recognition of the need to engage foreign private and public capital in some areas of the operation to accelerate the development of the mineral resources.[191]

To the general laws categorization discussed above, the proclamation has made the following amendments:

[184] Id., Article 3(1) a.
[185] Id., Article 3(1) b.
[186] Id., Article 3(1) c.
[187] Id., Article 4(2).
[188] Id., Article 4(12) and (13).
[189] Id, Article 4(18).
[190] Government Control, *supra* note 172, Preamble.
[191] Id.

1. It included the resources platinum and other precious minerals, and the exploitation of uranium, radium and geothermal power to the government exclusive ownership listing.[192]
2. It cancels the petroleum and natural gas operation that was assigned to the exclusive jurisdiction of government ownership and puts the same under joint government and foreign capital listings.[193] It seems the nationalization dictum was met with the reality of the government's actual operational capacity that a need to engage foreign capital was realized.
3. The terms ferrous and non -ferrous metals were clarified with specific mineral names as iron, copper, and nickel and the category of metallic minerals was added under the joint operation listing.[194]
4. In the private sector category, the term quarry was clarified to incorporate marble, limestone, sand, gravel, stone and other quarrying substance.[195] The prospecting, exploration and mining of industrial clay and minerals necessary for the manufacturing of bricks, chinaware, ceramic, glass and bottle with mineral water and thermal water mining.[196]
5. It gives the Ministry of Mines and Energy the power to issue regulations necessary for the better implementation of the proclamation.[197]

Other than expanding the list of categories, the only additional point made is the recognition provided for the continuing of the mining lease term for operation already in place, as long as the minimum 51% government equity is ensured for mining activities the law set to be undertaken jointly with foreign

[192] Government Control, *supra* note 172, Article 2(1).
[193] Id., Article 5(1).
[194] Id., Article 3(1) b.
[195] Id., Article 4(1).
[196] Id., Article 4(3).
[197] Id., Article 6.

capital.[198] The job security of employees in the transferred entities or equity shared entities is also protected by the law.[199]

6. Conclusion

This article explored the long-standing experience Ethiopia had accumulated in extractive industry governance since era of Emperor Menelik II. As a landmark move in this regard, the emperor established a governance system whereby he authorizes the exploitation of areas by investors on conditions regarding taxes, working conditions, term of permit, the scope of permit concerning the type of mineral to be exploited, and certain investment guarantees from the side of the government. This can be inferred from the various letters issued to operators at different times. These letters were further supported by the duties required by local officials to facilitate the operation of permit holders in the provision of labor, favorable working environment, right of way, and transportation.

A governance structure in a form of legislation first appears in the era of Emperor Hailesellase I. Although various imperial decrees were issued regarding the mineral wealth of the nation and the right of the state to act as protectorate and owner of the resource, the first legislation with explicit governance element was the one that prohibits the export of certain selected minerals from the empire. Another legislation of similar nature with a broad aim of governing the transaction of minerals was also enacted during the imperial period.

A detailed governing structure for minerals needed to wait for another three decades. Mining Proclamation of the Empire of Ethiopia 1971 with its regulation was a comprehensive governance structure, albeit its limitation, in

[198] Id., Article 3(2).
[199] Government Ownership, *supra* note 174, Article 9.

failing to incorporate some major issues of extractive governance of current time as community rights and environmental considerations. The preamble to the proclamation has the economic growth and welfare of the Ethiopian people linked with the exploration and development of mineral resources making the development and extractive governance nexus readily available since the earlier laws of mineral operation governance. It was also stated in the preamble that a statement and clarification of the law concerning mineral development is a key to foster private investment, national and foreign, in the sector. The 'Derg' regime did not repeal the substantive content of the proclamation. Hence a brief look at how the new economic conception of socialism has impacted the governance structure was made.

Legal Space for the Creation and Operation of *Fintech* in Ethiopia

Metages Tewabe[∝]

Abstract

The digital economy is reshaping the global financial system, driving the transformation and development of financial technology irreversibly. Financial technology (Fintech), which combines technology and financial services, has revolutionized how businesses could run. The use of such tools has been steadily increasing in Ethiopia in the last few years and is expected to grow fast. The country's financial regulator, the National Bank of Ethiopia, is amending a decade-old Payment System law, allowing foreign investors to set up business in this country. The delicate nature of financial systems imperatively requires legal and regulatory systems to regulate Fintech creation and operations. Yet activities related to Fintech are inadequately addressed by the current law in place. The legal or regulatory response is unclear due to the novelty of the products, services, and players. Because of these fragmented and inconsistent regulatory environments, examining Ethiopia's legal landscape and regulatory frameworks for Fintech has become critical. This article, dedicated to such end, analyze the legal regime for the creation and operation of Fintech under the national bank of Ethiopia regulatory framework. The investigation employed a mixed research methodology with dominant qualitative data generating tools. The evidences from the investigation show that the Ethiopian law in place today does not

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include technology assessments for Fintech. Additionally, current regulations on Fintech are insufficient because they do not address consumer protection and maintaining consumer trust procedures. Accordingly, the evidences suggest that lawmakers need to create a comprehensive regulatory framework to manage Fintech and pave a way for a healthy development of financial technology.

Key Words: *Fintech*; Finance; Regulatory framework; technology

Introduction

Over the last two decades or so, the world economy has undergone a thorough modernization and digitalization across sectors. The enabling tools for such transformations are a package of financial technologies widely termed as *Fintech*. These set of tools combine the use of technological innovation and automation to improve financial services. The tools are increasingly recognized as key enablers for financial sectors, enabling more efficient and competitive financial markets worldwide.[1] In more unprecedented magnitude, digital *Fintech* tools are allowing access for financial services to unbanked areas in emerging economies. As such, they permit customers to access financial services at an affordable price, increase convenience, improve financial inclusion, and boosts productivity gains.[2]

[1]Boeddu,Gian Luciano and Chien,Jennifer, Consumer Risks in Fintech : New Manifestations of Consumer Risks and Emerging Regulatory Approaches : Policy Research Paper (English). Finance, Competitiveness and Innovation Global Practice Washington, D.C. : World Bank Group (2023) ,available at http://documents.worldbank.org/curated/en/515771621921739154/Consumer-Risks-in-Fintech-New-Manifestations-of-Consumer-Risks-and-Emerging-Regulatory-Approaches-Policy-Research-Paper last accessed on 23,January 2023.

[2] Banking evolution; how take on the challenge of Fintech, (Jan.19,2023), available at https://legal.thomsonreuters.com/en/insights/Articles/how-to-take-on-the-challenges-of-Fintech last accessed on 22,January 2023.

Such rapid advances in technology are changing the landscape of the financial sector with more products continually added to the developing system.

Fintech, as a recent concept, has no an agreeable definition. For financial practice experts such as Varga, it refers to companies that develop financial services and products by relying much on intense information technology[3]. Schueffel, a scholar, who reviewed more than 200 articles in the scholarly discourse,[4] defined this concept as a new financial industry that uses technology to improve economic activities. Apart from individual scholars and practitioners, institutions define the concept in terms of its role in institutional operation and transformation. To this end, Financial Stability Board (FSB)[5] describes it as "… Financial innovation made possible by technology that could lead to new business models, applications, processes, or products that would significantly affect financial markets and institutions as well as the provision of financial services."[6]Although there are some differences in the scope and perspectives of the definitions for this concept, there are three common core elements underlying its essence: new technological innovation, finance, and efficiency.

The three elements take the center stage in the definitions signifying that there is a symbiotic relationship between technological revolutions and business practices including legal operations of institutions. Experience shows that

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[3] Varga, D. 'Fintech, the new era of financial services', Budapest Management Review, (November, 2017), p.12.

[4] Schueffel, P. Taming the beast: a scientific definition of Fintech. Journal of Innovation Management, Vol 4, No 4, (2016), p.32.

[5] The Financial Stability Board is an international body that monitors and makes recommendations about the global financial system. It was established after the G20 London summit in April 2009 as a successor to the Financial Stability Forum.

[6] Johannes Ehrentraud, &Denise Garcia, Policy responses to Fintech: a cross-country overview, Financial Stability Institute, FSI Insights on policy implementation No 23, (January, 2020), p.6, available at https://www.bis.org/fsi/publ/insights23.pdf last accessed January 26.

some technological innovations lead to the modification of business practices, and consequent changes in the law. But the pace of these changes varies. Legal systems may need time to reflect the implications of progressive technological changes and develop a consistent, predictable, and flexible response to new challenges.

The National Bank of Ethiopia, regulating the country's financial system, has made tremendous changes in the last decade or so. Among others, it is amending a Payment System law that has been in force for ten years. The new law is meant to allow foreign and domestic investors to establish businesses in Ethiopia as providers of digital financial services.[7] It will pave the way for *Fintech* to contribute to the growth of Ethiopia's economic and financial environment. Until recently, the payment services sector in Ethiopia was exclusively reserved for two types of financial institutions: banks and microfinance institutions. The major shift from such market players happened recently with the recognition of nonbank digital financial service providers (*Fintech)*.

The regulatory Framework for *Fintech* is poorly defined worldwide.[8] Ethiopia as well does not have adequate regulatory laws covering *Fintech* in general. There are only sporadic laws, yet not concise enough to regulate the specific area of *Fintech*. This gap in the law is so clear that it requires formulation of sound regulatory systems addressing *Fintech* creation and operation. Moreover, due to the novelty of the products, services, players, and the sporadic legal/regulatory response, courts may risk making inconsistent ruling

[7] Hawi Dadhi. Why Ethiopian local Fintech are worried, (2022), available at https://qz.com/africa/2175298/why-ethiopias-local-Fintechs-are-worried, last accessed on February 4, 2023.

[8] Matthias Lehmann. Global rules for a global market place? Regulation and supervision of Fintech providers, Boston university international law journal vol. 38, No, 1, (2020), p. 142.

and swing towards approaches that may not always be the most appropriate option given the context of a specific jurisdiction.[9] Thus, ensuring a level playing field between regulated financial institutions and *Fintech* players and amongst them remains a challenge.

Financial services are among the most heavily regulated sectors in the world. Not surprisingly, regulation has emerged as governments' first concern as *Fintech* companies take off. As technology is integrated into financial services processes, regulatory problems for such companies have multiplied. In some instances, the issues are a function of technology. In others, they reflect the tech industry's impatience to disrupt finance.[10]

Looking into the service providers, one could find emerging *Fintech* organizations to provide financial services in Ethiopia. Some of them could be privately owned or owned by the government; it could also be independently providing financial services or with other financial organizations. These irregularities of regulation could constrain *Fintech* provider’s customers, and this in turn might open a space for an individual to infringe on users’ interests.

Against this backdrop, this article examines the Ethiopian legal regime in terms of its potential to regulate the creation and operation of *Fintech*. The study employed mixed doctrinal and empirical methodology to explore governing rules and the practical issues on the topic.

1. Overview of *Fintech* in General

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[9] Financial Stability Implications from Fintech, Supervisory and Regulatory Issues that Merit Authorities’ (Jan. 23,2023)available at https://www.fsb.org/wp-content/uploads/R270617.pdf last accessed on February23.2023.

[10] The Fintech Industry: Definition, Landscape, and Companies,(Jan.25,2023)available at https://academy.apiary.id/blog/the-Fintech-industry-definition-landscape-and-companies .last accessed on February 23,2023.

1.1. Meaning of *Fintech*

The supply of financial services is being challenged by a new industry called Financial Technology (*Fintech*), which combines cutting-edge technology and innovation to improve financial operations.[11] *Fintech* uses technology creatively to build and provide financial services and solutions. As such, *Fintech* often addresses every facet of the connection between a bank and its customers and develops cost-effective, more convenient, and generally more effective digital substitutes. It has developed into a platform that connects banks with essential service providers like utilities, telecom, transit, card programs, shops, healthcare, and education, among others.[12]

Since the internet technology began to penetrate the financial market, all financial fields involving computer technology such as block chain technology, cloud computing technology, digital information technology, and network communication technology have been called financial technology. *Fintech* refers to any digital service a consumer uses to manage their money, including online banking, payments, investing, savings, budgeting, and borrowing.[13] *Fintech* businesses can offer more creative and customer-focused business models. In contrast to traditional financial services, which came under urgent pressure to revisit their business models and change their

[11] Silva, L. A., Financial inclusion in the age of Fintech: a paradigm shift. Fourth FSI-GPFI conference on standard-setting bodies and innovative financial inclusion: implications of Fintech and other regulatory and supervisory Developments, Switzerland: Basel. (2018), p. 4.

[12] Mehrotra, A. Financial Inclusion through Fintech – A Case of lost focus. International Conference on Automation, Computational and Technology Management (ICACTM), Dubai, UAE. (2019), p. 5.

[13] Liudmila Zavolokina, & Mateusz dolata, The Fintech phenomenon: antecedents of financial innovation perceived by the popular press. (2016), P.16. Available at https://jfin-swufe.springeropen.com/Articles/10.1186/s40854-016-0036-7 last accessed on February 25.2023.

strategies to be more competitive, these disruptive businesses are steadily gaining market share and profitability.[14]

In Ethiopia, any business that seeks to become a digital financial service provider has two options. Either it can become a payment instrument issuer (electronic money issuer) or a payment system operator. Payment instrument issuers are digital wallet operators or digital banks obliged to guarantee their customers' electronic deposits with a guarantee deposit in one of the commercial banks of Ethiopia. This is an obligatory requirement to safeguard financial stability if they go bankrupt. According to Licensing and Authorization of Payment Instrument Issuers Directive No. ONPS/01/2020 Article 6(1), payment instrument issuer may be allowed to provide the following services:[15]

a. Cash-in and cash-out.
b. Local money transfers, including domestic remittances, load to the card or bank account, transfer to the card or bank account.
c. Domestic payments, including purchases from physical merchants and bill payments.
d. Over-the-counter transactions: and
e. Inward international remittances.

A customer of a payment instrument issuer has a daily transaction limit of 5,000 ETB and deposit limit of 30,000 ETB.[16] Its services are expected to cater to small-value retail transactions and peer-to-peer sending. The newly introduced Tele Birr mobile service is licensed under this category. In

[14] Nicoletti, B. The Future of Fintech. Rome, Italy: Palgrave Studies in Financial Services Technology, (2017), Available at https://link.springer.com/book/10.1007/978-3-319-51415-4 last accessed on 26, February 2023.
[15] Licensing and Authorization of Payment Instrument Issuers, Directive No. ONPS/01l2020,Article 6(1)
[16] Licensing and Authorization of Payment Instrument Issuers, Directive (amendment) No. ONPS/06/2022,Article 2

addition, all bank wallet services, such as Coop Pay, CBE Birr, and Amole fall into this category. As per Article 6(2),[17] based on written approval of the National Bank, a licensed payment instrument issuer under the full responsibility of and written outsourcing agreement with a regulated financial institution and pension funds may be allowed to provide Micro-saving products, Micro-credit products, micro-insurance products, or pension products.

On the other hand, payment system operators are *Fintech* companies that focus on payments between consumers and merchants. A payment system operator cannot perform cash in/out; it is expected to provide interoperable and interconnected payment services between buyers and sellers with its market-facing products. Such an operator is expected to collect the buyer's account information digitally through a mobile or a web as a customer touch point. Then the initiated payment will be sent to the national payment switch for clearing and settlement of payment transactions[18].

According to national bank Directive ONPS/02/2020 on licensing and authorization of payment systems operator, a comprehensive application must be submitted as one of the following by anyone seeking to operate payment systems:[19]

a. national switch operator
b. a switch operator

[17] Id., *supra* note 17, Article 6(2).

[18] Nurhassen mensur, Digital technologies and competitive strategies of commercial banks and Fintech in Ethiopia, Ethio- Fintech weekly Article by yene financial technology, (October 2021).p.4.

[19] Licensing and authorization of payment system operators, Directive no ONPS/02/2020, Article 4(3).

c. an automated teller machine operator
d. a point-of-sale machine operator
e. Payment gateway operator.

Upon submitting an application, both payment instrument issuers and payment system operators will become direct participants within the Ethiopian national payment system, which puts them on equal footing with any bank in Ethiopia when initiating, processing, and settling payments.

1.2. *Fintech* Developments

The evolution of finance has been influenced by technical advancement for centuries. Over the past few years, we have seen an increase in automation, specialization, and decentralization. In contrast, financial institutions have discovered ever-more-sophisticated and effective ways of leveraging enormous amounts of customer and firm data.[20] These are going through a significant shift due to the rapid development and adoption of new technology. Globally, *Fintech* emerged and flourished at the fastest intensity[21].

Fintech has evolved through three phases over the last 150 years. [22] The first stage is known as '*Fintech* 1.0' between 1886 -1987. In this stage, correspondent banking was established, and the financial institutions globally became interconnected. The second stage, known as '*Fintech* 2.0', occurred from 1987 to 2008; this stage witnessed the development of the traditional financial sector into digitized banks.[23] Also, this stage witnessed innovative

[20] Fintech and Financial Services, D. H.-G. Fintech, and Financial Services. IMF. (2017).

[21] The History and Evolution of the Fintech Industry, The C2FO team,(January.23,2022) ,available at https://c2fo.com/resources/finance-and-lending/the-history-of-Fintech-how-has-the-industry-evolved/ last accessed on February 27,2023).

[22] Douglas Arner, &Jànos Barberis. 'The Evolution of Fintech: A New Post-Crisis Paradigm?' University of Hong Kong Faculty of Law Research Paper. (2015), p.23.

[23] Id.

financial services provision outlets such as Automated Teller Machines (ATM), the adoption of stock exchanges, central clearinghouses, and international correspondent banking. The present stage is titled '*Fintech* 3.0 (from 2008 onwards).[12] This stage marks the evolution of new companies offering technology-enabled financial services and traditional institutions seeking to meet evolutionary trends in financial innovation.

The Ethiopian baking practice has more or less passed through these stages. As of 1931, shortly after Emperor Haile Selassie assumed power, the country's financial sector expanded. It was a very new phenomenon in comparison to other jurisdictions. Even more, *Fintech*'s emergence is a relatively recent trend. Although there is no fully developed *Fintech* industry in Ethiopia, commercial banks have incorporated *Fintech* into their operations. Examples include online payment systems, payment transfers, automated teller machines, digital lending, and other financial services banks offer through *Fintech*. The first ATM was unveiled by the Commercial Bank of Ethiopia in 2001.[24]

M-BIRR plans to launch a mobile banking service in Ethiopia in early 2013 as financial technology with the view to allow people to carry out fundamental financial transactions from their mobile phones, such as sending and receiving money, paying bills, receiving salaries and other government or non-governmental benefits, and repaying loans.[25] Belcash of the Netherlands also introduces Hello Cash. Banks and microfinance organizations in Ethiopia

[24] Gardachew Worku, Electronic -Banking in Ethiopia- Practices, Opportunities and Challenges, Journal of internet Banking and commerce (2010), p. 5. available on https://www.icommercecentral.com/open-access/electronicbanking-in-ethiopia-practices-opportunities-and-challenges-1-8.php?aid=38390 last accessed on February 26,2023

[25] M-Birr national mobile money service, Ethiopia, InclusiveBusiness.net (Jan. 16, 2023) available on https://www.inclusivebusiness.net/IB-Universe/ib-companies/m-birr-national-mobile-money-service-ethiopia, last accessed on February, 27, 2023.

offer Hello Cash, a mobile money service.[26] With this platform's help, consumers can make deposits, withdrawals, transfers, and payments using mobile devices. The previous ten years have seen the introduction of several platforms for financial services, including Chapa, Coop pay, Amole Mobile, Tele birr, CBE-Birr, etc.

Another key milestone in the development of payment system operators in Ethiopia was the establishment of the Ethiopian e-Payment and Settlement System. Three banks, namely, Nib International Bank S.C, Awash International Bank S.C, and United Bank S.C, linked their ATM networks into a single network known as a "premier switch solution" for the first time in February 2009 to facilitate the country's electronic payment system.[27] Later, three additional banks joined this network: Birhan International Bank, Addis International Bank, and Cooperative Bank of Oromia. Although developing a shared system began in 2009, it wasn't operational until July 5, 2012. Following the realization of this shared system, a customer of one member bank may use the ATMs of any other member bank, regardless of whose bank he currently uses.[28] Even though the country's first shared network was the premier switch solution due to the NBE's national payment project, all commercial banks, the NBE, and the Ethiopian Bankers Association banded together in 2011 to establish the Ethswitch national shared ATM network. This nationwide payment system has also been combined with Premier Switch Solution.[29] The Ethswitch payment system is a centralized electronic payment system that facilitates secure and efficient

[26] Payment platform in Ethiopia, (Jan 16, 2023) available at research proposal.docx> last accessed February 28, 2023.

[27] Tajebe Getaneh Enyew, Shared Automated Teller Machine (ATM) Network in Ethiopia: Appraisal of the Competition Concerns, Bahir Dar University Journal of Law, Vol.9, and No.2 (June 2019), p. 233.

[28] Id.

[29] Id.

electronic fund transfer, clearing, and settlement of financial transactions. Lastly companies such as chapa, Arif pay, Santim pay, Addis pay, etc. joined this sector. Now it has become the backbone for various payment system operators and enables interoperability between financial institutions and service providers.

1.3. Need for regulation of *Fintech*

The *Fintech* regulatory framework aims to take care of specific areas. These areas include possible regulatory mechanisms for the beginning (innovation) of the *Fintech* industry, regulation of cybercrime and fraud, consumer protection and data protection, regulation of the creation of the *Fintech* industry, and regulation of the operation. Regulating bank *Fintech* can be justified on several grounds. Yet the major one is to maximize benefits to financial institutions and the overall macroeconomic health of the nation. *Fintech* introduces a lot of possibilities of making the financial markets accessible to the public and serving as a tool to generate income. The availability of investing, getting personal or company loans, obtaining mortgages, and even buying insurance has increased because of *Fintech.*[30] To leverage such demands as a means of ensuring growth in the industry and the economy, regulatory bodies must govern *Fintech* to maximize their benefits.

One of the elements covered by *Fintech* regulatory frameworks is the innovation of *Fintech* startups. *Fintech* startups are beginner companies that provide financial services.[31] This *Fintech* policy establishes a specialized

[30] Fintech and its Role in the Future of Financial Services,(2018),available on https://center-forward.org/wp-content/uploads/2018/02/Fintech-3.pdf,last accessed on March 29,2023.

[31] Henner Gimpel, Daniel Rau &Maximilian Roglinger, Understanding Fintech stArt-ups– a taxonomy of consumer- oriented service offerings, FIM Research Centre, University of Augsburg, (2018), p. 247.

environment for innovation, company development, and testing new ideas in a safe and controlled setting. It does this by deploying a regulatory sandbox[32]. It creates a specialized setting for testing new ideas and conducting business development in a safe and regulated environment.[33]

Fintech companies handle sensitive financial information and conduct transactions on behalf of consumers. Without proper regulation, there is a risk of fraud, data breaches, and other unlawful activities that can harm consumers. Regulation ensures that *Fintech* companies have adequate safeguards in place to protect consumer interests. Fraud also includes depriving another person or an institution of a benefit to which they are legally entitled. *Fintech* fraud may be manifested as identity theft, hacking, and deep fakes.[34] *Fintech* policy helps to ensure that *Fintech* companies had adequate procedures to prevent these illegal activities.

Another area that requires regulation in the *Fintech* era is data protection. *Fintech* companies collect and process vast amounts of consumers' personal and financial data. The law can help protect consumer privacy and ensure that *Fintech* companies handle and store this data responsibly, minimizing the risk of data breaches or unauthorized access. Data protection mainly involves defending sensitive information from loss, compromise, or corruption[35].

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[32] RBI regulatory sandbox: How this Fintech uses block chain for cross-border pay,(2018) available at https://www.livemint.com/companies/stArt-ups/rbi-regulatory-sandbox-how-this-Fintech-uses-blockchain-for-cross-border-pay-11631690871141.html , last accessed on March 6, 2023.

[33] Id.

[34] Edlyn Cardoza, 9 types of fraud the Fintech industry needs to beware of in 2022,(2022),available at https://ibsintelligence.com/ibsi-news/9-types-of-fraud-the-Fintech-industry-needs-to-beware-of-in-2022/ accessed on July 26 ,2023

[35] What is data protection, (2021) available at < https://www.techtarget.com/searchdatabackup/definition/data-protection last accessed on June 21, 2023.

Customer protection guards consumers of financial services against substandard goods, dishonest and fraudulent corporate practices.[36] Additionally, it helps the customer feel secure and guaranteed.

It is essential to balance regulation and innovation in the *Fintech* sector. While regulation is necessary to mitigate risks, protect consumers, and maintain financial stability, it should not stifle innovation or hinder the industry's growth. Therefore, a flexible and adaptive regulatory approach is needed to address such *Fintech's* unique challenges and opportunities.

1.4. The Global Experience in Regulating *Fintech*

The global experience in regulating *Fintech* is characteristically dynamic and an evolving one. As technology continues to disrupt and transform the financial industry, regulators worldwide have been working to strike a balance between promoting innovation and protecting consumers and the financial system's stability. Countries and regions have taken varied approaches to regulate *Fintech* based on their unique circumstances, priorities, and regulatory frameworks.

USA, India, and Kenya are jurisdictions with the richest experience in relation to *Fintech* concerning payments and digital lending. This review draws insights from the reservoir of best practices in these jurisdictions.

1.4.1. United States of America (USA)

The United States of America (USA) has been actively involved in regulating the *Fintech* sector over the past decades. The regulatory landscape for *Fintech*

[36] Consumer protection laws, (2021), available at https://www.law.cornell.edu/wex/consumer_protection_laws last accessed on July 2, 2023.

in the USA is a complex mix of federal and state regulations, varying depending on the type of *Fintech* activity being conducted.

Unlike some jurisdictions, there is no single central entity in the United States that mandates payment criteria and improvements for the entire industry.[37] Instead, various payment systems and service providers are subject to a multitude of laws, rules, and regulations, all aimed at safeguarding end users' interests[38]. Operators, providers, and rule-making bodies for payment systems also establish specific rules and agreements. However, depending on the types of payment services they offer, *Fintech* providers are required to comply with various laws, rules, and money transmission licensing requirements in each of the 50 states.[39]

Fintech providers typically do not offer the same range of products and services as financial institutions, and they may not be subject to the same types of regulation. The Consumer Credit and Protection Act[40], in particular, governs online lending in the United States. Banks and *Fintech* institutions may conduct loans offered via *Fintech*. The majority of pertinent legislation in the USA are consumer protection laws[41]. The Consumer Financial Protection Bureau (CFPB) oversees consumer protection and fair lending practices. It has been actively monitoring and taking enforcement actions against *Fintech* companies that violate consumer protection laws.

[37] Payment system in USA,(2023),available at https://fasterpaymentstaskforce.org/payment-landscape/payments-in-the-u-s/ last accessed July 21, 2023.

[38] Id.

[39] Id.

[40] Fintech laws and regulation 2021 in USA, (2022), available at https://www.globallegalinsights.com/practice-areas last accessed July 2, 2023.

[41] Samuel Girma, the legal and regulation crypto currency in Ethiopia, Thesis Submitted in PArtial fulfilment of the Requirements of LL.M Degree in Business Law(2011) , p. 20.

The USA has also seen the emergence of regulatory sandboxes, which are controlled environments where *Fintech* companies can test their products and services under the supervision of regulators. These sandboxes allow companies to innovate and experiment with their offerings while ensuring consumer protection.

Overall, the regulatory environment for *Fintech* in the USA is evolving and adapting to keep up with technological advancements. The federal and state governments are working to balance encouraging innovation and protecting consumers, ensuring that the *Fintech* industry can thrive while maintaining regulatory oversight.

1.4.2. India

India has made significant progress in regulating the *Fintech* industry in recent years. The country has recognized the potential of *Fintech* to promote financial inclusion, increase transparency, and accelerate economic growth.

The Reserve Bank of India (RBI) introduced the concept of regulatory sandboxes in 2016 to enable *Fintech* startups to test their innovative solutions in a controlled environment.[42] The objective is to allow these startups to experiment with new technologies, products, or services without being subjected to the full burden of regulatory compliance.

Fintech institutions may offer in-bank and out-bank payment services when using *Fintech*. India has recognized both[43]modalities. *Fintech* as a whole and

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[42] RBI regulatory sandbox is shaping the future of Indian banking,(2022) ,available at https://www.finextra.com/blogposting/22907/rbi-regulatory-sandbox-is-shaping-the-future-of-indian-banking last accessed on July 2, 2023

[43]Payment system in India, available at https://www.rbi.org.in/scripts/PaymentSystems_UM.aspx last accessed at July 2, 2023.

payment via *Fintech*, in particular, have no complete and unified regulatory document[44]. According to the Payment and Settlement System Act of India 2007, master directions on issuing and operating prepaid payment instruments are among the regulations of payments in India, which primarily focus on the beginning of payment provider entities[45]. Payment service providers must be licensed and registered upon commencement and starting up.

In India, digital lending is a recent phenomenon. Different lending models are possible with digital lending; the most popular ones are person-to-person, business-to-business, person-to-business, and business-to-person[46]. Lender exposure criteria and aggregate borrowing limits were prescribed and regulated by regulations and guidelines since 2017[47].

As *Fintech* services gain prominence, protecting consumers from potential risks and fraudulent activities becomes critical. Accordingly, the RBI has adopted a customer-centric approach, emphasizing the need for data privacy, cyber security, and dispute-resolution mechanisms.[48] The regulations focus on safeguarding customer interests and promoting fair practices by *Fintech* players.

1.4.3. Kenya

[44] Fintech laws and regulation in India,(2021),available at https://www.globallegalinsights.com/practice-areas last accessed at July 2, 2023

[45] Id.

[46] Reserve bank of India, Report of the Working Group on Digital Lending including Lending through Online platforms and Mobile Apps (2012), p. 25.

[47] Id.

[48] Das flags concerns on digital lending including usurious rates, data privacy issues,(2022),available at https://www.thehindu.com/business/das-flags-concerns-on-digital-lending-including-usurious-rates-data-privacy-issues/Article65914787.ece last accessed at July 3,2023.

Kenya has been a pioneer both in east Africa and Africa in *Fintech* provision for mostly unbanked populations for decades ago. Hence, it increased the number of populations in the country's financial inclusions, for it is easy and fast to be accessed with lesser costs than traditional banks' lending services.[49] In recent years, Kenya has emerged as a leader in *Fintech* innovation, particularly in mobile money services. The country's most notable *Fintech* success story is M-Pesa, a mobile phone-based money transfer and microfinance service.[50]

The central bank of Kenya introduced a regulatory sandbox framework. This enables *Fintech* startups to test their innovations in a controlled environment, allowing them to experiment and refine their products or services before full-scale deployment. Kenya has also enacted data protection laws, such as the Data Protection Act to safeguard the privacy and security of individuals' personal data. *Fintech* companies are required to comply with these to protect consumer information. The central bank of Kenya has put in specific regulations to supervise and monitor mobile services, including-money laundering and consumer protection measures[51]. This has helped institutions promote financial inclusion and access to financial services for a large segment of the population.

The Central Bank of Kenya must grant authorization as Payment Service Providers to *Fintech* businesses working in Kenya's payments sector[52]. The National Payment Systems Act (NPSA) and the National Payments Systems

[49] Kenya and Its Fintech Ecosystem in 2022, available at https://theFintechtimes.com/kenya-and-its-Fintech-ecosystem-in-2022/ last accessed at July 2, 2023.

[50] Id.

[51] Rodgers Musamali, Bhavish Jugurnath, &Jackson Maalu,Fintech, in Kenya: a policy and regulatory perspective journal of smArt economic growth, vol. 8, no.1,(2023), p. 36.

[52] Id.

Regulations (NPSR), which are currently in effect, govern the beginning and operation of payments made available by *Fintech*[53]. In contrast, CBK has the authority to regulate and license digital credit service providers, including banks[54]. Digital lending and payment through *Fintech* are recognized and regulated, but cryptocurrencies are not recognized as legal cash in Kenya.

Company Act is one of the relevant legislations applicable to Kenyan digital lending service-providing legal frameworks starting from stipulating minimum establishment requirements for service-providing companies passing through their operations to providing legal grounds for their dissolutions.[55]

Kenya's approach to regulating *Fintech* has aimed to leverage technology to drive financial inclusion, encourage innovation, protect consumers, and maintain financial stability. The country's success in fostering a thriving *Fintech* ecosystem makes it a regional leader and an example for other countries to follow.[56]

1.5. *Fintech* Regulatory Approaches

Fintech may be governed and regulated in various ways, with sub-sectors occasionally determining the possible approach. Four regulatory approaches namely, wait and see/hands off, test and learn/case-by-case forbearance,

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[53] Id.

[54] Central Bank of Kenya Act, Chapter 491 of the Laws of Kenya (as amended by the Central Bank of Kenya (Amendment) Act.

[55] The Kenya Companies, Act No. 17 of 2015.

[56] Fintech in Kenya: Towards an enhanced policy and regulatory framework,(2022),available at https://www.thecityuk.com/our-work/Fintech-in-kenya-towards-an-enhanced-policy-and-regulatory-framework/ last accessed at July 2,2023.

structured experimental/innovative approach, and regulatory laws and reforms are widely in use today. This paper discusses the features and potentialities of these approaches for the desired end.

1.5.1. Wait-and-See

This approach is characterized by institutional actions of observing and monitoring innovation trend(s) from afar before intervening where and when necessary. Over time, however, as regulators gain capacity in innovation and technology and start to adopt it by licensed entities over time, policymakers may incrementally change regulations.[57] A *wait-and-see* approach has commonly emerged when there is regulatory ambiguity on whether an activity falls under the remit of a particular institution. Alternatively, this approach offers regulatory forbearance to allow innovations to develop unhindered under situations where there is a need to further build regulator capacity before issuing a response. Still in other instances, depending on its application, it also includes a do nothing response, which involves the use of soft laws. Many jurisdictions have applied this approach when there is a collective need to understand better the technology and its possible application in the financial market[58].

1.5.2. Test-and-Learn

This approach involves creation of a custom framework for each business case, allowing it to function in a live environment (often with a *no objection*

[57] World bank, How Regulators Respond to Fintech Evaluating the Different Approaches—Sandboxes and Beyond pdf, Fintech Note ,No 5 ,(2020), p. 10.avalable at https://documents1.worldbank.org/curated/es/579101587660589857/pdf/How-Regulators-Respond-To-Fintech-Evaluating-the-Different-Approaches-Sandboxes-and-Beyond.pdf last accessed at Jan.20.2023.

[58] Id.

letter from the regulators). However, the scope of supervision, oversight, and safeguard measures vary across jurisdictions. Policymakers have sometimes followed a *light touch* without close supervision. In others, policymakers follow more extensive frameworks on a case-by-case basis that involved stringent supervisory attention and oversight.[59]

1.5.3. Innovation Facilitators

Innovative approaches involve top-down moves, unlike the learning and test approach. Further, they tend to be more resource intensive than the other approaches. Their use characteristically involves several regulators setting up new units requiring staff with specialized skill sets.[60] Such operation constitutes a point of contact or a structured framework environment to promote innovation and experimentation. This may take such forms as Innovation Hubs/ Offices, Accelerators, and Regulatory Sandboxes as different types of facilitators.[61]

1.5.4. Regulatory Laws & Reforms

Regulatory law reforms include introducing new laws or licensing requirements that are both overarching and product specific in response to innovative firms or business models. In some cases, countries use new laws to

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[59]How regulator respond to Fintech, available at https://www.wdronline.worldbank.org/bitstream/handle/10986/33698/How-Regulators-Respond-To-Fintech-Evaluating-the-Different-Approaches-Sandboxes-and-Beyond.txt?sequence=6 last accessed on January 16, 2023.

[60]Policy challenges and approaches to innovative Fintech, available at https://www.itu.int/hub/2021/06/policy-challenges- and-approaches-to-innovative-Fintech/ > last accessed on, January 18, 2023.

[61]World bank, How Regulators Respond to Fintech Evaluating the Different Approaches Sandboxes and Beyond ,(2021) p.10 available at https://www.wdronline.worldbank.org/bitstream/handle/10986/33698/How-Regulators-Respond-To-Fintech-Evaluating-the-Different-Approaches-Sandboxes-and-Beyond.txt?sequence=6 ,last accessed Jan.20.2023.

expand their mandate, to build capacity, or to raise awareness over accountability while supporting the development of more discreet, secondary reforms and amendments to existing frameworks. One or more of such moves might eventually lead to regulatory reforms.[62] The National Bank of Ethiopia (NBE) is responsible for issuing licenses and regulating the activities of *Fintech* companies in the country. The government periodically reviews its policies and regulations related to *Fintech* to ensure recent relevance of the technological products. *Fintech* companies are also required to obtain relevant licenses and to comply with regulations in place in the country. Ethiopia adopted this regulatory approach to support and regulate the growth of the *Fintech* sector. It is particularly taking a proactive regulatory approach, striking a balance between supporting *Fintech* innovation and ensuring consumer protection and financial stability. These regulatory approaches aim to foster a thriving *Fintech* ecosystem and contribute to the country's economic growth and financial inclusion goals.

2. Ethiopian Legislative Documents Relevant to *Fintech*: An Overview

2.1. Policies and strategies related to *Fintech*

Governments are inherently in constant move to devise mechanisms that best regulate and benefit their financial systems. Such moves may be policy actions that the government decides to take,[63] or a strategic move with a comprehensive plan or a method of doing multiple policy activities. A closer look into the Ethiopian macro strategic documents or financial policies shows that there are only limited policies or strategies relevant to *Fintech* in the country. Those documents include the national digital strategy, National

[62] Id.

[63] Public polices, available at, https://www.civiced.org/project-citizen/what-is-public-policy , last accessed on Jan.18, 2023.

digital payments, NBE monetary policy framework, and national information and communication technology policies and strategies.

The Federal Democratic Republic of Ethiopia formulated the national Digital Ethiopia 2025-A Strategy for Inclusive Prosperity in Ethiopia.[64] This new fourth industrial revolution (4IR) is advancing across the globe at an unprecedented rate, and Ethiopia proactively embraces it to ensure societal benefit from this technological tool and to cultivate innovation among the youth who should get ready for a different future world.[65] From the strategy, sectors and institutions can design and/or align action plans to create inclusive prosperity, leveraging technology that will catalyze the realization of Ethiopia's broader development vision: job creation, forex generation, and becoming a middle-income country.

While such vision is set out in the strategic documents, Ethiopia's digital economy is still in its infancy, with few private firms providing online services and some government-driven initiatives to go digital. To scale up the capacity of the system, the proposed digital strategy is committed to achieving the following key goals: proposing an inclusive digital economy that accelerates the realization of a broader development vision; becoming a visionary umbrella from which sectors and institutions design action-oriented strategies; highlighting the need for urgency, mobilizing stakeholders that enable an inclusive digital economy; coordinating and strengthening current initiatives under the most strategic and pragmatic path possible.

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[64] Ethiopian Digital strategy, 2020, available at (https://mirror.explodie.org/Ethiopia%20Digital%20Strategy%202020.pdf ,last accessed on February 2,2023.

[65]Digital Ethiopia 2025 – Summary digital Ethiopia ,available at https://mint.gov.et/wpcontent/uploads/2022/01/Summary_of_Digital_Strategy_Final_English1.pdf ,last accessed on February 5,2023,

In addition to this, National strategy for digital payments (NDPS) Strategy for 2021-2024 is another package that the National bank of Ethiopia has prepared. This strategic plan, which constitutes 32 action plans, will support a cash-lite and a financially accessible economy, which aim to create a secure, competitive, efficient, innovative, and responsible payment ecosystem[66]. Compared to preceding financial products, this approach is unique and thorough for digital payments, incorporating positive international experiences.

By providing incentives, NDPS encourages *Fintech*[67]. The goal of the incentives is to launch *Fintech* and consumer protection. In addition, NDPS advise enacting strict consumer protection legislation to foster/increase customer confidence and trust by promoting security, safety, and transparency.[68] Complaint resolution mechanisms are essential for consumer protection and trust-building.[69]

Ethiopian Financial Inclusion is also another strategy dedicated to the same end. By assessing the current financial exclusions and developing strong frameworks to hasten the planned financial inclusion, the 2017 national financial inclusion strategy aims to accelerate the nation's overall economy. Numerous regional studies suggest that, despite the current progressive financial development, the Ethiopian financial service provisions are full of gaps or exclusions.[70] For instance, a 2014 poll by the index found that 56% of

[66] NBE’s strategy, National Digital payment strategy (NDPS) (2021-2024), p. 19.
[67] National strategy for digital payments (NDPS) Strategy for 2021 to 2024, p. 37.
[68] Id, page 51
[69] Id.
[70] Financial inclusion strategy, 2017, NBE, available at https://nbebank.com/wp-content/uploads/pdf/useful-links/ethiopian-national-financial-Inclusion-strategy.pdf. , last accessed on Febuarary.23, 2023.

individual citizens did not owe any money but instead saved, borrowed, and used informal measures to protect themselves against hazards.

Several plans with priority activities to overcome related barriers to financial inclusion are prepared as part of implementing the national financial inclusion strategy. Therefore, it is believed that the primary strategic areas to be concentrated on are strengthening financial and other infrastructure, ensuring the supply of an adequate range of suitable products, services, and access points, developing a strong financial consumer protection framework, and improving financial capability.

2.2. Banking Business Proclamation

In Ethiopia, proclamation number 592/2008 and its amendment proclamation number 1159/2019 govern the banking industry. In the traditional sense, banking business refers to financial transactions involving a company that offers loans, credit, payment, currency exchange, savings accounts, and checking accounts[71]. Saving and receiving money, lending money for investments, purchasing and selling gold, sending money to domestic and international banks, dealing with bonds, agency banking, and digital financial services are all examples of financial transactions.[72]

Articles 2(2) (f) and 2(21) of the Banking (Amendment) Proclamation define digital financial services as a service offered by *Fintech*. The legislative provisions mentioned financial services such as payments, remittances[73], and

[71] Business banking, available at https://www.investopedia.com/terms/b/business-banking.asp, last accessed on 23 February 25,2023.

[72] Business banking proclamation, proclamation No. 592, Federal *Negarit Gazeta*,Year 14, No 57, (hereinafter referred to as banking business proclamation), Art. 2(2, a-f),

[73] Banking business (amendment) proclamation, No. 1159, Federal *Negarit Gazeta*,Year 25, No 88, (hereinafter referred to as Banking(amendment) proclamation), Art. 2(1, f &g.

digitally accessed insurance services as major *Fintech* services.[74] Yet other financial services categories such as digital loans and financial exchanges carried out by *Fintech* are left out of this classification. From the wording of this provision, it seems that the list of the subcategory of digital financial services is non-exhaustive.

Additional definitions of digital financial services include those for payments, remittances, and insurance that can be accessed and provided online[75]. Digital credit is not listed among the digital financial services in these provisions. Through a close reading of the provisions, one may observe that the legislature alludes to non-exhaustive list by including phrases like *other financial services.* Yet equally, anyone would argue that the Directive of Digital Financial Service, which has not yet been implemented, might remedy the gap[76]. The stipulations in the directive suggest that Ethiopia lacks a legal basis for introducing digital credit independently by *Fintech* or banks.

2.3. National Payment System Proclamation

Ethiopia issued the first national payment system proclamation in 2011 after recognizing the importance of the national payment system in ensuring the efficiency, effectiveness, and financial stability of the nation's overall economic growth. The proclamation also demanded that guidelines for creating, administering, and controlling the national payment system be provided[77]. The national payment system in Ethiopia encompasses a variety

[74] Banking business (amendment) proclamation 1159/2019 Art. 2/21.
[75] Banking business Proclamation no 1159/2019, Article 2(21),
[76] Id, Art 58.
[77] National Payment System Proclamation, No. 718, Federal *Negarit Gazeta*, Year 17, No 84, the Preamble (hereinafter referred to as National Payment System Proclamation).

of components, including both *Fintech* and conventional payment systems, along with associated processes, regulations, and technology.[78]

Apart from the issue of permits, the proclamation covers rules that apply to the payment made in the conventional bank and *Fintech*. Yet the regulatory provisions, the writer argues, are not strong enough to meet the needs of customers. For example, the user's growing confidence in payment methods and services offered by financial institutions, notably *Fintech*, is not adequately reflected in the regulatory rules. Trust must be there for economies, societies, and financial markets to be robust. Payment providers must adhere to data protection and privacy laws to safeguard customer information. They need to implement strong security measures and encryption protocols to protect financial data from unauthorized access or breaches, but this issue is not well regulated in this proclamation[79]. There are no strict requirements for a starting payment provider, particularly for *Fintech*, and there is no provision in the proclamation for harmonizing international payment system laws.

The law allows citizens to operate a firm as payment instrument issuers and Payment System Operators under their respective Directive.[80] Foreign nationals are also allowed to engage in a payment instrument issuer and payment system operator business or establish a subsidiary[81]. In addition, the Directive stipulates that anyone other than financial institutions must first get an NBE license to operate a payment instrument or to work as payment system operator. Financial institutions sometimes infringe on these

[78] National Payment System Proclamation, Proclamation No. 718, Art. 2(16, a-e).

[79] Ronald J. Colombo, The Role of Trust in Financial Regulation the Role of Trust in Financial Regulation, Villanova University Charles Widger School of Law,(2020), p. 26,

[80] National payment system (amendment) proclamation, no.1282/2023, Art.6 (8).

[81] The National payment system (amendment) proclamation no.1282/2023 Art. 6(8) and Art .6(7)

obligations by assuming that the National Bank of Ethiopia (NBE) has already granted them permission to offer banking services. However, according to the law, they may only utilize the payment system for the services associated with their regular financial transactions.[82]

Consumers will be reluctant to use the services if the industry is not trusted; this would, in turn, harm the industry and the national economy by limiting the amount of cash available for investment and productivity.[83] The National Payment System Proclamation lays out many rules for the Ethiopian payment system. Yet the payment service providers who carry out their activities using these rules may not have sufficient security measures to protect users' personal and financial information, leaving them vulnerable to data breaches and fraud. Inadequate governance can also result in poor dispute resolution processes, making it difficult for users to recover their funds in cases of unauthorized transactions or other payment-related issues.

A single provision alone cannot ensure users' transaction security. While Articles 20/1/ and /2/ of the proclamation outline the process for handling complaints, these stipulations may not effectively address users' concerns regarding security issues. Paradoxically, the course of addressing complaints typically comes into play only after the issue has been resolved.

The National Payment System Proclamation's Article 7/4/ specifies the startup requirements for *Fintech* payment platforms. These requirements include the system's proposal, technological specifications, security procedures, clearing and netting procedures, management and integrity

[82] Id., Art. 20.

[83] C V.D. Cruijsena,J.D.Haanb & R.Roerinka, Trust in financial institutions: A survey, University of Groningen, The Netherlands, (2020), p. 27.

experience, consumer interest, and policy implications.[84] The regulatory sandbox is a framework that allows innovators, startups, and financial technology (*Fintech*) companies to test their products, services, or business models in a controlled environment under the supervision of regulatory authorities.[85] Sandboxes allow financial institutions and *Fintech* firms to test out novel financial goods or services in a real-world setting, but only for a limited time and in a specific location. The objective is to foster innovation, promote competition, and ensure consumer protection in emerging sectors or new technologies. Yet despite the global popularity of and key role of regulatory sandboxes, no framework for the use of such tools has been established in Ethiopia.

Moreover, the innovation hub exam should also be added to the list of requirements before the launch of *Fintech* platforms.[86] The innovation hub exam is a formal assessment conducted by regulatory authorities to determine the eligibility and suitability of *Fintech* companies and innovators to participate in a regulatory sandbox. These requirements are crucial to guarantee quality and system caliber for *Fintech* startups. However, they are not included in the prerequisites.

Ethiopia has no specific sandbox and innovation hub regulatory framework for *Fintech*. While the National Bank of Ethiopia has conducted a pilot test, this test does not constitute a full-fledged sandbox and innovation hub.[87] Its primary purpose is to grant licenses for *Fintech* businesses rather than

[84] National payment system proclamation no 718/2011 Art. 7/4, a-h.
[85] Attery,A,M.Lesher & C.Lomax The role of sandboxes in promoting flexibility and innovation in the digital age, going digital tookili policy not, No2. (2020), p.36.
[86] Radostina Patarni, Sandboxes and Innovation Hubs for Fintech Impact on innovation, financial stability and supervisory convergence, European parliament committee, (2020), p. 33.
[87] Interview with Solomon Damxewu, NBE Director, payment and settlement system (July 5,2023)

providing a comprehensive sandbox environment[88]. Furthermore, it is worth mentioning that Ethiopia's Information Network Security Agency (INSA) primarily focuses on testing security issues related to *Fintech* and not on establishing a comprehensive sandbox and innovation hub, as is the case in some other countries[89]. No dedicated institution or regulatory body has the expertise and infrastructure to oversee such a hub. Thus, Ethiopia lacks both practical implementation and a regulatory framework for a sandbox and innovation hub.

The Cooperative Bank of Oromia is the first financial institution to introduce an online credit system called "MICHU." It is digital lending for micro, small, and medium-sized businesses platform[90]. The platform evaluates SMEs' risk and growth potential, so lenders can decide whether to issue loans based on risk assessment outcomes. Cooperative Bank of Oromia launched this platform as a bank for the first time without needing a sandbox on this brand-new platform[91].

Lastly, the proclamation cannot regulate digital credit in the form of digital assets or crypto assets. No online credit is permitted on a block chain platform in the form of crypto currency[92] within Ethiopia's jurisdiction since NBE

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[88] Id

[89] Id

[90] MICHU Uncollateralized Lending Platform, coop bank of Oromia available at https://coopbankoromia.com.et/michu/, last accessed on January 21, 2023.

[91] Interview with Abdi Fekede, Director, Digital products, and services. (March 8,2023)

[92] Crypto-asset could be defined as a form of digital currency based on a network that is distributed across a large number of computers. It is a virtual currency formulated to function as a medium of exchange like dollar, euro, and birr. A digital currency in which transactions are verified and records maintained by a decentralized system using cryptography, rather than by a centralized authority. The main plat form deployed to establish decentralized crypto- asset is that block chain. Block chain is an online decentralized ledger technology that registers transactions between two pArties connected in a peep-to-peer ("P2P") network.

circulars prohibit digital assets. Additionally, this results in lack of regulatory capacity to control various digital credit forms, including businessperson, person-to-person, business-to-business, and person-to-business credits. This inadequacy leads to the mistreatment of consumer complaints, abuse of consumer interests, and mistrust.

2.4. Prevention and Suppression of Money Laundering and Financing of Terrorism Proclamation

The Ethiopian legislature passed the Prevention and Suppression of Money Laundering and Financing of Terrorism Proclamation to protect national security, to stabilize financial markets, and to boost the effectiveness of financial institutions[93]. The major goal of Anti-money laundering laws is to authorize and assist competent institutions in discovering and reporting suspicious conducts, including crimes that serve as a foundation for money laundering and terrorist financing[94].

Money laundering appeals to criminals in *Fintech* because it is made easier for them by the rise in transaction initiation in these systems, unlimited money flow, and anonymous accounts.[95] While the legislative's move on preventing and combating money laundering and terrorism financing is encouraging, it appears to place little emphasis on digital financial services and instead emphasizes traditional financial services. *Fintech* is currently updating itself continually at the fastest rate. Given this pace of developments and

[93] Prevention and Suppression of Money Laundering and Financing of Terrorism Proclamation, proclamation No. 780, Federal *Negarit Gazeta***,** year 19, No 21, the preamble, (hereinafter referred to as Prevention and Suppression of Money Laundering and Financing of Terrorism Proclamation).

[94] Anti-money laundering law (AML), Rule and Guidance, available at https://www.finra.org/rules-guidance/key-topics/aml , last accessed on January. 19,2023.

[95] Anti-Money Laundering Guidance for Fintech, available at https://sanctionscanner.com/blog/anti-money-laundering-guidance-for-Fintech-167, last accessed on January 30,2023.

sophistications in *Fintech*, it is imperative to have a more advanced anti-money laundering regulatory framework at all levels of financial system operations. As such more legislative moves are required to balance the *Fintech* industry's development and the control of criminal activity such as money laundering and support for terrorism.

Referring to the proclamation's clauses, one could conclude that the definition of funds and property does not expressly cover *Fintech* payments and digital lending.[96] According to Article 2/9 of the proclamation, financial institutions include insurance companies, microfinance organizations, postal savings institutions, and money transfer institutions. *Fintech* and digital financial services are not expressly included in this proclamation.[97]

2.5. National Bank Directives Regulating *Fintech*

2.5.1. Licensing and Authorizations of Payment Instrument Issuers

To promote the safety and efficiency of the payment system by establishing clear and enabling regulatory requirements and protecting the interests of the users–in addition to mitigating associated risks and maintaining reliability[98]–the NBE issued D**irective No. ONPS/01/2020** as per the provisions of the National Payment System Proclamation[99] and the Amendment Banking Business Proclamation[100]. According to the Directive, a person who holds a license from NBE and issues tangible or intangible instruments such as cards,

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[96] Prevention and Suppression of Money Laundering and Financing of Terrorism Proclamation 780, Art. 2(5).

[97] Id, Art. 2(9)

[98] NBE issues directive To licence ,Authorize payment instrument issuer-National Bank, available at https://nbe.gov.et/nbe-issues-directive-to-license-authorize-payment-instrument-issuers-2/ .last accessed on Feb1,2023.

[99] National Payment System Proclamation number. 718/2011, Art. 4(2, a) and 37(2).

[100] The amendment of banking business proclamation number.1159/2019, Art.58.

checks, and e-money that allow a person to make payments or transfer funds is referred to as a payment instrument issuer[101]. This Directive ensures that *Fintech* companies comply with relevant legislation and uphold consumer protection standards.

The payment instrument issuer may be permitted to offer standard banking services like cash-in and cash-out, local money transfers like domestic remittances, loading to the card or bank account, transferring to the card or bank account, domestic payments like purchases from merchants, bill payments, over-the-counter transactions, and inward international remittance services based on requests made and written approval by the NBE.[102] A licensed payment instrument issuer with full accountability and a written outsourcing agreement with regulated financial institutions and pension funds may also be permitted to offer micro-savings, micro-credit, micro-insurance products, and pension products with the written consent of the NBE.[103]

Laws in Ethiopia prohibit providing digital credit services, independently by Fin-techs. Such activities require a written outsourcing agreement with a regulated financial institution[104]. However, it is also important to examine the potential consequences of these restrictions. Digital credit services have the potential to bridge the gap in financial inclusion. Moreover, digital credit services can contribute to economic growth by enabling entrepreneurs and small businesses to access capital for expansion and investment. Another point to consider is the innovation and competition that *Fintech*s bring to the market. By restricting their ability to provide digital credit services, there

[101] The Licensing and Authorization of Payment Instrument Issuers Directive No. ONPS/0112020. Art.2 (19).
[102] Id., Art, 6(2).
[103] Id., Art, 6(1).
[104] Id., Art, 6(2).

could be a dampening effect on innovation and consumer choice[105]. Also, regulations that are too stringent and inflexible may discourage *Fintech*s from operating in the country altogether. This could hinder the growth and development of the *Fintech* ecosystem.

Like the previous proclamation, no sandbox and innovation hub requirement is set as tests for the payment instrument issuer.[106] *Fintech* companies must put in place measures to protect customers' interests and ensure fair treatment. This may include providing clear and transparent information about fees, charges, and terms and conditions and addressing customer complaints and disputes. *Fintech* companies must comply with ongoing obligations, such as reporting requirements, maintenance of appropriate risk management systems, and ensuring the protection of consumer funds.[107] Yet all sets of issues are not well regulated under this Directive.

Disagreements and grievances are part of every economic transaction. Require substantive legislation to address those disagreements and complaints; no rule or legal clause currently deals with disputes and grievances brought up by digital credit platforms. Additionally, because digital credit operates differently than traditional loans, applying other pertinent laws to address disputes and complaints is challenging and confusing. In other words, the service providers decide everything, including who gets the loan, how much is borrowed, when it is due, how long it will take to pay it back, and the contract terms.

[105] Interview With Gelata Abate, Innovation hub director of Cooperative Bank of Oromia, (March 09.2023)

[106] Licensing and authorization of payment system operators, Directive no ONPS/02/2020, Art, 4, 4.6, a-i.

[107] What is regulation in Fintech? Available at https://www.idnow.io/Fintech/what-is-Fintech-regulation/ last accessed on July 3.2023.

The international payment system is essential and facilitates international trade and remittance. Digital payments made through *Fintech* are more convenient[108] than other mechanisms. Yet for national security reasons, direct payment conducted through digital manner is restricted. All payments are like the traditional banking system; they need the presence and physical conduct of the customer to the bank. Different payment platforms for international payment need no physical presence and are made online through normal electronic devices. For instance, PayPal, venom, and eBay are among the online global payment platform. Globally, there is a digital platform for remittance and exchange of foreign currency[109]. However, the Ethiopian jurisdiction has no direct online payment system for national security purposes[110]. Moreover, those platforms are nonexistent due to the absence of regulatory framework for such international payment. Even though building a regulatory capacity to oversee a sophisticated payment system can be time-consuming, waiting indefinitely to acquire regulatory capacity might not be a viable approach. International transactions and cross-border payments are becoming increasingly common in today's interconnected world. The absence of a direct online international payment system could slow down or restrict economic growth, hinder cross-border trade, and potentially put at disadvantage businesses or individuals who rely on global transactions[111]. It is important to find a balanced approach in this situation.

[108] The report of United Nations Capital Development Fund (UNCDF) in collaboration with NBE, Ethiopia remittance review; assessment of payment and financial markets infrastructures, (2020) ,p. 6.

[109] Guide; how to get started as a payment system operator in Ethiopia, available at, https://shega.co/post/guide-how-to-get-stArted-as-a-payment-system-operator-in-ethiopia/, last accessed on Febuarary.3.2023.

[110] Interview with Muluken Mirehetu, NBE legal expert. (February 25,2023)

[111] Solomon, *supra* note 89

2.5.2. Licensing and Authorizations of Payment System Operators

The second Directive affecting *Fintech* is ONPS/02/2020, which deals with the licensing and authorization of payment system operators. As one can observe from its name, the primary focus of this Directive is the payment system. It specifies the criteria, procedures, and documents required for obtaining a license, such as company registration, financial statements, business plan, and proof of technical capability.

The Directive stipulated that anyone other than financial institutions must first get an NBE license to operate a payment instrument. They are considering that NBE has already granted them a license to offer banking services. However, they may only utilize the payment system for their own services associated with their regular financial transactions.[112]

A payment system operator is defined under the Directive as a licensed financial institution by NBE that owns, operates, and administers a payment system,[113] a system that is used to settle the transfer of funds/financial transactions (the system includes the institutions, the people, the rules and procedures, standards, and the technology that make the financial transaction possible) upon authorization by the NBE. The Directive at hand allows only Ethiopian nationals and foreign nationals of Ethiopian origin to engage in the payment system operating business. It also provides that the applicant for provision should be established as a company, where the ownership should be vested in Ethiopian nationals and foreign nationals of Ethiopian origin.

Further, the Directive prohibits payment system operators from engaging in other business activities. On the other hand, an entity or person engaged in

[112] Payment System Operators Directive No. ONPS/0212020. Art. 20.
[113] Payment System Operators Directive No. ONPS/0212020. Art. 2(34).

business activity and interested in the payment system operators' business must form a separate company exclusively engaged in payment system operation, fulfilling the requirements provided under the Directive. The National Payment system operator, Ethswitch, is also established under this Directive to facilitate the overall interoperability between financial transactions in the country. The private payment system operators are also invited to join Ethswitch upon fulfilling the prerequisites stipulated under this Directive.

As such the directive covers five categories of licenses: the National switch operator Payment Switches, ATM Operators, POS Operators, and Online payment gateway operators' services.[114] A company can apply for one or multiple licenses, as the need arises. At the same time, the regulation prohibits a payment system operator from engaging in other business activities, including payment instrument issuer business such as Mobile money[115].

2.5.3. Financial Consumer Protection

A new directive, Directive 01/2020, was issued to regulate the protection of financial consumers. This bylaw was enacted based on Article 57 of the amended banking business proclamation that stipulates national banks to issue directives with minimum conditions for consumer protection.[116]

[114] Licensing and authorization of payment system operators Directive no ONPS/02/2020.Art. 4(3).

[115] African Fintech state of the industry, African Fintech summit, Is an Ethiopia Market Map from the Africa Fintech State of the Industry Report,(2020), available at https://africaFintechsummit.com/wpcontent/uploads/2021/08/AFTS_StateoftheIndustry_2020_final.pdf last accessed on Febuarary.12,2023.

[116] Amendment of banking business proclamation Number 1159/2019, Art .57.

The directive, which is special due to its inclusiveness, applies to all financial institutions and financial services[117]. As such, it targets all financial institution consumers. Accordingly, digital lending service consumers (borrowers) are entitled to exercise rights provided under the Directive at hand, including the right to access accurate and appropriate information about the lending service they are requested for, including the interest rate, terms, and conditions of the agreement, protection against misuses of their personal data, fair and dignified treatment, easy, speedy and accessible dispute resolution mechanisms, etc.

General principles such as fair treatment, transparency and disclosure, suitability, data protection (confidentiality), complaint handling, and dispute resolution are generally regulated under this directive. To this effect, Article 2.11 of the Directive defines digital financial service by stating what it is and listing the categories. Payment, remittance, and insurance are among the list provided by the Directive. From this, we could conclude that digital crediting is not included under the definition; In addition, the Directive focuses on traditional bank services. So, legal protection given by this Directive to consumers of digital finance, to the *Fintech* consumers, is minimal. Comparatively, payment-related *Fintech* is regulated slightly.

CONCLUSION

Fintech has become a popular catch-all for technology-enabled financial solutions. A customer uses every digital financial service to manage their finances, including online banking, payments, investing, and borrowing and lending money.

National Digital Ethiopia 2025, Ethiopian Financial Inclusion Strategy, and NDPS are all taken from an evaluated legislative document. Ethiopian-related

[117] Financial consumer protection Directive, Directive ,No FCP/01/2020, the Preamble

Fintech policies are incomplete and lack specific provisions for *Fintech*. In the meantime, NDPS appears to be a recent and comprehensive *Fintech* law about payments. However, NDPS is insufficient on its own to address all *Fintech* categories.

To set minimum requirements and prerequisites for providers to launch the service, the current regulatory environment for *Fintech* is insufficient. The *Fintech* regulations do not cover the listing criteria, particularly technology assessments. These technological trials could be innovation Center trials or sandbox trials for regulations. The lack of an innovation hub and sand box impacts users' interest. However, neither in law nor in practice are there now any technology tests.

Fintech also needs a thorough document that governs matters connected to safety, security, consumer protection, and the duties of regulatory agencies by focusing primarily on payment-related *Fintech*. In addition, it is suggested to assess the regulatory perimeter and update it on a timely basis. Regulators need to have a proactive framework that responds to fast changes in the *Fintech* space and regularly implement or contribute to a process to review the regulatory perimeter.

The amendment to the Banking Business Proclamation No. 1159/2019, as outlined in Articles 2(1)(f) and 2(2), permits banks to engage in digital financing, or *Fintech*, exclusively for payment, remittance, and insurance purposes. This clause should be revised to also encompass online lending activities. NBE should outline different startup requirements and prerequisites for various bank *Fintech* types. Proclamation 718/2018 and its amendment proclamation 1282/2023, Directive NO FIS/01/2012, Directive NO ONPS/2/2020, and other legislation should manage digital financial services in a special way that increases consumer confidence to uphold and sustain consumer trust.

Finally, Digital credit is sub-categories of *Fintech*. Ethiopian laws forbid *Fintech* companies from offering independent digital credit services and demand a signed outsourcing arrangement with a licensed financial institution. This might hamper expansion and development of the ecosystem for fin-tech in the country.

In addition to allowing digital credit by *Fintech* in Ethiopia, various types of digital lending, including person-to-person, person-to-business, business-to-business, and business-to-person lending, the NBE needs to give due consideration and be governed by different legislations. Therefore, due to the multiple gaps in the pertinent laws, Ethiopia's regulatory environment for *Fintech* is not adequately regulated and needs an enabling comprehensive law.

Making Foreign Investment Contributory to Sustainable Development in Ethiopia: A Normative Analysis.

Woldetinsae Fentie[π]

Abstract

To ensure positive impacts of Foreign Direct Investment (hereinafter FDI) to domestic human good, it has become imperative for host states to identify responsibility of foreign investors to sustainable development and devise mechanisms to effectuate the same. However, this task poses challenges for least developed countries like Ethiopia, which must balance the competing interests of attracting foreign capital and pursuing sustainability objectives. The governance of FDI is a highly debated subject within the international investment regime. It is currently threatened by legitimate crisis, requiring a concerted, well-crafted and comprehensive response from varying actors in the FDI landscape. This paper suggests that if FDI is appropriately managed, guided, and regulated, it is possible not only to minimize its impairment on sustainability but can also contribute to sustainable development. The paper qualitatively explores potential approaches within the existing framework of norms in the Ethiopian legal system to establish the sustainable development responsibilities of foreign investors. While treaty terms and contents are often influenced by global power dynamics, leaving little room for least developed countries like Ethiopia, the current global backlash against the regime could be taken as opportunity for reform. Drawing insights from the treaty practices of other states and by aligning itself with reform forces in the international investment regime, Ethiopia can strategically move to capitalize on the advantageous conditions. Findings of this paper suggests that, together with reform in the investment treaty regime, exhausting alternative measures could

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help the country install sustainable development friendliness in the existing frameworks.

Key Words: Sustainable Development; Social license to operate; Corporate Social responsibility; Counter claims; Contributory fault

1. Introduction

Ethiopia, a landlocked country in the Horn of Africa, has gained good records of FDI in the years between 2017 and 2021.[1] The World Bank report of 2022 indicated that the country is one of the most preferred FDI destinations in the region.[2] Further, the report showed that the country has made many policy adjustments by reforming its economic framework laws and substantially amending its age-old Commercial Code. All this has been made with the ambition to attract foreign capital.[3] However, the contents and underlying visions of the FDI legal frameworks still require close scrutiny. Embracing widely acclaimed standards of measures, this paper holds the view that while the availability of FDI is one of the major inputs of national economies, its impact should be development-friendly and sustainable.

The continued survival of the international investment frameworks especially that of the Bilateral Investment Treaties (hereinafter BITs) regime relies on

[1]Macrotrends, Ethiopia Foreign Direct Investment 1977-2023, https://www.macrotrends.net/countries/ETH/ethiopia/foreign-direct-investment (accessed, Dec. 25,2023).

[2] United Nations Conference on Trade and Development (UNCTAD), World Investment Report 2022: International Tax Reforms and Sustainable Investment, United Nations, 2022, p12, [hereinafter UNCTAD], see also Magdalene Teiko Larnyoh, Business Insider Africa, https://africa.businessinsider.com/local/markets/here-are-the-top-10-african-countries-with-highest-fdi/7264vlz (accessed Dec. 20, 2022).

[3]U.S DepArtment of State, 2023 Investment Climate Statements: Ethiopia, https://www.state.gov/reports/2023-investment-climate-statements/ethiopia/(accessed Dec. 15, 2023).

the fairness of its procedural and substantive elements and their sensitivity to wider public policy objectives.[4] This could be evident from reform attempts by some countries introducing new model BITs with the view to embrace sustainable development agenda.[5] Attracting foreign direct investment and attaining sustainable development are, of course, two competing phenomena in contemporary policymaking and require proactive policy moves from governments. Thus, Ethiopia must move to navigate ways that maintain the balance between attracting FDI and safeguarding its national interests including sustainable development.

In Ethiopia, the principle of sustainable development is not only a universally recognized value but it is also a value protected by its current constitution.[6] By designing Sustainable development-friendly FDI regulatory framework, governments could make economic activities through FDI a viable contributor to this cherished value. Further, this paper advances the argument that where governments show an utmost will and made concerted effort to so, there are global and national opportunities to reframe and gear FDI legal frameworks to more sustainability.

[4] David Ma, BIT Unfair: An Illustration of the Backlash against International Arbitration in Latin America, Journal of Dispute Resolution,Vol.2012:No,2.(2012),p571, https://scholarship.law.missouri.edu/jdr/vol2012/iss2/6. (accessed Jun. 20, 2023).

[5]United Nations Conference on Trade and Development (UNCTAD), United Nations, "Taking Stock of IIA Reform" (1 IIA Issues Note 2016) https://unctad.org/system/files/official-document/webdiaepcb2016d3_en.pdf. (accessed Oct. 20, 2023), see also Indian Model Bilateral Investment Treaty of 2015, https://edit.wti.org/document/show/d0eac9a8-2de6-44a8-9e9f-2986b8817aa9, (accessed on Jan. 12, 2024); 2012 U.S. Model Bilateral Investment Treaty, https://ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf, (accessed Dec. 12, 2024); Canada Model Foreign Investment Promotion and Protection Agreement (FIPA) of 2021 https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/6341/download, (accessed Dec. 12, 2024).

[6] The Constitution of Federal Democratic Republic of Ethiopia, Proclamation No.1/1995, Federal *Negarit* Gazetta, (1995), Article 43, [hereinafter FDRE Const.].

2. Legitimacy Crisis in The International Investment Regime and Its Implication to Sustainable Development

Currently, it is widely held that the international investment law regime is grappling with legitimacy crisis, prompting persistent calls for reform.[7] The legitimacy crisis signals the need for the ongoing pursuit of reform within the international investment regime, which is widely criticized for over protecting private investment interests at the expense of other legitimate public policy concerns.[8]

Many attribute the legitimacy crisis to multiple contributory causes in the current framework.[9] In some situations, the uncertainty surrounding the effectiveness of BITs in promoting and attracting FDI while limiting policy space of host states poses concerns. In others, it is largely caused by the overly protective nature of BITs towards private property rights at the expense of limiting the regulatory autonomy of host countries. The other contributory causes include the existing asymmetric relationship between countries and investors along with the absence of responsibilities imposed on foreign investors, the controversial benefits of Investor-State Dispute Settlement (hereinafter ISDS), the concerns regarding arbitrator bias and lack of

[7]Fabio Morosini and Michelle Ratton Sanchez Badin, Re-conceptualizing International Investment Law from the Global South, 1st Edition, Cambridge University Press, (2018) p.3.; see also Susan D. Franck, The legitimacy crisis in investment arbitration: privatizing public international law through inconsistent decision, Fordham Law Review, Vol.73: No 4, (2005). P1523; see also David Schneiderman, The Paranoid Style of Investment Lawyers and Arbitrators: Investment Law Norm Entrepreneurs and Their Critics, in C.L. LIM,(ed.) Alternative Visions of The International Law on Foreign Investment, 1st edition, Cambridge University Press, (2016), p.135.

[8] Peter Muchlinski et al, The Oxford Handbook Of International Investment Law, 1st edition, Oxford University Press, (2008), p.9.; David Schneiderman, International Investment Law's Unending Legitimation Project, Loyola University Chicago Law Journal, Vol. 49: No 2., (2017). p.229.

[9] Lim, *Supra* note 7; Susan D. Franck , *Supra* note 7, p.1593.

accountability, the insufficient transparency in the ISDS process, the absence of amicus curiae and third-party participation, the inconsistencies in arbitral awards, the lack of appeal mechanism, and the constraints on policy space.[10]

Many countries are now making foreign investment policy reform as a way to overcome the effects of such multiple challenges.[11] The United Nations Conference on Trade and Development (hereinafter UNCTAD) indicated that in 2012 - 2015, at least 110 countries have reviewed their national and/or international investment policies and a considerable number of countries have developed new model IIAs.[12] Yet it is important to note that the response given to such legitimacy crisis varies from country to country.

One of the targets of policy reforms of many countries is the responsibility of foreign investors. Debates concerning foreign investors' responsibilities in host states are hot and lingering. It is, in fact, taken to be the next frontier of international investment law. Evidencing such facts, it prompted, at international level, varying voices over the effects of the legitimacy crisis on public interests such as sustainable development in a host states.[13] Thus, it has become imperative for many countries to incorporate foreign investors' sustainable development responsibilities in FDI regulations as one of the essential reform moves in this regime.

3. Conceptualizing Sustainable Development and Sustainability

The notion of sustainable development is rooted in eighteenth-century German forestry science and Hans Carl von Carlowitz who is widely taken as

[10] Id.

[11] Morosini and Badin, *Supra* note 7. Pp.16-25.

[12] UNCTAD, Reforming the IIA Regime - a Stocktaking (01 March 2016), https://unctad.org/news/reforming-iia-regime-stocktaking, (accessed Apr. 22, 2023)

[13] Jola Gjuzi, Stabilization Clauses in International Investment Law: A Sustainable Development Approach, 1st ed., Springer International Publishing, (2018), p.5.

the founding father of modern idea of sustainable development.[14] According to Hans Carl, 'we have to find the right balance between resource use and the regeneration of natural capital'.[15]

At institutional level, this concept attained implicit recognition in the Universal Declaration of Human Rights (hereinafter UDHR) in 1948 while its explicit recognition begins in the Stockholm Declaration in 1972.[16] Since then it has become recurring notion in international conferences focusing on environmental protection and human development.

Despite this recognition, sustainable development is still an evolving concept, with no universally agreeable understanding and definition for it as such.[17] It is indicated by some that sustainable development is one of the main aspirations of human societies in the 21st century.[18]It aims to achieve a balance between natural, economic, and social dynamics. While traditionally encompassing environmental, economic, and social dimensions, the concept recently includes new elements such as governance, technology (knowledge),

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[14] Judith C. Enders and Moritz Remig, Theories of Sustainable Development: introduction, in Judith C. Enders and Moritz Remig, (ed.),Theories of Sustainable Development, 1st edition, Routledge, (2015), p.2.

[15]Id; see also Virginie Barral, Sustainable Development in International Law: Nature and Operation of an Evolutive Legal Norm, The European Journal of International Law Vol. 23: no. 2, (2012), p.377.

[16]Mekonnen Seid Demeke, Renegotiating Ethiopian Bilateral Investment Treaties in line with the Constitutional Goal of the Right to Sustainable Development, City University of Hong Kong, DPhil thesis,(2021), p.58.

[17] Lorenzo Cotula, Foreign investment, law and sustainable development: A handbook on agriculture and extractive industries, Natural Resource Issues No. 31. (2016), p.4.

[18] Bert J.M. de Vries and Arthur C. Petersen, Conceptualizing sustainable development An assessment methodology connecting values, knowledge, worldviews and scenarios, Ecological Economics, vol.68, (2009), p.1006.

and culture as critical dimensions for successful implementation of sustainable development policies and laws.[19]

Assessing sustainability from the point of view of investment is one of the major engagements of policy practice and academic inquiry, through which different models have been suggested as tools of analysis. Among others, it can be viewed through two paradigms: strong sustainability and weak sustainability. The weak sustainability paradigm allows for substituting one form of capital with another, while the strong sustainability paradigm considers certain forms of capital such as natural capital as irreplaceable.[20] It is advisable for a state to employ a combination of these approaches on a case-by-case basis, adopting a stronger definition when irreversible loss of resources is at stake, and a weaker definition when substitutability is possible.

Of course, there are critics surrounding the concept of sustainable development, arguing that over obsession with this concept leads to more destruction rather than actual sustainability. They particularly contend that sustainable development is merely a superficial label used to appease environmentalists by promoting a neoliberal development model.[21] Further,

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[19] Ethan D. Schoolman et als, How interdisciplinary is sustainability research? Analyzing the structure of an emerging scientific field, Sustainability Science, (2011), p.67. https://graham.umich.edu/media/pubs/published-research_sustainabilityscience.pdf, (accessed Nov. 20, 2023).

[20] Simon Dietz and Eric Neumayer, Weak and Strong Sustainability in the SEEA: Concepts and Measurement, Ecological Economics, Vol.61:No.4, (2007), p.621., https://papers.ssrn.com/sol3/papers.cfm?abstract_id=957994#. (accessed Feb. 10, 2023), See also JérômePelenc and Tom Dedeurwaerdere , Weak Sustainability versus Strong Sustainability (Brief for GSDR 2015), p.3. https://sustainabledevelopment.un.org/content/documents/6569122-Pelenc Weak%20Sustainability%20versus%20Strong%20Sustainability.pdf. (accessed Mar.20, 2023).

[21] Manjiao Chi, Integrating Sustainable Development in International Investment Law: Normative Incompatibility, System Integration and Governance Implications, Routledge, (2018), p.163.

the critics hold that sustainable development has inherent flaws as it is not feasible to achieve unlimited growth with limited resources. While these polarized views are available in the literature, the author in this paper holds that attaining sustainable development is possible, yet governments need to effectively adhere to an all-inclusive model, which enables to achieve a balance between environmental, economic, and social aspects in the context of FDI governance and operations. The all-inclusive model, which the author employs, takes sustainable development as an overarching concept which embraces the three dimensions.

4. Sustainable Development in Legal Spaces

Whether sustainable development is a policy, soft law, or law has not been settled yet.[22] The developing discourse in this area could be divided into those who are skeptical of its legal nature and those who try to establish its legal nature.[23]The uncertainty attending the concept sparks perplexity, requiring the attention of many international legal scholars and policy practitioners.[24]

The legal status of a given proposition could be determined based on the extent to which it attains accepted sources of legal norms with clear legal consequences. To this end, sustainable development is, at least gradually, surging into both non-binding and binding international legal instruments. In

[22]Leslie-Anne Duvic-Paoli, From Aspirational Politics to Soft Law? Exploring The International Legal Effects of Sustainable Development Goal 7 On Affordable and Clean Energy from Aspirational Politics to Soft Law? Melbourne Journal of International Law, Vol.22: No.1,(2021), p.5.

[23] Michael Mc Closkey, The Emperor has no Clothes: The Conundrum of Sustainable Development, Duke Environmental Law and Policy Forum, Vol.9: Spring issue, (1999), p.153.; see also Marie-Claire Cordonier Segger and Ashfaq Khalfan, Sustainable Development Law, Principles, Practices & Prospects, Oxford University Press, (2004).

[24] Barral, *Supra* note 15. p.1.

this connection, Virginie Barral, one of the influential authorities in human rights law observed:

> *Sustainable development has, over the last 30 years, received wide support in a vast array of non- binding international legal documents. It finds expression in countless Declarations of states, resolutions of international organizations, programmes of action, and codes of conduct. (...) But sustainable development also finds expression in a far from negligible number of international treaties. It is included in over 300 conventions, and a brief survey of these is revealing from the point of view of the categories of conventions at stake, the location of the proposition relating to sustainable development, and the function attributed to it. References to sustainable development can indeed be found in 112 multilateral treaties, roughly 30 of which are aimed at universal participation.*[25]

We can notice from the observation of this writer that sustainable development is gradually penetrating important sources of international law. Accordingly, one may argue that even if it is mentioned in binding conventions, the concept is found in the non-operative part of a convention such as preambles and hence less significant for its implementation. But some surveys indicate that about 69% (207 of 300) of those conventions inculcating sustainable development include it in the operative part of a convention.[26]

Taking perspective of the customary international practice, commentators claim that there is only obligation of means with respect to sustainable development.[27]In an obligation of means, the focus is on the efforts or means employed to accomplish a task or objective. The party undertaking the

[25]Barral, *Supra* note 15. P.384 (citation omitted).
[26]Id.
[27]Id., p.385.

obligation is required to use reasonable or best efforts, skills, or resources to achieve the desired outcome. As such the emphasis is on the actions and resources applied rather than solely on achieving a specific result.[28] However, we need also notice that a closer examination of obligations related to sustainable development does include negative obligations like obligation not to violate certain environmental or labor standards.

Nonetheless, some argue that impregnation of legal mentality and hence opinio-juris with sustainable development will be created from a wide range of 'wealth of resolutions, declarations, gentlemen's agreements, programs of action, international and national judicial decisions, national legislation, and conventional provisions referring to it'.[29] Thus, there is considerable potential for sustainable development to crystallize into customary international law. There is little disagreement in taking sustainable development as an objective to aspire.

Apart from such conditions, sustainable development can also be taken as an interpretative tool available at the hands of judges and could give them liberty, authorizing value, or circumstantial choices to be made. Emphasizing this role, Virginie Barral states that '[s]sustainable development may… have a hermeneutical function … as a customary principle or as a conventional rule and its characteristics make it a particularly useful interpretative tool'.[30]

To make the best out of this interpretive role of sustainable development, governments need to include it both in preambles and operative part of treaties. Parties to a treaty may also agree that sustainable development is an

[28] Id., p.386.
[29] Id., p.388.
[30] Id., p393.

'evolutive interpretative tool'[31]. That is, they may incorporate terms of a treaty that allows a space for 'an interpretation in the light of the law enforce at the time of the dispute and in the light of current norms of international law, not just of the law enforce at the time of the conclusion of the treaty.'[32]

Encouraging such moves, the 70th Conference of the International Law Association, held in New Delhi, India in 2002, adopted a declaration of Principles of International Law relating to Sustainable Development which could potentially inform policy and law making in host states.[33] The legal nature of sustainable development can slowly emerge if sustainable development law makes its base on such principles. These principles include: (1) the duty of States to ensure sustainable use of natural resources; (2) the principle of equity and the eradication of poverty; (3) the principle of common but differentiated responsibilities; (4) the principle of the precautionary approach to human health, natural resources and ecosystems; (5) the principle of public participation and access to information and justice; (6) the principle of good governance; and (7) the principle of integration and interrelationship, in particular relating to human rights and social, economic and environmental objectives.[34]

These principles are carefully crafted by high profile professionals including all latest dimensions of sustainable development. Therefore, the notion of sustainable development is making gradual evolution to crystalize into normative standards. Even if the incorporation of sustainable development

[31]United States v. India et al., United States – Import Prohibition of Certain Shrimp and Shrimp Products, Report of WTO Appellate Body, WT/DS58/AV/R, 1998, at para 129.
[32] Barral, *Supra* note 15. P. 394.
[33]International Law Association (ILA), New Delhi Declaration of Principles of International Law Relating to Sustainable Development, (2002).
[34]Id.

clauses in international investment agreements is increasing, their level of enforcement and effectiveness requires further research.

5. Approaches to Establishing Foreign Investors' Sustainable Development Responsibilities in Ethiopia

The normative imperatives of foreign investors in Ethiopia's sustainable development journey should embrace responsibilities of foreign investors to sustainability and go beyond recognizing their right to profit-making. As per the development norms and visions of the country, they should adhere to and observe ethical responsibility, sustainable business models, environmental stewardship, respect for human rights, social and economic inclusion, and technology transfer. By embracing these imperatives, foreign investors can create a positive impact on Ethiopia's development trajectory. Ultimately, their commitment to these normative obligations will contribute to Ethiopia's long-term prosperity, environmental integrity, and the well-being of its people. Multiple approaches to embrace sustainability into Ethiopian FDI normative frameworks are available and commendable.

5.1 Limiting the BITs' Regulatory Chill Potential on Host States

Regulatory chill refers to a situation where governments refrain from implementing or enforcing regulations due to fear of potential investment claims.[35] Moving a step in the right direction, currently, the epistemic community is recommending the importance of reserving regulatory space to

[35] SATWIK SHEKHAR, 'REGULATORY CHILL': TAKING RIGHT TO REGULATE FOR A SPIN, (Working paper, Centre for WTO Studies, Indian Institute of Foreign Trade, New Delhi.), SEPTEMBER, 2016, p.2 https://wtocentre.iift.ac.in/workingpaper/%27REGULATORY%20CHILL%E2%80%99%20TAKING%20RIGHT%20TO%20REGULATE%20FOR%20A%20SPIN%20(September%202016).pdf.(Accessed Apr. 29/2024).

a host state.[36] This will enable the host state to regulate the behavior of foreign investors in the public interest including in the interest of sustainable development. Regulatory chill effect could be evident from high-profile international investment arbitration cases such as *Vattenfall et al. v. Germany*[37] and *Philip Morris v. Australia*.[38] In such cases, foreign investors usually challenge host states regulatory measures through international investment arbitration and this could impede countries' efforts to pursue sustainable development.

Looking into Ethiopian BITs, especially those signed before 2015, one could see that most of them are not designed in a manner that protects regulatory power. Many of these BITs incorporated Fair and Equitable Treatment (herein after FET) and indirect expropriation provisions without indicating their precise scope and meaning.[39] Claims based on indirect expropriation and violation of FET standards are potentially and practically emerging as it is

[36] Id.

[37] Vattenfall AB et al. v. Federal Republic of Germany (ICSID Case No. ARB/12/12), as elaborated in UNCTAD, 2012a. 7 For a case example please refer to Philip Morris Asia Limited v. The Commonwealth of Australia (PCA Case No. 2012-12), as elaborated in UNCTAD, 2011.

[38] Philip Morris Asia Limited v. The Commonwealth of Australia (PCA Case No. 2012-12), as elaborated in UNCTAD, 2011.

[39] Treaty between the Federal Republic of Germany and the Federal Democratic Republic of Ethiopia concerning the Encouragement and Reciprocal Protection of Investments, (2005), Art.2(2)& 2(4); Agreement between the Federal Democratic Republic of Ethiopia and the Kingdom of Spain on the Promotion and Reciprocal Protection of Investments, (2006), Art. 3; Agreement Between The Government Of The Republic Of South Africa and The Government Of the Federal Democratic Republic Of Ethiopia For The Promotion And Reciprocal Protection Of Investments, (2008), Art.3(1); Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the People's Republic of China Concerning the encouragement and Reciprocal Protection of Investments, (1998), Art.3; Agreement between the Republic of Turkey and the Federal Democratic Republic of Ethiopia Concerning the Reciprocal Promotion and Protection of Investments, (2000), Art 2.

evidenced in the *ICL Europe v. Ethiopia*.[40] The claimant in this case, revealing the caveats of Ethiopia's investment and economic framework, raised a claim challenging tax assessment by Ethiopian tax authorities.

While FET and indirect expropriation provisions are important tools to protect the interests of foreign investors, they pose a danger to host states in pursuing sustainable development goals. These clauses are known as sustainable development impeding provisions.[41]This is worsened with ISDS provisions which permit investors access to international investment arbitration tribunals. Concerning ISDS, almost about 19 Ethiopian BITs permit dispute settlement through court or arbitral tribunal after an attempt is made through amicable mechanisms.[42]

The majority of Ethiopian investment treaties use the definition of expropriation which seems to limit regulatory space. Vague indirect expropriation seems to be part of expropriation provisions in many of Ethiopian BITs. This is evident from terms included in clauses defining expropriation. The provisions use phrasings such as 'measures having a

[40]UNCTAD Investment Dispute Settlement Navigator, ICL Europe v. Ethiopia, ICL Europe Coöperatief U.A. v. Ethiopia (PCA Case No. 2017-26)

[41] Chi, *Supra* note 23, p. 60

[42]Treaty between the Federal Republic of Germany and the Federal Democratic Republic of Ethiopia concerning the Encouragement and Reciprocal Protection of Investments, (2005), Art.10&11; Agreement between the Republic of Turkey and the Federal Democratic Republic of Ethiopia Concerning the Reciprocal Promotion and Protection of Investments, (2000), Arts 7&8; Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the People's Republic of China Concerning the Encouragement and Reciprocal Protection of Investments, (1998), Arts. 8&9.

similar effect as expropriation or nationalization' indicating inclusion of indirect expropriation from expropriations scope.[43]

Currently, with the view to minimize such restraining effect on host state regulatory power, treaty practice is innovating different balancing provisions. These may include listing elements for a standard, specifying carved-in exception, indicating mitigating factors etc.[44] In elements listing, a treaty lists out measures that can be taken as indirect expropriation. It also lists out elements that can be taken as violation of FET standards. This can reduce chilling effect on host states.[45] In indicating mitigating factors, a certain measure by the host state may be considered as indirect expropriation. However, in considering compensation to the investor, compensation may be reduced in favor of the host state if the host state takes the measure to achieve public interest ends.[46]

There are various mechanisms to help the host state preserve its regulatory power in international investment treaties. Even if Ethiopia, as least developed host state, lacks strong bargaining power to influence terms of its BITs, attending legitimacy crisis of the international investment regime, the related backlash and calls for change may feed important input for possible reform. As such, the BITs to which this country is a party always require close

[43] Agreement Between The Government Of The United Kingdom Of Great Britain And Northern Ireland And The Federal Democratic Republic Of Ethiopia For The Promotion And Protection Of Investments, (2009), Art.5; Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the People's Republic of China Concerning the Encouragement and Reciprocal Protection of Investments, (1998), Art.4; Agreement on encouragement and reciprocal protection of investments between the Federal Democratic Republic of Ethiopia and the Kingdom of the Netherlands, Art.6.

[44] Chi, *Supra* note 21, pp. 56-59.

[45] Id.

[46] Id., p.59.

examination so that they can embrace emerging changes in the international investment regime.

While such post-treaty formulation effort is important, it is further more important to make, from the outset, FET provisions outline rights and obligations clearly, to limit or avoid ISDS clauses, to use public interest carve-outs, and to make clarification on indirect expropriation provisions as a way to preserve regulatory rooms for sustainable development.[47] Reserving regulatory rooms in BITs will particularly help the country to prescribe standards of behavior expected of foreign investors towards sustainable development without fear of risk towards arbitration.

Moreover, the relationship between signing and ratifying BITs and investment inflow is illusive. The same is true concerning investment inflow and giving better terms at the expense of host state. For instance, currently, there is no active BIT between Ethiopia and India. However significant numbers of Indian Foreign investors are investing in Ethiopia, arguably, implying that designing regulatory frameworks at the expense of sustainable development agenda may not serve foreign investment promotion ends.[48]

5.2. Orienting BITs with Sustainable Development Provisions

While many agree on the need to align BITs with the sustainable development agenda, there is a heated scholarly debate over the mechanisms for creating criteria for IIAs' orientation towards sustainable development.

[47]United Nations Conference on Trade and Development (UNCTAD), Preserving Flexibility in IIAs: The Use of Reservations, (UNCTAD Series on International Investment Policies for Development) (New York and Geneva, 2006), pp. 7-9.

[48]Next to China, Saudi Arabia, and the United States, India is the 4th in investing in Ethiopia. See Standard Bank, Foreign direct investment (FDI) in Ethiopia https://www.googleadservices.com/pagead/, (accessed June 10, 2023).

The inclusion of provisions for sustainable development in various formulations is recommended by some group of policy practitioners and scholars.[49] These clauses could be of various types, ranging from broad sustainability clauses to clauses that cover a particular matter. A treaty preamble that adopts the broader form contains general sustainability clauses identifying sustainable development as one of the goals of the pact. These clauses are declarative and obligate contracting states to implement policies or advance sustainable development. Another approach to structure these clauses for sustainable development is to include particular clauses addressing difficulties with the environment, society, human rights, or security concerns.

Such elements for sustainable development are rarities in Ethiopian BITs. The general sustainable development provision (hereinafter SDP) is found only in few BITs of the country.[50] Some BITs have specific SDP such as *no lowering standards in the preamble*.[51] For example, the Ethio-Brazil BIT and Ethio-United Arab Emirates BIT incorporate such Sustainable development Provisions.[52] Yet in other BITs, in specific operational provisions, a preambular broad reference to sustainable development is missing.

[49] Chi, *supra* not 21.

[50] Agreement between The Government of the Republic of South Africa and the Government of the Federal Democratic Republic of Ethiopia for the Protection and Reciprocal Promotion of Investment, (2008), preamble; Agreement between the Government of The Federal Democratic Republic of Ethiopia and The Government of The United Arab Emirates Concerning the Promotion And Reciprocal Protection Of Investment, (2016), preamble; Agreement between the Federative Republic of Brazil and the Federal Democratic Republic of Ethiopia on Investment Cooperation and Facilitation,(2018), preamble and Art 14.

[51] Agreement between the Government of the Republic of Finland and the Government of the Federal Democratic Republic of Ethiopia on the Promotion and Protection of Investments, (2006), preamble.

[52]Agreement between the Government of The Federal Democratic Republic of Ethiopia and The Government of The United Arab Emirates Concerning the Promotion And Reciprocal Protection Of Investment, (2016), preamble; Agreement between the

Currently, the increase in ISDS cautiously suggests that if investment treaty making continue as it is, it would contradict with public policy especially those related to sustainable development.[53] Scholars such Wolfgang Alschner&Elisabeth Tuerk have suggested host states' response to these difficulties in treaty procedures.[54] These responses include adding balancing clauses to treaties, limiting arbitral discretion through language clarification in treaties, expanding the purview of investment treaties beyond just investment protection to cover other issues like upholding environmental standards, combating corruption, and corporate social responsibility, etc., and enhancing the defensive nature of investment treaties by adding deadlines for filing notices of arbitration.[55]

Currently, capital exporting countries with better bargaining position are also recognizing the concerns of least developed host states. In recognition of such challenge, they are taking positive steps towards enhancing their BITs regime by providing new BIT models and renegotiating their existing BITs.[56] This would, debatably, encourage least developed countries like Ethiopia to push modification of its BITs in a manner that enable it create domestic legal frameworks which are sustainable friendly.

Federative Republic of Brazil and the Federal Democratic Republic of Ethiopia on Investment Cooperation and Facilitation, (2018), preamble and Art 14.

[53] Wolfgang Alschner& Elisabeth Tuerk, The role of international investment agreements in fostering sustainable development. pp3-4, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2295440. Accessed on 13/5/2023

[54] Id.

[55]Id., see also Markus A. Petsche, The Fork in the Road Revisited: An A visited: An Attempt to Overcome the Clash Between Formalistic and Pragmatic Approaches, Washington University Global Studies Law Review, VOL. 18: No.2, (2019), p. 395.

[56]UNCTAD, *Supra* note 5.

5.3. Soft Law Norm Approaches and Sustainable Development

Soft law refers to standards of behavior that are neither binding hard law nor mere political or moral statements. They lie between the two and play an important role in the interpretation and development of international investment law.[57] There are diverging views on the role of soft law.[58] Though it may not be compared with hard law norms, soft law norms also provide important form of regulation, especially in areas where there is scarcity of binding multilateral norm. To this effect, foreign investors are expected to observe such standards of soft laws in varying moves of their investment operations. As such, such laws are taken to be one of the major tools to gear FDI to sustainable development ends. The next paragraphs explore the nature and possible utilization of soft laws in regulating investment moves of individual foreign investors and transnational companies.

5.3.1 Corporate Social Responsibility

Corporate Social Responsibility (hereinafter CSR) is a standard of corporate behavior that demands corporations to pursue policies which are desirable in terms of the objectives and values of societies.[59] As such, it is a normative model of corporate governance and operations that seeks to contribute to the attainment of sustainable development by regulating and balancing the

[57] M. G. Desta, Soft Law in International Law: An Overview, in A. Bjorklund and A. Reinisch (eds.), Soft Law and International Investment Law (Cheltenham, Edward Elgar Publishing Ltd., 2013), p. 40.

[58] Melaku Geboye Desta, Soft law in international law: an overview in Andrea K. Bjorklund and August Reinisch, International Investment Law and Soft Law, (2012), pp. 42-49.

[59] H. R. Bowen, Social Responsibility and Accountability (New York: Harper & Row, 1953), as cited in Archie B. Carroll, 'Corporate Social Responsibility: Evolution of a Definitional Construct', Business and Society38(3) (1999), p. 270.

interests of corporations, investors and other private actors with the concerns and interests of the public.[60]

In contemporary development discourse and policy debate, there is a widely shared expectation among academics, policy practitioners and other public stakeholders for sustainable development to be integrated into corporate strategies and programs.[61] Currently, through the soft law approach, there are international instruments trying to prescribe responsibilities of foreign investors in host states. Instruments such as the United Nations (UN) Global Compact[62], the UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises about Human Rights,[63] the UN Guiding Principles on Business and Human Rights[64] are important examples with CSR standards. The instruments lay down standards of behavior expected from foreign investors. Such moves are, in fact, one of the potential mechanisms to instill socially responsible behavior on foreign investors.

Therefore, it is important to note that the CSR movement is geared toward corporate self-regulation than creating binding instruments which help in punishing noncompliance by corporations.[65] Yet compliance based on UN

[60] Jarrod Hepburn and VuyelwaKuuya, Corporate Social Responsibility and Investment Treaties, in CordonierSegger et al. (eds), Sustainable Development in World Investment Law, Cambridge University Press, (2013), p. 585.

[61] Norma Schönherr et al., 'Exploring the Interface of CSR and the Sustainable Development Goals' TRANSNATIONAL CORPORATIONS, Vol. 24: No.3, (2017) 33, p.39.

[62] UN Global Compact, www.unglobalcompact.org. accessed on 6/5/2023.

[63] Sub-Commission on the Promotion and Protection of Human Rights, Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights (13 August 2003) UN Doc.E/CN.4/Sub.2/2003/12/Rev.2 http://undocs.org/E/CN.4/Sub.2/2003/12/Rev.2.

[64] UN Office of the High Commissioner for Human Rights (OHCHR), Guiding Principles on Business and Human Rights (2011).

[65] Id.

Global Compact and the UN Guiding Principles on Business and Human Rights are important sources of norms governing corporate behavior towards sustainability.[66]

Jean Ho summed up the substantial departure made in this respect as:

> *When corporate investors, whether motivated by profit or civic duty, voluntarily adopt sustainable and lawful business practices, the pursuit of investor responsibility in international fora becomes redundant. To be fair to its proponents, the CSR movement has made some headway in Europe. Starting from 2018, large public interest corporations are required by law to report their policies on various aspects of social responsibility, such as environmental protection and human rights preservation. However, until the European model of imposing mandatory CSR reporting only on the largest corporations converts all corporations into socially responsible actors (...).*[67]

As a way to make such norms, countries employ different treaty practices of incorporating CSR element into a treaty. Some include a call for encouragement of CSR in a preamble to promote CSR-friendly reading of the whole treaty.[68] This purpose could also be achieved through making direct reference to international standards to CSR like the UN Global Compact or OECD Guidelines for Multinational Enterprise. Secondly, it is also possible to directly include CSR clause and make best endeavor commitments. Currently, there is also an attempt to impose direct obligations on foreign investors. For instance, the Brazil-Malawi Investment Cooperation and

[66] Jean Ho, The Creation of Elusive Investor Responsibility, (Symposium on Investor Responsibility: The Next Frontier in International Investment Law, (2019), p. 12.
[67] Id. P.13.
[68] Norway Draft Model BIT (2007) Preamble and Article 32.

Facilitation Agreement contained detailed provisions aligned with sustainable development objectives.[69] Article 9(1) of the agreement provides for direct obligations of investors to the local community.[70] Similarly, the Argentina – Quatar BIT lays down corporate social responsibility duties under Articles 11 and 12.[71]

Following a more normative approach, the Pan-African Investment Code (PAIC) urges investors to comply with internationally recognized human rights laws and combating corruption laws.[72]Such CSR inclusion is getting its way into model BITs. For instance, the Ghana Model BIT normatively obligates investors to engage in human capital formation, local capacity building through close cooperation with the local community, to create employment opportunities and facilitate training opportunities for employees, and to pave ways the transfer of technology.[73]

In sum, the global experience shows that there is a substantial move to harmonize CSR norms with relevant laws and globally acknowledged benchmarks of human rights, international labor and environmental standards, anti-corruption norms, and endeavors that foster sustainable development. Further, it is widely held that CSR encompasses both active contributions to and prevention of detrimental effects on sustainable development.

Turning to the Ethiopian policy practice, we could see that the majority of the BITs are almost devoid of CSR clauses in contrast to a changing landscape in

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[69] Article 9 of the Brazil–Malawi Investment Cooperation and Facilitation Agreement (an investment treaty that is different from traditional BITs)

[70] Id.

[71] The Reciprocal Promotion and Protection of Investments Between The Argentine Republic and The State Of Qatar, (2016), Art 11 and 12.; See also Art 21 and 24 of the Pan Africa Investment Code.

[72]The Pan Africa Investment Code, Arts 21 and 24.

[73] Ghana Model BIT, 2008. Art 12.

FDI governance in the other world. However, we can find CSR clauses in some recently signed Ethiopian BITs. The Ethio- Brazil BIT[74] and Ethio-UAE BIT[75] are the rare instance that included some direct and indirect CSR provisions. The Ethio-Brazil BIT (not yet ratified) provides that '[i]nvestors and their investment shall strive to achieve the highest possible level of contribution to the sustainable development of the Host State and the local community, through the adoption of a high degree of socially responsible practices."[76]

Similarly, the Ethio-UAE BIT states that '[i]nvestors and investments shall strive, to the extent possible, through their management policies and practices, to contribute to the development objectives of the Host State and to the benefit of the local community where the investment is made.'[77] Based on such provisions, the host state could take administrative or regulatory measures with the view to enhance sustainable development agenda.

Thus, soft law can play important roles in the regulation of international investment law in line with the sustainable development needs of a host state.[78] In this instance, for example, the existence of CSR provision in a BIT helps Ethiopia to limit scopes of investors legitimate expectation and scope of

[74] The Agreement Between the Federative Republic of Brazil and the Federal Democratic Republic of Ethiopia on Investment Cooperation and Facilitation, (2018), The preamble and Art 14.

[75] Agreement between the Government of The Federal Democratic Republic of Ethiopia and The Government of The United Arab Emirates Concerning the Promotion and Reciprocal Protection of Investment, (2016), Arts 11,12,13.

[76] The Agreement Between the Federative Republic of Brazil and the Federal Democratic Republic of Ethiopia on Investment Cooperation and Facilitation, (2018), Art 14(1).

[77] Agreement between the Government of The Federal Democratic Republic of Ethiopia and The Government of The United Arab Emirates Concerning the Promotion And Reciprocal Protection Of Investment, (2016), Art 11.

[78]Giovanna Adinolf, Soft Law in International Investment Law and Arbitration; the Italian review of international and comparative law 1 (2021), p. 89.

FET clauses in a treaty. Further, soft law instruments can serve as alternative outlays of a regulatory tool when negotiation and deliberation processes of adopting hard law regulatory instrument fail. Often, this process generates by-products that can be regarded as soft laws and become subjects of exploration and discourse within the academic community. It can also serve as an experimenting laboratory of regulation, giving a chance to do and learning through time. Emphasizing such opportunities, Stephan W Schill and Kerem Gülay state: 'Soft law can also react to the dynamics of FDI regulation in allowing for the incremental and, at times, experimental infusion of legal change by trial and error, without the need to settle on durable hard law rules.'[79]

5.3.2. Social License to Operate

Social License to Operate (hereinafter SLO) in the context of FDI regulation refers to the level of acceptance and support that a company or investor receives from the local communities, stakeholders, and society at large in a host country.[80] It goes beyond legal and regulatory requirements and encompasses the broader social and environmental expectations of local communities.[81] Obtaining a social license to operate implies that a company

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[79]Schill, Stephan W. and Gulay, Kerem, Approaches to Foreign Direct Investment in Legal Research (December 19, 2019). published in Markus Krajewski and Rhea T Hofmann (eds), Research Handbook on Foreign Direct Investment (Edward Elgar 2019) Ch. 2, Amsterdam Law School Research Paper No. 2019-19, Amsterdam Center for International Law No. 2019-08, Available at SSRN: https://ssrn.com/abstract=3506743. (accessed May, 20, 2023).

[80] Emma Wilson, What is the social license to operate? Local perceptions of oil and gas projects in Russia's Komi Republic and Sakhalin Island, The Extractive Industries and Society, (2016), vol. 3, p. 74.

[81] Robert Boutilier and Ian Thomson, Modelling and Measuring the Social License to Operate: Fruits of a Dialogue Between Theory and Practice (2011), p.2 https://socialicense.com/publications/Modelling%20and%20Measuring%20the%20SLO.pdf. Accessed on 10/5/2023.

has effectively engaged with and gained the trust and approval of the community, demonstrating responsible and sustainable business practices that align with the community's values and interests. In terms of impact, investment processes based on SLO principles involve active management of relationships, addressing community concerns, respecting human rights, preserving the environment, and contributing to the overall well-being and development of the host community.

Historically, one can trace the genesis of SLO to 2007 UN Declaration on the Rights of Indigenous Peoples.[82] This international human rights instrument states that indigenous people shall not be forcibly removed from their lands or territories and no relocation shall take place without the Free, Prior and Informed Consent (FPIC) of the indigenous people.[83]

However, this SLO is distinctively different from FPIC, as it represents a continuous undertaking throughout the entire investment venture. Whereas FPIC is much about governments' duty, SLO falls under the purview of companies. SLO as a normative behavior had initially gained prominence only in the extractive industry. Yet later, it progressively is attaining traction in other sectors such as energy production and agriculture.[84]

A common understanding and uniform definition are lacking about the concept of social license to operate. Some relate it to moral legitimacy of enterprises which refers to the ethical acceptability of an institution or its

[82] UN Declaration on the rights of indigenous people, see also DomènecMele and JaumeArumengou, Moral Legitimacy in Controversial Projects and Its Relationship with Social License to Operate, Journal of Business Ethics, Vol. 136, No. 4, Special Issue on The 26th EBEN Annual Conference in Lille (July 2016), p.731.

[83] Art 10 of UN Declaration on the rights of indigenous people.

[84] Marieke Evelien Meestersa and Jelle Hendrik Behagel, The Social Licence to Operate: Ambiguities and the neutralization of harm in Mongolia,Resources Policy, Vol. 53, (2017), p. 274.

activities.[85] Others take it as unwritten contract between an industry and the community it operates.[86]This license goes beyond strict compliance with regulation, and requires companies to demonstrate a commitment to sustainable development throughout their operations.[87] Implying the contractual essence underlying the concept, the Minerals Council of Australia explained:

> *Foundation[al] to the industry's commitment is the concept of a 'social license to operate'. Simply defined the 'social licenses to operate' is an unwritten social contract. Unless a company earns that license, and maintains it on the basis of good performance on the ground, and community trust, there will undoubtedly be negative implications.*[88]

Placing societal stake at the center, others take SLO as perceptions of local stakeholders in terms of the extent to which a project, a company, or an industry operating in a given area or region is socially acceptable or legitimate.[89] The community in which the investment is destined would grant the license where it fulfills requirements beyond what is required legally. Thus, it imposes implied obligation on foreign investors to discharge sustainable development responsibilities - which is usually not yet fully prescribed in normative frameworks.

[85]Domènec Mele and Jaume Arumengou, *supra* note 82. p. 729.
[86] Id. P.732.
[87] Id.
[88]Minerals Council of Australia, 2005, p. 2.
[89]Raufflet, E., Baba, S., Perras, C., Delannon, N. (2013). Social License. In: Idowu, S.O., Capaldi, N., Zu, L., Gupta, A.D. (eds) Encyclopedia of Corporate Social Responsibility. Springer, Berlin, Heidelberg. https://doi.org/10.1007/978-3-642-28036-8_7. (Accessed Jul. 18, 2023).

In other circumstances, the significance of SLO extends beyond the local community and encompasses the investment itself. The extent of SLO granted to a company is inversely correlated with the level of sociopolitical risks that the company encounters. This is especially important in least developed countries like Ethiopia where there is less legitimacy to public authorities. In host states where indigenous people or local communities question government authority, the license from governments may not be sufficient for the investment to operate safely in the locality. This implies that a foreign investor possessing such licenses could mitigate sociopolitical risks on the investment. However, there are critique leveled against such SLO related to lack of clarity as to who is in the position to grant this license and on what conditions that community shall grant that license.[90]

Apart from such theoretical analysis, the normative nature or judicialization/legalization[91] of SLO comes to the scene in relation to defense of contributory fault for investors claims (see section 5.6). Host states intervention in the form of taking corrective measures against investors usually entails social conflict between investment/investors and local community. In this connection, SLO will usually ease the difficulty to make a link between investors conduct, resultant social protests, and resulting host state measures. However, an insightful understanding of the relationship between defense of contributory fault and SLO will defy this problem. It could be taken as contributory fault of the investor that provoked state measures and thus reduces states liability. It therefore helps in establishing sustainable development responsibilities indirectly.

[90] Marieke Evelien Meestersa and Jelle Hendrik Behagel, *supra* note 84. P.275.

[91] Raúl F. Zúñiga Peralta, The Judicialization of the Social License to Operate: Criteria for International Investment Law, https://ssrn.com/abstract=3855028. (Accessed Jun. 20, 2023).

In this connection, when we come to Ethiopia, we can find some normative prescriptions in domestic legislative documents with underlying elements of SLO. To this effect, the Mining Operation Proclamation No 878/2010 provides that mining operators should participate and contribute to the development of the community.[92] It particularly obliges mining operation licensees to reserve funds for such purposes. Such legislative moves are potential opportunity for the investment projects to build positive relationship with the local community and to obtain the SLO in addition to the legal license from government authorities.

Of course SLO is not explicitly enshrined in legal statutes of Ethiopia mentioned earlier and legal status of the underlying SLO elements is disputed. Yet its significance and bearing on businesses cannot be underestimated.[93] Several legal elements intersect with the concept of SLO, influencing corporate actions and outcomes. These include Regulatory Compliance, Social and human rights impact assessment, Environmental Impact Assessments, Indigenous Rights and Consultation, respecting land use rights and property ownership and engaging in community development projects.[94] Judicialization and legalization of such concepts could gradually be established if clarity and understanding is made through continuous works on notion of SLO.

Foreign investors, on their part, must recognize the importance of fostering sustainable partnerships and collaboration with the local communities, civil society organizations, and other stakeholders. By actively engaging in

[92] Mining Operation Proclamation, Proclamation no 878/2010, Federal Negaret *Gazeta*, (2010), Art 60(3).

[93] Geert Demuijnck and Björn Fasterling, Social License to Operate, Journal of Business Ethics, Vol. 136, No. 4, Special Issue on The 26th EBEN Annual Conference in Lille (July 2016), https://www.jstor.org/stable/24755721. Accessed on 6/19/2023, p.683.

[94] Id.

dialogue and incorporating diverse perspectives, investors can align with national development plans and priorities as well as community interests. Transparency, accountability, and responsible business practices should be at the core of these partnerships, ensuring mutual trust and long-term sustainability.

5.4 Role of Counterclaims in Establishing Sustainable Development Responsibilities

Counterclaims refer to legal actions initiated by host states against foreign investors in response to alleged breaches of investor obligations. In the realm of international investor-state disputes, there exists a noticeable pattern where claims predominantly originate solely from investors, displaying a unidirectional flow.[95] This trend did not reflect the whole dimension of international investment dispute as the interests of individuals and the local community may not be represented by other bodies than host states at international forums.[96] While institutions or individuals representing states at arbitral forums articulate government interests, they may not sufficiently cover damages sustained by communities or individual citizens.

Alternative mechanisms for the representation of the interests of individuals and local communities in international forums have been almost missing, except through counter claims by host states.[97] However in recent years, counterclaims against foreign investors have emerged as a mechanism to address potential conflicts between investment protection and sustainable

[95] Tomoko Ishikawa, Counterclaims and the Rule of Law in Investment Arbitration. (Symposium On Investor Responsibility: The Next Frontier In International Investment Law) (AJIL UNBOUND Vol. 113, (Published online by Cambridge University Press), p. 33, available at https://doi.org/10.1017/aju.2018.96 (accessed Nov. 5, 2023).

[96] Id.

[97] Id. P. 35

development objectives.[98]Consequently, the act of filing counterclaims provides host states with an opportunity to hold international investors responsible for their non-compliance of environmental and social responsibilities and the resulting harm inflicted upon local communities.

Emphasizing the role of counter claims and the need for expanding the space for such moves, James Gathii and Sergio Puig have this to say:

> *The emergence of a debate about investor responsibility as a prominent dimension of international investment law is attributable to at least three recent developments. The first is the appearance of provisions in newer investment treaties demanding that investors respect human rights, protect the environment, and act in a socially responsible manner when operating in the host state. The second is the growth of counterclaims by respondent host states in ISDS, seeking rulings from tribunals on the claimant investors' responsibility under domestic or international law. The third stimulus has been the adoption of Resolution 26/9 by the United Nations Human Rights Council to elaborate an international legally binding instrument to regulate, in international human rights law, the activities of transnational corporations and other business enterprises.*[99]

[98]SaArthak Jain, Bridging the Gap Between Investment Arbitrations and Environmental Concerns: Can Inclusion of Counterclaims Help?, available at https://aria.law.columbia.edu/bridging-the-gap-between-investment-arbitrations-and-environmental-concerns-can-inclusion-of-counterclaims-help/. (accessed Nov. 5, 2023).

[99]James Gathii and Sergio Puig, Introduction to The Symposium on Investor Responsibility: The Next Frontier in International Investment Law, AJIL UNBOUND, Vol. 113, (2019), p. 2; available at https://doi.org/10.1017/aju.2018.97. (accessed Aug. 6, 2023).

Given these grounds to regulate conducts of foreign inverstors, host state has the responsibility to take due diligence in authorizing and monitoring foreign investors' projects as part of their obligations to safeguard the rights of local communities. The recognition of such obligations in international practice has been demonstrated by the stance taken by the African Commission on Human and Peoples' Rights. In a position statement, the Commission presents arguments highlighting the Nigerian government's failure to provide protection to the 'Ongonis'[100] people.[101]As such it took as a breach of obligation by a state actor to protect persons against interference with the enjoyment of their rights.[102]

If effectively utilized, raising counterclaims in international investment dispute settlement forums would also provide one additional dimension of gearing foreign investors' responsibility to achievement of sustainable development. Tribunals may face difficulty to determine investors' responsibilities for the mere fact that such is not provided in the treaty terms.[103] However, it should be noted that it is the persistent state practice which could create binding norms in the long run. Thus, counterclaims serve to enhance the effectiveness of investor-state arbitration for several compelling reasons. It contributes to efficient time utilization, facilitates equality and narrows the asymmetrical investor-state relations, and minimizes the attending legitimacy problem of investor-state arbitration.[104]

[100] One of the Indigenous people living in South-East Nigeria.
[101]Mavluda Sattorova, Investor Responsibilities From A Host State Perspective: Qualitative Data And Proposals For Treaty Reform, Symposium On Investor Responsibility: The Next Frontier In International Investment Law,(2019), P.36.
[102] Id.
[103]Yaraslau Kryvoi, Counterclaims in Investor-State Arbitration, MINNESOTA JOURNAL OF INT'L LAW, Vol 21: No. 2, (2012), p. 216.
[104] Id. P. 220.

To this end, host states should actively participate in the process of establishing the international responsibility of investors by raising claims in international forums or use other mechanisms. They should try to invoke investors' misconduct based on international law in counter claims or in original claims so that investors' rules for responsibility could be developed in arbitration tribunals or elsewhere.[105] As noted by Jean Ho, 'in accordance with this principle, the Copper Mesa tribunal recognized that the investor's own actions contributed to a damage claimed to have suffered by communities. Through this recognition, the court justified a reduction in the compensation owed by Ecuador for expropriating the investor's mining concessions.'[106]

If investors are aware of the risk that host countries can successfully bring counterclaims based on their failure to exercise due diligence, they could tend to be responsible. Equally, they would be discouraged from initiating arbitration proceedings where they would need to justify their own actions.[107]

These instances clearly show that counterclaims are promising tools to push foreign investors to engage in meaningful dialogue with stakeholders, including local communities, civil society organizations, and governmental bodies. By actively participating in discussions and addressing concerns, investors can foster collaboration, gain insights, and incorporate diverse perspectives into their decision-making processes.[108] This collaborative approach would help them build trust, ensures transparency, and creates a sense of shared responsibility towards sustainable development goals.

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[105] Ho, *Supra* note 66. P. 12.

[106] Id.

[107] Giovanna Adinolf, Soft Law in International Investment Law and Arbitration; the Italian review of international and comparative law 1 (2021), p.89.

[108] Gleason, T. Examining Host-State counterclaims for environmental damage in Investor-State dispute settlement from human rights and transnational public policy perspectives. Int Environ Agreements, Vol.21, (2021), p.35, available at https://doi.org/10.1007/s10784-020-09519-y (accessed on 5/5/2023).

Ethiopia has been involved in a limited number of ISDS cases to date. In this connection, Ethiopia is advised to make the ISDS process accountable and transparent. It is also commendable for Ethiopia to institute counter claims so that it could open a door to make irresponsible foreign investors aligned with sustainable development ends.

5.5 Host State's Legitimate Expectation

The concept of a host state's legitimate expectation refers to the reasonable expectations and requirements that a host state may have regarding the conduct and behavior of foreign investors. This concept serves as an important legal and policy consideration, and there are arguments supporting the recognition and protection of a host state's legitimate expectation.[109] Proponents of this notion justify its recognition on grounds of public interest, host states inherent right of sovereignty, and the right to regulate social and economic development.

On the other hand, the doctrine of investors' legitimate expectation is one of the major subjects of scholarly dialogue host state and foreign investor relationships. It refers to the obligation of the host state to act in line with certain expectations of foreign investors. Accordingly, the host state could not act contrary to certain expectations of foreign investors. Usually, these expectations are based on BITs provisions which are concerned with FET standards and provisions which are meant to address indirect expropriation issues. It is believed that the arbitral jurisprudence has created the doctrine of legitimate expectation. Currently, there are some attempts to use such doctrine

[109] Karl P. Sauvan and Daniel Allman, Colombian Center on Sustainable development: Columbia FDI Perspectives: Perspectives on topical foreign direct investment issues No. 183 September 26, (2016).

of legitimate expectation by extension to the host states' legitimate expectation, too.[110]

In *Sempra v. Argentina*, Argentina argued that "the government[…] had many expectations in respect of the investment that was not met or was otherwise frustrated."[111]In this case, Argentina expected that foreign investors would work diligently and in good faith and dutifully observe contractual commitments, and respect the regulatory frameworks. It would be logical to argue that if private investors with their commercial purpose are granted such protection of the doctrine, for stronger reason, host states holding and promoting public purpose should be given the protection of such doctrine. It is natural for the host state to expect the foreign investor to respect its regulatory frameworks and measures as it is the state's inherent right and obligation to do so.

Some authors justify the need for enabling host states to claim such legitimate expectations by analogizing foreign investors' legitimate expectations. For instance, Karl P. Sauvan and Daniel Allman stated:

> *By analogy, the question arises whether host countries, too, can have legitimate expectations concerning the behavior of foreign investors within their economies, absent in any specific investor obligations in IIAs. Such expectations could be inferred from treaty preambles recognizing the objectives of IIA parties' economic or "sustainable development", as well as articles providing that investors shall strive to carry out the highest ...possible contributions to the sustainable development of the host State and the local community or corporate*

[110]Id.

[111]Id.; Sempra Energy International v. Argentine Republic, ICSID Case No. ARB/02/16, Award, 28 September 2007, para 289.

> *social responsibility (CSR) articles reaffirming the importance of each Party encouraging enterprises ... to voluntarily incorporate into their internal policies those ,internationally recognized standards, guidelines and principles of CSR.*[112]

In addition to logical and analogical argumentation, host state legitimate expectation could be based on soft law principles advocated by some regional organizations that are calling for more responsibility by multinational enterprises.[113]More specifically, Southern African Development Community (SADC) model BIT calls for foreign investor responsibilities.[114] Such persistent desire and practice for host state legitimate expectation could gradually contribute to sustainable development norm-making. Moreover, host state legitimate expectation demands investors to act in accordance with reasonable standards and obligations, which may include compliance with domestic laws and regulations, adherence to environmental and labor standards, or respect for social and cultural norms. This is in line with principles of equity and fairness as well.

Arguably, some of the BITs to which Ethiopia is a party do have some space to invoke host state legitimate expectation. Implying such room, it employs sustainable development related terms like *improve living standards*, *without relaxing labor* and *environmental standards, economic growth or prosperity*.[115] Yet more specifically, some recently signed BITs include the

[112] Sauvan and Allman, *Supra* note 109, citation omitted.
[113] Id.
[114] SADC Model Bilateral Investment Treaty Template with Commentary, (2012), Arts 10-17.
[115] Agreement between the Government of the Republic of Finland and the Government of the Federal Democratic Republic of Ethiopia on the Promotion and Protection of Investments, (2006), preamble; Agreement between the Government of The Federal Democratic Republic of Ethiopia and The Government of The State of Israel for The Reciprocal Promotion And. Protection of Investments; Agreement between the

term sustainable development and CSR provisions.[116] Giving recognition to host states legitimate expectation would be a step towards the right direction to make balanced international investment regime. This author would suggest that foreign investment arbitral tribunals be part of a solution in the process of creating equitable and balanced FDI regulatory framework by recognizing such host states' legitimate expectation.

5.6 Contributory Fault and Host State Measures

Contributory fault in relation to international dispute arbitration comes to the scene to serve as a defense to the host state. The host state invokes contribution of the investor to the problem or to the disputes and alleged damage.[117] And the investor is required to be responsible together with the host state for damages caused to communities, individuals, or the society at large.[118] As such this principle acknowledges that investors are obligated to bear costs of compensation for damages equitably traceable to the negative consequences arising from their own actions.[119]

Thus, contributory fault is typically considered in cases where the investor's conduct, such as non-compliance with contractual obligations, violation of

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Government of the Federal Democratic Republic of Ethiopia and the Government of the People's Republic of China Concerning the encouragement and Reciprocal Protection of Investments, (1998), preamble.

[116] The Agreement Between the Federative Republic of Brazil and the Federal Democratic Republic of Ethiopia on Investment Cooperation and Facilitation, (2018), The preamble and Article 14.

[117] Martin Jarrett, Contributory Fault and Investor Misconduct in Investment Arbitration, Cambridge University Press, (2020), p. 79.

[118] UNCITRAL Secretariat , Possible reform of investor-State dispute settlement (ISDS) Assessment of damages and compensation, 2021, p12, https://uncitral.un.org/sites/uncitral.un.org/files/note_by_the_secretariat_-_assessment_of_damages_and_compensation_.pdf. (Accessed on 5/25/2023.)

[119] Id.

local laws, or failure to take reasonable precautions, has contributed to the dispute or the harm suffered. Its purposes are to balance the interests of both the investor and the host state by taking into account the investor's contribution to the dispute when assessing liability and determining the appropriate remedies.

Contributory fault is punitive on foreign investors for their misconducts, and not directly imposing obligations. It indirectly requires investors to act responsibly by reducing the possible compensations for damage in final settlement of disputes. Such effects of contributory fault are typically illustrated in Copper *Mesa vs. Ecuador*.[120] In this case, the tribunal made the investor (Copper Mesa) liable together with Ecuador (host state) for inflicting violent attack on the local community.[121] Material facts of the case show that the investor has materially contributed to the occurrence of its own damages by provoking state measures. Based on the evidence and assessment of damage made, the tribunal allocated 30% of the compensation to the investor.[122]

This is an important experience worth drawing on for other states and foreign investors alike. Particularly, it encourages government authorities host states to take measures with the purpose to regulate behavior of foreign investors to the effect of supporting or, at least, restraint themselves from hampering sustainable development ends. As these moves are becoming common practices in FDI operations in many parts of the world, foreign investors are coming under global pressure to observe laws of the host state. Such growing

[120] Copper Mesa Mining Corporation v. Republic of Ecuador (PCA Case No. 2012-2), March 2016.

[121] _______________when arbitrators reward mining corporations' human rights abuses Copper Mesa Vs Ecuador available at https://10isdsstories.org/wp-content/uploads/2019/06/Copper-Mesa-vs-Ecuador.pdf. (accessed on 10/05/2023).

[122] Id.

norms could give the host state legitimate grounds to take regulatory measures even in situations where such obligation is not expressly stated in bilateral treaties regarding a specific investment in question.[123]This by implication means that foreign investors are expected, as a matter of norm, to refrain from misconduct that prejudices host state interests which includes sustainable development ends. As evidence of recognizing it as a norm, usually host states use it as a defense when they are alleged for violation of Full Equitable Treatment standards and Indirect Expropriations.

The notion of contributory fault is also based on Article 39 of Responsibility of States for Internationally Wrongful Acts, which states that '[i]n the determination of reparation, account shall be taken of the contribution to the injury by willful or negligent action or omission of the injured State or any person or entity concerning whom reparation is sought.'[124] The host state's persistence in taking proper measures with the end to further sustainable development and its continuous invoking of contributory fault as a defense is, therefore, imperative to further establish it as a norm. Of course, contributory fault is not directly related to upholding sustainable development. Yet it can indirectly help in aligning behaviors of foreign investors to sustainability.

As governments in many parts of the world stick to such norms, investors may become more cautious and diligent in assessing risks associated with their investment decisions. They may consider the potential for contributory fault and evaluate their own actions or decisions that could contribute to

[123]Judith Gill and Rishab Gupta, The Principle of Contributory Fault after Yukos, Dispute Resolution International, Vol. 9: No.2, (2015), p.93.; Jean-Michel Marcoux and Andrea K. Bjorklund, Foreign Investors' Responsibilities and Contributory Fault in Investment Arbitration, International and Comparative Law QuArterly, Vol.69, (2020), p. 879.

[124] General Assembly resolution 56/83, Responsibility of States for Internationally Wrongful Acts 2001, A/56/49(Vol. I)/Corr.4. Art 39 https://www.ilsa.org/Jessup/Jessup11/basicmats/StateResponsibility.pdf (accessed 10/12/2023).

negative outcomes. Investors may adopt a more conservative approach in their decision-making process where they understand that the host state may invoke contributory fault as a defense. Availability of such defense can also encourage host state to take corrective measures on sustainable development non-compliance by foreign investors.

Concluding Remarks

Ethiopia as least developed state has a strong desire for FDI and to make the most out it. The country should prepare well designed regulatory frameworks not only to obtain optimal benefits but also to minimize negative effects on sustainability. This paper, while illustrated the imperative need for tailoring FDI activities and operations to ends of sustainable development, it explored the available mechanisms to attain such goals in this country. Among others, it suggested that the responsibility for sustainable development be shared between host states and foreign investors. The governance of international foreign investment is currently undergoing a gradual evolution towards embracing varying legitimate public interests together with investment protection. Such changes could give opportunities to Ethiopia so that it can adjust its regulatory frameworks with sustainable development ends.

By comprehending and drawing on the current FDI governance practices, we can identify platforms that allow least developed countries, like Ethiopia, to align their FDI regulations with sustainability objectives. The global consensus on the promotion and endorsement of sustainable development agenda presents a favorable opportunity in this regard. Aligning FDI regulatory frameworks with this globally valued objective can serve as a

means to address and legitimize the ongoing legitimacy crisis within the international investment regime.

Though Ethiopia has little opportunity to influence nature and contents of BITs as a result of its weak bargaining power and its strong desire to foreign capital, the global backlash against the international FDI regime and the resulting reform desire would supply some enabling opportunity if it is taped properly. Taping this opportunity, among other things, includes initiating renegotiation of investment treaties with treaty partners that may wish to make changes resulting from changing global investment landscape. In this process Ethiopia should demand to inculcate provisions that promote sustainable development friendliness.

Alternatively, Ethiopia could focus on acting in the existing playing field together with the push to reforming the international investment treaty regime. While treaty reform holds its own merits, it is equally important to make silent adjustments without impairing its economic diplomacy. This paper has outlined opportunities or avenues for making subtle adjustments in the FDI regulation process without necessarily employing transformative actions that may be beyond the capabilities of Ethiopia. These strategies, which involve varying moves, can be exercised within the existing international legal frameworks as way to (1) protect national interest and (2) to further create state practice which is essential constituent element for international custom.

Taxation of Islamic Finance (IF) and Its Exposure to Tax Costs under Ethiopian Tax Law

Kassim Kuffa Jarra[ϒ]

Abstract

The uncertainty of the rule applicable for the taxation of Islamic finance (IF) causes vulnerability to cumbersome tax cost or tax avoidance risks. Stakeholders blame Ethiopian tax law for the differential tax treatment of IF and conventional bank (CB), exposing beneficiaries of IF to intermediary taxes (twice stamp duty - on purchase and resale) in trade intermediation services, triple in sharia compliant bond (sukuk), and denial of the deduction of financial costs. An article aims to examine the tax treatment of IF returns, intermediary activity, exemption and the deductibility of financing costs for IF. It has utilized a doctrinal research design which is limited to the analysis of law, secondary sources and some primary data. Specifically, it uses a comparative qualitative approach drawing lessons from Malaysian, the UK and SA because such jurisdictions have experience regarding tax treatment of IF transactions. The finding indicates that the Ethiopian tax law is silent on deductible IF costs, intermediary activities and whether or not IF returns are subject to corporate income, dividend and interest income taxes. The 2016 tax law allows deduction of interest cost for CB loans and denies deduction of equity finance costs (dividend) exposing IF for cumbersome costs. Thus, the silence of tax law, lack of a playing tax field for IF and CB and the law's denial of deduction denial to IF expose latter to higher costs and unsustainability. Thus, the Ethiopian tax law needs to be revisited in light of the equal tax treatment of IF and CB.

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Key words: Islamic finance taxation; cumbersome costs; intermediary activity; deduction; parity; Ethiopian tax law

Introduction

IF is non-interest funding, investment and trade centered mobilization and provision of financial resource with consideration that encompasses (a) trade intermediation like *murabaha* (cost plus profit or sale of goods at spot delivery with deferred payment), *ijara* (financial lease that combines financier's and client's joint purchase and ownership, financing, lease of right and hire purchase), forward sale (spot payment with deferred delivery), (b) partnership bank involving mudarabah (loss bearing and profit sharing equity) and *musharaka*h (profit and loss sharing partnership); (c) Islamic security (*sukuk*) market, and (d) *sharia* compliant insurance that involves mudarabah, agency investment and combination of investment, trade and financing with the prohibition of interest, uncertainties, exploitation and other prohibited behaviors that harm humans.[1]

Although IF is broader, it is interchangeably used with Islamic bank (IB) which refers to a *sharia* law compliant intermediation approach whereby an entity mobilizes depositors' fund as an intermediator similar to CBs. However, it has the distinction that IFB (a) shares profits, risks and loss with the depositors' along with removal of interest, uncertainties and other injustices and (b) sale varieties (*murabaha*, *ijara*) deliver asset to customers instead of cash and financier bears risk.[2] An Islamic IFB is the financial intermediation that conducts usuary-free and *shari'ah* compliant banking

[1]M. Kabir Hassan and Mervyn K. Lewis, Handbook of Islamic Banking, Edward Elgar Publishing Limited, (2007), p. 277.

[2]Munawar Iqbal and Philip Molyneux, Thirty Years of Islamic Banking: History, Performance and Prospects, First Edition, Palgrave Macmillan, (2005), p.36.

business services involving capital and labor partnership for profit and loss sharing and trade intermediation.[3] Paradoxically, CBs intermediates surplus deposits of lenders and shortages of borrowers through trading in debt that involves interest, transfers of cash and risk from lender to borrower in a loan contract relation with the borrower's commitment to repay principal and interest.[4]

In both CB and IF, the taxpayers' profit and state tax motives contradict. The inherent natures (real activities of merchandise, investment, joint acquisition of asset to lease usufruct and sale residue) of IF lead to two potential problems. First, IF's incomes likely escape tax (non-taxability of products for religious character of services or subject to lower taxation (non-intermediary activities like gain from sale and lease of asset escape tax) because of the way one characterizes return and costs to claim better tax reliefs.[5] Second problem is IF's exposure to excessive property transfer, capital gain tax costs, denial of loss and business costs deductions due to compliance with religious requirements of performing the real activities, series of financier participation in investment and merchandise of commodities.[6]While tax escaping creates revenue loss, extra taxation makes IF more expensive than CB loans due to

[3]Rafeeq Yunus Al-Masri, Islamic Jurisprudence of Financial Transactions, Islamic Economics Institute, King Abdul-Aziz University (2001), p.290.

[4]Larisa Dragomir, European Prudential Banking Regulation and Supervision: The legal dimension, First edition, Routledge (2010), p.30.

[5]IFB incomes that escape taxation include murabaha discounted interest loan fringe benefit - a house finance provided by commercial bank of Ethiopia to an employee when the markup rate (only 7%) under the finance is less than the market lending rate under Art. 8 and 12 of Income Tax Regulation 410/2017. Financier's charging of only 7% markup profit amounts to typical tax avoidance, difficulty of distinguishing recovery of *ijara*-capital goods lease cost and income.

[6]Interview with Teshome Ragasa, Legal Officer of Awash Bank SC (March 30, 2024) and Yahia Abdulrahman, The Art of Islamic Banking and Finance: Tools and Techniques for Community-Based Banking, John Wiley & Sons, Inc., New Jersey, (2010), p.57-58.

costs to its consumers, depositors and financiers.[7] Such cost causes a reduction in the IFB's investors profits and diversion of IFB users to CB where transaction costs are lower.[8]Such unfavorable and costly tax treatment may result in a reduction of IFB competitiveness losing customers for CB.[9]Further, non-diverting religiously sensitive IFB beneficiaries are exposed to high tax costs.[10]Tax costs perpetuate less financial inclusion, reviving the legacy of financial marginalization due to the lack of alternative IF in Ethiopia.[11]Thus, both under taxation and over taxation of IF breach the principles of equity, certainty, neutrality and convenience of taxation.

Nations diverge on the tax treatment of corporations', individuals',, transactions', investments and trading gains and respective costs. The Malaysia, the UK and SA have IF suitable tax rules for IF , ensuring parity treatment with CB, relief on the deductibility of costs, exemption of intermediary transactions and returns equivalent to interest.[12]

Ethiopia's IFB window services (since 2008) and four banks (zamzam, Hijra, Shebale and Rammis) have introduced stand alone IFB since 2018. But state's legal uncertainties, silence and non-responsiveness to IF expose the

[7]Syeda Fahmida Habib, Fundamentals of Islamic Finance and Banking, John Wiley & Sons Ltd, (2018), p. 88.

[8]Interview with Semir Teka, Director of Legal DepArtment of Zamam Bank SC (March 30, 2024).

[9]Ragasa, *supra* note 5.

[10]Mohammad Tembu, Legal Affairs Director at Hijra Bank SC (August 26, 2023).

[11]Semir Teka *supra* note 8 and Abdu director of Islamic finance at Maxbridge Education Development Share Company (2022).

[12]Ercanbrack, Jonathan G, The Law of Islamic Finance in the United Kingdom: Legal Pluralism and Financial Competition, School of Oriental and African studies, (2011), p.264.

sector to prohibitive tax costs, making IF less favorable than CB.[13]IFB stakeholders complain about 'tax, lack of specific rules and other legal barriers as the impediments inhibiting them from diversifying the IF transactions.'[14]The existing tax legal framework remains uncertain, unclear and silent so far as Ethiopian tax laws do not fully contemplate the underlying nature of IF.[15]Such uncertainty either opens room for tax avoidance or gives the discretion to tax authority which may interpret the law to impose taxes on IF due to (a) its vulnerability to property transfer tax, stamp duty and intermediate transactions like financer's purchase of commodity for resale and the Islamic bond (special vehicle purpose-SVP) buyer who purchases commodities or instruments to get profits from deals and (b) IF's stranger character hardly known to stakeholders who are exposed to risk of multiple costly tax.

Moreover, the means of separating of capital (financier's intermediary purchase from supplier and resale to client) and the repayment which customers pay to financier each year in IFB's asset finance is unclear in determination of taxable profit. As a result, banks and savers incomes may escape tax due to rule that suits nature; or capital, transactions and incomes could be subject to extra tax in Ethiopia. Furthermore, the Ethiopian tax laws' silence on the fate of taxability or otherwise of intermediary – special purpose vehicle's (SPV) transaction is also one of the uncertainties that question sustainability of IF. An uncertainty also exists in relation to deductibility of IFB loss in profit and loss sharing scheme, markup for customers and equity

[13]Interview with Nuri Husen, Vice President at Commercial Bank of Ethiopia-CBE Noor (August 5, 2023).

[14]Mohammad Tembu, *supra* note 10 and Eristu Kemal, Head of finance and investment division, Zamzam Bank SC (July 15, 2022).

[15]Zamzam Bank, Strengthening the Legal & Regulatory Frameworks of the IFB Business in Ethiopia (2022), p.13-14.

(mudarabah investment deposit cost of finance for financiers), demarcation of taxable and non-taxable payments for IF as compared to CF.

Although IF is pressing issue for banks and affects 34% of Ethiopia population, its taxation obstacle and related costs hardly got policy makers' priority since none of policy makers address IF prohibitive tax costs.[16]Thus, tax laws' non-responsiveness to IF's unique characters, its exposure to tax costs and intermediary transactions might hinder alternative IFB, financial inclusion and competitiveness of IF than CB.[17]

The article aims to examine the tax treatment of IF under Ethiopian Law. It studies the law's suitability for the taxation of trade intermediation business, capital gain and cost deduction for IF. It also examines the taxation treatment of lease payment, deductibility or otherwise of finance cost for IF and the existence of Ethiopian tax rules that suit the inherent nature of IF.

In doing so, the article has utilized a doctrinal approach which is limited to the analysis of law, secondary sources and interview data on the taxation of IF in Ethiopia. Specifically, it uses a comparative qualitative method taking lesson from Malaysian, the UK and South Africa (SA) due to their adoption of a dual bank system similar to Ethiopia and having better experience or substantial tax laws for the taxation of IF system. The study has confined to intermediary taxes on the transfer of asset (real estate, movable property, and stamp duty), IF income taxes payable by bodies and individuals for IFB sales, Islamic bond incomes and respective deductible costs compared to counter transactions in CB income. Article excludes VAT, TOT and transnational business tax because such taxes are eligibility for tax exemption and to avoid

[16]Interview with Ali Idris Ministry of Finance Officer (April 23, 2024) and Mohammad Kadir, Ministry of Revenue officer (April 15, 2024).

[17]Zamzam Bank, *supra* note 15.

the broadness of the work This Article argues for introducing neutral tax rules applicable for the taxation of IF incomes, reliefs of costs and intermediary activities to eliminate both costly tax impediment and non-taxation of IF incomes.

1. Nature of IF and Intermediation Taxation Foundations

1.1. Nature of IF

Islamic finance (IF) is the provision of non-interest bank, commodity backed intermediation, acquisition of fund for personal, joint project by two financiers, entrepreneurs and financiers for the production and distribution of goods or services to share profits and losses according to *sharia* principles.[18]It involves asset merchandise, leasing usufruct and investment intermediary partnership banking that subject to *sharia* commercial principles.[19]IF also entails *sharia* compliant capital market, microfinance service, insurance system, and IFB transactions whereby return free, commercial (financier engagement in asset merchandise disclosing cost of acquisition and profit), agency investment on behalf of owners or depositors for return and profit-and-loss sharing principles which are the base for financial asset mobilization and allocation among depositors, investors and entrepreneurs.[20] The profit and loss sharing models involve mudaraba (trust financing where only one partner provides the capital, and *musharaka* (partnership finance where both partners contribute the capital).[21]Thus, IF encompasses trade intermediation,

[18]M. Kabir Hassan and Mervyn K. Lewis *supra* note 1.

[19]Hassan and Lewis, *supra*note 1, Iqbal and Molyneux, *supra* note 2, and Abdulrahman *supra* note 5.

[20]Hatem Elliesie, Approaches to Islamic Financing and Banking: Between Islamic Legal Theory and Economic Practice, 20 Y.B. Islamic & Middle E. L. 204 (2018-2019). p.210.

[21]Id.

partnership of capital and work, investment agency, mixture of trade and investment, asset lease and finance characters unlike CB loans.[22]

IF has several inherent characteristics that establish *sharia* compliance. First, it centers on the inseparability of the bank's financial asset and real commodity or service acquisition by customers - all financial transactions are representative of real transactions.[23]Second, it centers on the prohibition of (interest, injustice, exploitation, risk transfer to borrower) and the permissibility of trade and investment as bank business which enables the bank to engage in (a) merchandise of assets and services for profit and (b) investment in real economy participating in equity ownership and profit and loss sharing.[24]Third, it relies on the inseparability IF business from sharing return, risk, effort and contribution.[25]Fourth it promotes the bank's inseparability from morality (utmost good faith of management, disclosure of acquisition cost and profits), benefits of the community (restriction of financing to permissible domains, useful projects) and compliance with the standards of *sharia*.[26]Thus, IF is mainly characterized by recognition of *sharia* compliant trade (asset purchase and resale at a disclosed price on credit sale) and investment for sharing contribution, effort, profit and risk as a bank. Such inherent natures of IF necessitate additional *sharia* requirements-intermediary activities which expose IF to extra tax costs.

1.2. Foundations of Intermediation Taxation

1.2.1. Feature of Good Tax System

[22]Munawar Iqbal and Philip Molyneux, *supra* note 2.
[23]M. Kabir Hassan and Mervyn K. Lewis, *supra* note 1 p, 279.
[24]Zamir Iqbal and Abbas Mirakhor, Introduction to Islamic Finance: Theory and Practice, (2nd Edition John Wiley & Sons Pte. Ltd 2011), p.158-161.
[25]Muhammad Ayub, Islamic Finance, (John Wiley & Sons Ltd 2007), p. 81.
[26] M. Kabir Hassan and Mervyn K. Lewis, *supra* note 1, p.84.

The good tax system is characterized by the following fundamental features which are significant for IF business too. First is sufficiency of revenue generation for financing public services.[27]Second is fair allocation of tax burden between persons, income and transactions consistent with norms of fairness (correlation of tax burden with benefits of a taxpayer and ability to pay).[28]Third is tax revenue's utilization only for lawful public purposes and welfare of taxpayers.[29] A Good tax system also entails simplicity (clarity and lower tax costs), convenient, certainty of rules applicable to payers, reasonable exemptions, non-taxation of capital, neutrality to economic activity and avoidance of double tax.[30]

A tax system is good for the financial system if it meets three main criteria. The first requirement is the minimization of tax distortions (tax law does not affect credit, deposit, business, investment in activity or operator via disintermediation).[31] The second requirement is tax system's equity for the rectification of distortions resulting from cost deduction or its denial, imperfect and asymmetric information and uniformity of allowance and exemptions for incomes.[32]Third, its neutrality to (a) capital inflow and outflow has the same standards for the treatment of onshore and offshore financial intermediaries – elimination of different marginal costs between different jurisdictions and (b) residents, non-residents, transactions, income

[27]OECD, Addressing the Tax Challenges of the Digital Economy, (2014).
[28]Taddese Lencho, The Ethiopian Income Tax System: Policy, Design and Practice, PhD Dissertation Tuscalosa, Alabama, (2014), p.131.
[29]Id.
[30]Hossein Askari Zamir, etal, Introduction to Islamic Economics Theory and Application, John Wiley & Sons Singapore Pte. Ltd, (2015), p.135.
[31]Matt Grudnoff, Principles of a Good Tax Evaluating our Taxation Choices, Australian Institute (2021), p.6-8 available at https://australiainstitute.org.au/wp-content/uploads/2021/07/Principles-of-a-good-tax.
[32]Freudenberg Brett and Nathie Mahmood, infra note 57, p.16.

and gains of depositors and businesses and expenses deduction ensuring neither item escapes the tax nor is subject to higher or lower tax.[33]

States have several approaches regarding the fiscal treatment of financial intermediation. The first is the tax law imposition of express taxes similar to real economy (finance subjection to income and withholding tax when receiving of paying interest or dividends, taxation of transfer of property) prioritizing revenue over other considerations.[34] Intermediary taxation involves deduction of expenses and loss plus exemption from sales taxes on account of: avoiding distortion of taxing intermediary characterization of financial activity, existence of technical difficulties in distinguishing costs and profits or pricing the service charges in intermediation and denial of costs deductions.[35]

The third is imposition of reserve requirements like a certain fraction of banks' deposits or capital in the form of liquid reserves in cash and designated government securities which are sold to banks or financial intermediaries who earn taxable interest via lending to state to enhance financial position of central bank – government.[36]Fourth, the government diverts fund of intermediaries' to public strategic sectors and borrowers who use it for manufacturing via interest rate regulations, incentives and subsidies functional to the intermediary deposit mobilized to allocate financial asset to the prioritized real economic sectors.[37]

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[33]The International Bank for Reconstruction and Development (IBRD), Taxation of Financial Intermediation Theory and Practice for Emerging Economies, The World Bank 1818 H Street, NW (2003), p.6.
[34]Id, p.6-7.
[35]Id and Taddese Lencho, *supra* note 28.
[36]Id and Matt Grudnoff, *supra* note 31.
[37]Id, p.6, and Matt Grudnoff, *supra* note 31.

The financial sector's income taxability, exemption and deductibility of its cost rely on considerations including sector's vulnerability for tax arbitrage, exemption of difficult incomes and intermediary transactions.[38] However, it is not clear whether Ethiopian tax law is (a) friendly to IF which allows taxation of capital and deductibility of almsgiving cost, (b) neutral to IFB's character of trading and investment and CB's loan, and (c) suitable to eliminate double stamp duty and asset transfer tax imposition on intermediary activity.

1.2.2. The Principles of Taxing Financial Intermediary

There are different principles that guide the legislations on the taxation of financial intermediation. First, ability-to-pay principle correlates incomes and equitable distribution of the tax burden across individuals, firms and activities.[39]It permits deduction of costs and allowance of exemption for essential services.[40] Second, economic efficiency principle entails maximum tax benefits with lower tax costs and distortion in allocation of tax burden.[41]Third, principle of neutrality encompasses tax law impartiality and equal application to transactions and income.[42]

Fourth, taxation centers on the principle of legality (representation for making tax law, firm legal basis for tax law making and administration, non-delegation of tax law making and its restricted and doubtful interpretation in

[38]Id, p.7-50, Freudenberg Brett and Nathie Mahmood, infra note 57, p.16.
[39]Brian J. Arnold, International Tax Primer, Kluwer Law International BV, The Netherlands (2016) p.1-10.
[40]Federal Income Tax Proclamation (FITP) Number 979/2016, Federal *Negarit* Gazetta, (2016), Article 9; Income Tax Regulation 410/2017 (ITR), Federal *Negarit* Gazetta, Art.27 and FITP Deductible Expenses Directive No. 5/2018.
[41]FITP Art.7 and Patrick Honohan, Taxation of Financial Intermediation: Theory and Practice for Emerging Economies, The World Bank, (2003), p.57.
[42]Matt Grudnoff, *supra* note 31, p.6-7.

favor of the taxpayer.[43] Sixth is the prohibition of unfair advantage in tax administration and its law application by partial court.[44]Adam Smith's principles of taxation are summarized as (a) equality - tax payments should be proportional to income and applied equally to all concerned areas; (b) certainty- tax liabilities should be clear and certainly known; (c) convenience of payment - taxes should be collected at a time and in a manner convenient for taxpayer and (d) economy-taxes should not be expensive to collect and should not discourage business.[45]

The Article argues for neutral tax treatment of CB and IF i.e. both subjection to similar tax rate, rules, allowance of cost and loss deduction principles which intend to restrain state taxing power.

1.2.3. The Considerations for Parity and Differential Tax Treatment of IF and CB

The argument for equal or differential tax treatment has several conceptual considerations. Primarily, Economic Substance Doctrine (ESD) holds that tax law (a) requires the transactions under question must have economic essence (feature) separate and distinct from economic benefit achieved solely by tax reduction for getting differential tax treatment; (b) allows the legislature to ignore disguised formality divergence of transaction and rely merely on inherent nature of the transaction for attribution of tax to activity or

[43]Victor Thuronyi, Tax Law Design and Drafting, volume 1; International Monetary Fund: Chapter 2, Legal Framework for Taxation, (1996), p.1-56 and Kassim Kufa, Nexus of Sustainable Development and Tax Laws and Policies under Ethiopian Tax System, The International Journal of Business & Management (ISSN 2321–8916) Vol.5 Issue 10 (2017), p.4.

[44]Id.

[45]Emile Woolf International, Principles of Taxation, The Institute of ChArtered Accountants of Pakistan (2016), p.5.

income.[46]ESD is concept that permits the taxing authorities to disregard the tax consequences of an arrangement, transaction or series of IFB transactions (sales) that nominally meets the tax code requirements due to non-satisfaction of actual economic activity's character.[47]

In other words, the transaction sufficiently satisfies the ESD and acquires similar tax benefits (deduction of costs, recognition of loss as expenses and claim for tax exemptions) only if the taxpayer proves that (a) the transaction transforms the taxpayer's economic position significantly other than tax reduction, and/or (b) taxpayer's substantial non-tax economic purpose for entering into such transaction.[48]Contrary to this, the disguised and distortive transaction with mere tax avoidance and deceptive business motives lack elements of ESD and result in denial of tax benefits: lower tax rates, exemptions, expenses and loss deductions.

The essence of ESD is that existence or absence of substantially similar transactions; change in economic position of tax payer and non-tax avoidance goal of taxpayer determine the eligibility for application of the same or differential tax law reliefs: exemption, tax cost and loss deduction advantages for CB and IF. Thus, ESD has two implications: capability of recognizing similar or differential tax treatment for income or activity that satisfies ESD and denying tax benefits to disguised transactions, understatement of profits and overstatement of expenses of taxation.

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[46]Thabo Legwaila, The Substance Over Form Doctrine in Taxation: The Application of the Doctrine after the Judgment in Commissioner for the South African Revenue Service v NWK Ltd, SA Mercantile Law Journal Vol. 28, No.1, (2016), Tareq Moqbel, The UK Islamic Finance Taxation Framework and the Substance v Form Debate in Islamic Finance, 18 LEGAL Ethics 84 (2015).

[47]Bruce Fort. *Et al*, State Economic Substance Doctrine: The Role of the Economic Substance Doctrine in State Business Tax Compliance, Multistate Tax Commission, (2019).

[48]Id.

Secondly, the legal form of the transaction determines the tax treatment of income, activity and deductibility or otherwise of costs of business. It holds that the form of the transaction has to be taken into account to determine the tax treatment of transactions i.e. legal arrangement (artificial form of structure) is prioritized over economic substance to decide tax treatment of activity.[49] Hence, different tax law treatment should be provided for financial transactions with diverging form despite the similarity of economic substance and its harms for taxpayers. This has limitation of breaching the principle of equity and creates room for tax arbitrages.

The third consideration is the business purpose doctrine which entails a subjective parameter to know whether the taxpayer has a vital autonomous non-tax avoidance objective to get tax benefits of transactions.[50] Although this supplements ESD, it has drawbacks of distinguishing motives of the taxpayer.

From these considerations the EDS is preferred for its compatibility with the principle of equality, equity and neutrality that promote charging equals equally and unequals unequally with neutral tax law that applies the principle of substantive and procedural equity that suggests similar and differential tax treatment of IF and CB transactions and incomes based on the rule of reason. IF satisfies the ESD to be eligible to get similar tax law treatment or benefits provided to CB loans and certain differential treatments that suits its nature.[51]

But use of legal form of transactions (sale, lease, investment) impose more tax on IF and result in different outcomes leading to violation of the principle of

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[49]Id.

[50]Thabo Legwaila, *supra* note 46 and Jonathan G, *supra* note 7.

[51]Jonathan G *supra* note 7 and Qatar Financial Center (QFC), Cross border taxation of IF in MENA region (2013).

equity due to application different tax laws for CB and IF forms.[52]This contradicts the equity principle that provides equal tax treatment of equals and unequal treatment of different persons and transactions.[53]Thus, non-EDS approach opens the room for more favorable treatment of CB and less treatment for IFB of finance despite similarity of activity.

1.2.4. Rationale for IF Vulnerability to Cumbersome Tax Costs

The inherent nature of IF including: the commodity sale, investment, right ownership and its trade intermediary required for *sharia* compliance of IF expose it to costly taxes.[54] The double transfer of assets creates double intermediary asset transfer taxes (on purchase and resale), increasing costs and reducing the competitiveness of IF.[55] This arises from the difficulty of: (a) separation of taxable incomes and supplementary activity (underlying intermediary transaction), (b) characterization of IFB trade related return and corporate income under schedular Ethiopian income tax system, (c) distinguishing tax free capital and taxable: capital gain, lease rent, mark up in lease finance, etc. which create IF's vulnerability to costly tax.[56]Besides, the involvement of IF's intermediation activities and associated costs incurred for ensuring *sharia* compliance of IF create concerns of taxing such activities by tax authorities which may refuse deductibility of such costs to IF.[57]

[52]Bruce Fort, *supra* note 47.

[53]Nicholas Jessop, Taxation of Islamic Finance in the UK: An Introduction, 8 J. TAX'n FIN. Products 17 (2009).

[54]Jonathan G *supra* note 7.

[55]Maria Bhatti, Taxation Treatment of Islamic Finance Products in Australia, 20 DEAKIN L. REV. 263 (2015).

[56]Id.

[57]Freudenberg Brett and Nathie Mahmood, The Constitution and Islam: Are Tax Reforms Possible to Facilitate Islamic Finance?, Revenue Law Journal: Vol. 20 : Iss. 1 , Article 5 (2011) http://epublications.bond.edu.au/rlj/vol20/iss1/5 (accessed February 25, 2024).

Furthermore, IF is exposed to legal risk of regarding the rule for the recognition of loss and its deductibility as cost by tax law due to its subjection to the principle of loss sharing.[58]These pose challenges to tax law to handle tax issues related to IF. Ethiopian IF sector is not immune from these inherent vulnerabilities of IF's transactions to cumbersome taxes and the challenges they pose to tax law. As a remedy the nations exercise taxing powers to adapt IF friendly tax rule for reducing transaction costs for IF via (a) extension of tax rules applicable to CF on taxation of (income, interest, etc); deduction of expenses and losses; (b) designing special rules for disregarding underlying – intermediary transactions of IF that produce costly tax; (c) the rule for separation of recovery of non-taxable capital and taxable gains in IF products to prevent less competitiveness of IF.[59]

Ethiopia also needs to reform its tax law for accommodation of IF for a several reasons. Primarily, Ethiopia needs to achieve national economic growth – benefits (foreign capital, jobs, innovation, prevention of tax revenue loss, product diversification and choice) which benefits not only Muslims but also all society from 200 billion business since IF would finance housing, education, business, health, unemployment, etc. of market, individuals and companies via alternative finance.[60]The failure to reform tax law amounts to the denial of access to good financial services and results in diversion of foreign IF asset and services to other IF friendly taxing jurisdictions.[61] Beside this, an inclusion of residents who neither invest asset in CB nor consume its services necessitates tax law change.

[58]Maria Bhatti, *supra* note 55.
[59]Id and Freudenberg Brett and Nathie Mahmood, *supra* note 57, p.34.
[60]Id, Zamzam Bank *supra* note 5 and Nuri Husen *supra* note 13.
[61]Freudenberg Brett and Nathie Mahmood, *supra* note 57, p.35.

The right to choice and the legality of any form of finance (including IF) from whatever ideology requires reforming every institution, practice and policy including tax law that imposes cumbersome tax costs on IF for ensuring compatibility of new bank's approach allowing IF and pre-existing tax rules which should correct defects and uncertainties on taxing IF.[62] The tax law reform for removing impediment to IFB is consistent with 1995 FDRE constitution that promotes financial inclusion and citizens' equality to financial rights irrespective of their ideology.

The second reason is to create the equitable working environment for CB (debt finance) and IF (equity finance and trade intermediation) alternative services compatible with constitutional principle of facilitating equal economic opportunity and the systems for all including favorable tax facilitating fair share.[63] The achievement of neutrality, non-discriminatory and equitable economic outcomes for IF and CB transactions and participants in tax is other reason.

Thirdly, tax law neutrality to IF has regulatory (revenue administration procedural and substantive consistency) and political (legislative consent for imposition of tax or relieving IF from tax) considerations - incorporation of ideologies, religions and faiths of different groups and peoples in law including taxation cost because tax law should not differentiate different religious groups and their business financing.[64]

Fourthly, more diversification of IF services ranging from *murabaha* (cost plus markup), lease, forward sale, manufacturing, partnership and *sukuk*

[62]Halefom Awet, Interest-Free Banking and Taxation in Ethiopia: A Critical Analysis, Jimma University Journal of Law 11, 2019, pp. 32-54.
[63]Robert W. McGee, The Philosophy of Taxation and Public Finance, Kluwer Academic Publishers (2004), p.15-32.
[64]Id, p.263.

investment finances and respective incomes require tax reform that clarifies uncertainty remained on rule of their taxation. Below article examines approaches to avoid costly taxes against IF.

2. Selected Jurisdictions' Tax Treatment of IF

Two approaches exist to tax IF. These encompass non-modified use of tax legislation applicable for CB for IFB transactions such as trade related services (the same law applies for taxing all residents and transactions)[65] and accommodative revision of tax law for difficult IF services like Islamic bond transactions (introducing special tax rule that suit nature of IF).[66]

2.1. United Kingdom (UK)

a/ Level Playing Field for IF and CF

In the UK the same tax law applies for taxing (a) all residents and bank services (b) individuals and companies with the freedom of forming any *sharia* compliant or otherwise finance institutions without contradicting UK law.[67]UK tax law adopts (a) the principle of tax neutrality - equal treatment of CB and IF (b) detail abstract principles in legislation entailing religiously neutral expressions like 'alternative banking, financial instruments, investment bonds and financial arrangement clauses instead of *Arabic* terms in various Taxation Acts; (c) a universalistic approach to the law which focuses on the equal legal treatment of residents' capital or business for refraining from taking legislative positions on identity driven bank model; (d)

[65]Abdul Karim Aldohni, The Legal and Regulatory Aspects of Islamic Banking A comparative look at the United Kingdom and Malaysia, Routledge, (2011), p.108-111.
[66]Irish Tax and Customs, Tax Treatment of Islamic Financial Transactions, (2022), p 30-31.
[67]Id.

elimination of differential treatment of debt and equity finance model to create level playing field that prevents IFB's competitive position distortion by partial tax rules.[68]Thus, UK law provides equal tax treatment to IF and CB without express recognition of Islamic commercial principles and defining of IF words in tax laws because the definition of transaction is entirely free standing and same tax treatment is provided to any transactions (including IF).[69]

Two statutes incorporate the neutrality of tax rules by defining finance arrangement eligible for tax benefit without connecting to *Sharia* compliance. Primarily, UK Corporation Tax Act (CTA) 2009 Sec.503 defines trade related IF including *murabaha* using neutral terminology including (a) purchase and resale arrangements (b) first purchaser and second purchaser which either of them or both should be financial institutions, (c) first purchaser buys asset as financial institution for the purpose of intermediation and immediately sells it to second purchaser; (d) entire or part of payment of second sale deferred for period after sale, (e) the second purchase price exceeds the first purchase price, (f) excess or difference of two purchases equates, in substance to the return on an investment of money at interest in CB. UK's law disregards financier's purchase while the difference between the sale price and purchase is treated as interest for tax purpose.[70] This establishes any IF markup is taxable as interest.

With abstract non-Islamic terms, section 507 of UK's CTA of 2009 introduces investment bond arrangements (*sukuk*) that (a) provide for one person (bond holder or investor in *sukuk*) to pay some capital to another

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[68]Jonathan G., *supra* note 7, p.108-111 and Shah M. Nizami, 'Islamic Finance: 'The United Kingdom's Drive to Become the Global Islamic Finance Hub'.

[69]Id.

[70]Id and QFC *supra* note 51, p.54-56, s503 to 508 UK Corporate Tax Act (2009).

person (bond issuer or Special Purpose Vehicle (SPV)) which issues *sukuk*); (b) identify assets or a class of assets (bond's asset or rights) which bond issuer would acquire before or after arrangement from third party for the purpose of generating gains directly or indirectly; (c) specify the tenure - when bond term ceases to have effect; (d) impose obligation on bond issuer to undertake: disposal (sale) of bond's all assets in its possession at the end of bond term, repayment of capital (subject to reduction of bond's asset price falls) to bond holder during or after tenure at installment or lump sum, conducting of additional profits (which do not exceed reasonable commercial return on a loan of capital) to bond holder in one or several installment during or after tenure, arranging management or disposal of bond's asset or rights to gain sufficient income for redemption of capital (capable to be satisfied by recovery or issue or transfer of share or other securities) and additional payments, entire or partial financial liability for arrangement; (e) permit bond holder to transfer rights to new investor or to terminate it; (f) require arrangement existence as listed security in recognized stock exchange. The Law also imposes determination of the additional payment amount at the beginning of the term in reference to value or income generated by bond assets or other methods.[71]

Similar or equal tax treatment of IF and CF by tax law extends to 'the returns paid to the debt like Islamic bond's return taxation if that investment return were interest on a debt security, and the deductibility of such cost in the determination of corporate tax.[72]Moreover, the law allows *sukuk* holders to benefit from stamp duty relief on transfer as the Finance Act 2009 states that

[71]QFC, *supra* note 51, p.54-56.

[72]Edana Richardson, 'The Accommodation of Islamic Finance in Ireland's Financial Legislation: A Comparative Study of Wholesale Islamic Financial Products' (2011) 34 Dublin U LJ 127.

stamp duty shall not be chargeable on the issue, transfer or redemption of an investment certificate or *sukuk* certificates alike that of conventional bonds. The UK's CTA provides the transaction for sale of property from owner or supplier to the SPV and from the SPV back to the owner is disregarded for the purpose of property transfer tax, stamp duties land tax and capital allowances (depreciation).[73]

b. Taxation of Debt and Equity Finances and Exemption of Intermediary Transaction

Debt finance involves a loan relation between lender and borrower against interest and asset merchandise on credit sales (cost plus profit and lease) basis for return while equity finance covers *mudarabaha* and *musharakah* investors' expenditure of capital in purchasing ownership interest in business or provision of finance by owner for sharing profits and losses with the recipient of capital.

The tax law's (a) permission of deductible costs' of CB interest and (b) uncertainty, silence or denial of IF costs (mudarabah investment and trade related services (*murabaha* and lease) profits) deduction are primary barriers that increase IF vulnerabilities to cumbersome tax costs.[74]The UK's remedy for problems (a) and (b) is equal tax treatment of CB interest income and IF return that eliminate differentiation of CB debt finance and IF models of banking.[75]The tax impediment of dividend profit distribution taxation for mudarabah depositors and denial of its cost deduction under s209 (2) (iii) of 1988 ICTA is remedied by the exclusion of the *muḍarabah* from dividend

[73]Id.

[74]QFC, *supra* note 51, p.54-56 and Freudenberg Brett and Nathie Mahmood, *supra* note 57, p.16.

[75]QFC, *supra* note 51, p.54-56.

tax. UK's tax Act introduces for tax purpose the *muḍarabah* is treated as a loan relationship to treat return if it were interest gain contrary to its investment substantive character.[76]The mudarabah investment account and equity finance return acquires tax benefits (return subjection to interest income exemption or lower tax rate equivalent to CB interest) of credit sale IFB debt finance because *mudaraba*, agency investment and *murabaha* returns are recognized as interest payable on loan and subjects to the same tax treatment eliminating less favorable tax treatment of IFB resource mobilization, allocation and more favorable tax treatment of CB savers.[77]

Parity treatment of CB interest income and IF return taxation also extends to similar taxation of markup of *murabaha* commodity in Islamic interbank commodity market and interest security market on account of s47 UK's Finance Act 2005 which introduces markup or 'alternative finance return' substantive equivalence to CB interest [78]due to the economic substance similarity of CB and IF services'.

The UK adopts a rule of reason based-on a case by case basis approach for *ijara* (hire-purchase) return taxation due to the difficulty of characterization of a lease as an operating lease and financial lease (loans).[79]Consequently, some lease finance incomes are not taxed if they were CB interest but Islamic lease finance is taxed as conventional asset lease income because (a) the re-characterization of IF lease return as CB interest will not apply to leasing arrangements used to finance the purchase of certain assets such as a house

[76]Jonathan G *supra* note 7, p.267, and Abdul Karim Aldohni, *supra* note 65, p.108-111.
[77]Shah M. Nizami, *supra*note 68, Angelo M Venardos, Current Issues in Islami Banking and Finance Resilience and Stability in the Present System, World Scientific Publishing Co. Pte. Ltd, Singapore, (2010), p.33.
[78]Maria Bhatti, *supra* note 55.
[79]Abdul Karim Aldohni, *supra* note 65, p.108-111.

and commercial assets i.e. capital goods lease tax treatment is retained for IF related to house lease finance and (b) it is not appropriate to adjust the taxation of leasing to align with loan taxing regimes as there are many commercial and legal differences between general leasing arrangements and finance lease transactions.[80]The remedy is the application of general lease tax rule for IF lease since general leases provide flexibility and tax advantages (financier exemption from income tax and deductibility of finance costs for the customer who retains withholding tax).[81]

In the other *ijara* (hire-purchase) scenario where the lessee acquires the asset at end of lease, there is a separation of lease finance income and residue sale contracts resulting in the dichotomization of payments into non-taxable recovery of capital and taxable markup which is taxed as if it were CB loan interest income using ESD for taxing income arising from markup in lease.[82]Moreover, diminishing *musharaka*h (lease to own) income is taxable as if it were CB loan interest income while it is exempted from capital gain and withholding stamp taxes.[83]However, in full or perpetual partnership financing- participatory intermediation model, profit would be taxed as dividend or corporate tax without the need to treat dividend as interest.[84]

UK develops the principle of economic substance (factual reality) similarity of transactions (equivalent nature, purpose, function and effect) rather than the legal form (structural CB attribution to cash loan with interest and IF attribution to commerce, investment and asset acquisition according to the rule) difference for establishment of equal tax treatment IFB *murabaha*,

[80]Abdul Karim Aldohni, *supra* note 65, p.108-111.
[81]Id.
[82]Id, p.109.
[83]Id, p.108-111.
[84]Jonathan G note 7, p. 267, Richardson *supra* note 72.

mudarahah investment and alternative capital market profits and CB interest.[85] While the use of similar economic substance facilitates level playing environment for IF and CB via same tax liability for both, wrong IF transactions subjection to different costly taxation due to its legal and multi-tiered contractual forms expose it to less favourable tax treatment.[86]

Alternative finance tax relief is subject to limitations like only one relief can be claimed in an effort to prevent tax avoidance and relief abuse.[87]The other limitation is not all IF incomes are taxed as if it were interest and only trade intermediation and Islamic bond or security investment should be taxed if they were CB loans interest incomes satisfying economic substance doctrine that establishes economic equivalence of CB loan interest and IF markup for taxpayers while the perpetual partnership banking model (*murabaha*h and *musharaka*h financing) should be taxed as corporate income taxes.

Secondly, the possibility of the imposition of double or multiple intermediary taxes (twice stamp duty on trade related IFB and alternative security services) arising from the inherent nature of IF makes its costs cumbersome than CB.[88]The UK's solution is level playing field treatment for every finance that involves (a) presuming IF sales as CB finance for taxation; (b) removal of the double asset or land transfer stamp duty on Islamic mortgage, *murabaha*, diminishing *musharaka*h, child trust funds, companies, trusts, charities and partnerships; (c) extension of conventional finance interest exemption to Islamic bond return and (d) IF exemption from tax on capital gains for redundant purchase and sale in intermediary activity via ignoring of

[85]Jonathan G *supra* note 7, p.265.
[86]Abdul Karim Aldohni, *supra* note 65, p.108-111 and Jonathan G *supra* note 7, p.263-264.
[87]Jonathan G, *supra* note 7, p.268.
[88]Id.

underlying transaction for ensuring similar tax treatment for IF and CB.[89] In order to avoid hire-purchase and diminishing *musharaka*h vulnerability to cumbersome stamp duty, UK entirely removed credit arrangements including *ijara*-lease for all assets that have the same characteristics as a hire purchase arrangement from stamp duty.[90]This covers recognition of profits distribution to investment account holders as finance cost deductions– similarly to deductible interest charges.

Although the UK's approach has limitations of complexity and suitability for non-Muslim majority countries where main consideration of IF is economic utility than financial inclusion of minority, Ethiopia may adapt the UK's principle of equal and neutral tax treatment to IF and CF with necessary adjustment irrespective of service compliance with *Sharia* principles adhered.

2.2. Malaysia

Malaysia adopts tax law that provides equal tax treatment for IF and CB recognizing any IF products is taxable as if it were CB loans disregarding underlying intermediary activity and SPV transactions for avoiding IF's exposure to cumbersome tax costs.[91]Its Income Tax Act of 1967 parag 2(7) provides any reference to interest in tax law shall apply, mutatis mutandis, to gains or profits received and expenses incurred, in lieu of interest, in transactions conducted in accordance with the principles of *sharia*. It entails taxability of any returns of IF as if it were CB interest and eligibility of any IF expenses to the deduction.

[89]Abdul Karim Aldohni, *supra* note 65, p.108-111.
[90]Id, p.109.
[91]QFC, *supra* note 51, p.20-54; Bhupalan Renuka, An Introduction to Islamic Finance and the Malaysian Experience (2009); and Malaysia Income Tax Act of 1967 (here after MITA) parag 2(8).

Moreover, Malaysia exempts an instrument executed pursuant to a scheme of financing for *sharia* compliance from stamp duty.[92]The act also provides any SPV and investment in Islamic security exemption from the responsibility of stamp and income taxes. Similar to equity oriented *sukuk*; other Islamic finance structures are accorded the tax neutrality treatment equating them to CF loan transactions and allow deductions, exemptions, etc of CB.[93] Similarly, all CB tax rules relating to 'interest' like withholding tax and exemptions on 'interest' will equally apply on the 'gains' or 'profit' of IF.[94]This exemption covers ten years relief for IB conducted in international currencies, income of *sukuk* and gain for local Islamic funds.[95]

Alike UK, it provides parity of tax treatment between IF services (*sukuk*, *murabaha*, mudarabah, etc) and CB services' return.[96]The law leaves out the underlying transaction so that tax neutrality can be achieved in IF transaction avoiding double stamp tax (at purchase and resale) while the mark-up element (profit) is a taxable income as if it were interest.[97]Moreover, the Art.2(8) of 1967 Malaysia ITA recognizes deductibility of financing cost for issuer of *sukuk* similar to interest deduction for loan in CF bond and non-imposition of stamp duty on the issue, transfer or redemption of a *sukuk* certificate. Subsection 2(8) ITA provides the underlying asset transaction between originator and SPV will be ignored for tax purposes.

In mudarabah and *musharaka*h, profit attracts business income tax if participants are financial institutions who can claim deduction as cost of

[92]Schedule II of The Malaysian Stamp Act (1949).
[93]QFC, *supra* note 51, p.20-54.
[94]Id.
[95]MITA and Bhupalan Renuka, *supra* note 91.
[96]Abdul Karim Aldohni, *supra* note, pp.108-111.
[97]MITA, subsection 2(8).

finance for the distribution of return to financier while partner's income does not attract firm tax.[98]The Malaysia's hire purchase and diminishing *mushakah* of financier's income and any eventual capital gain on disposal of residual asset to client may attract tax. The tax reform avoids cumbersome costs of *ijara*-lease finance via (a) disregarding underlying transactions from capital gain and stamp duty except client's capital gain; (b) taxing lease markup as if it were CB interest; (c) allowing lease markup deduction as costs of finance in determination of client's tax, and (d) making caution to ensure non-taxation of recovery of capital.[99]

2.3. South Africa (SA)

SA has tax law that provides same treatment for CB and IF disregarding intermediary transactions.[100] The SA Tax act of 2010 introduces a level playing field for CB and IF services (*murabaha*, lease and forward sales).[101]Tax reform covers (a) *shari'ah*-compliant banking products like *mudaraba, murabaha* and diminishing *musharaka* definition in income tax law (b) inclusion of *sharia* compliant arrangements accompanied by tax law parity treatment for CB and IF and (c) South Africa Reserve Bank (SARB) recognizing of any profits from IFB as its counter interest of CB and extension of CB threshold based interest exemption principle to mudarabah agreement to satisfy tax exemption presuming both mudarabah and CB saving accounts are comparable returns to investors.[102]

[98]Bhupalan Renuka, *supra* note, 91.
[99]Bhupalan Renuka, *supra* note, 91.
[100]Omar Salah and Christa Rautenbach, 'Islamic finance: A Corollary to Legal Pluralism or Legal Diversity in South Africa and the Netherlands? The Comparative and International Law Journal of Southern Africa, Vol. 48, No. 3.
[101]Id, 506.
[102]Freudenberg Brett and Nathie Mahmood, *supra* note 57, p.34.

Alike UK and Malaysia, the SA adopts the principle of substance over form as the foundation for taxing IF and CB arrangements similarly. Moreover, tax law responds to *murabaha's* - 'purchase for resale with profit' agreement whereby for tax purpose (a) the law presumes the financier - non-involvement in purchase or sale of the asset (b) law presumes client acquires asset directly from supplier for disregarding underlying transaction from sales and stamp duty; (c) regarding asset transfer duty and VAT the preceding two presumptions apply for shifting property transfer duty and VAT to customer instead of financier or bank and (d) law and SARB characterize mark up as interest to qualify for interest income tax exemption under income tax law.[103]

Furthermore, the Securities Transfer Tax Act permits *murabaha* agreement to be used by a Collective Investment Scheme in Securities (CIS) as a lender for the acquisition of securities favoring bank but the CIS is deemed not to have acquired beneficial ownership of the security under the *murabaha* agreement to eliminate tax associated with financing security in connection with *murabaha* via disregarding of the underlying transaction for security investment, thereby relieving transactions from costly intermediate tax.[104]Alike *murabaha*, the South Africa provides similar tax treatment for Islamic bonds (known as *sukuk*) and CF bond.[105]Furthermore, *Sharia'h*-compliant lease and sale contracts (comparable to conventional installment credit agreements) receive similar tax treatment to CB loan.[106]

[103]Omar Salah and Christa Rautenbach *supra* note 100, p.508-506.
[104]Freudenberg Brett and Nathie Mahmood, *supra* note 57, p.34.
[105]Omar Salah and Christa Rautenbach, *supra* note 100a, p.510-511.
[106]Id.

3. Taxation of IF Incomes under Ethiopian Tax Law

The main issues are whether or not: (a) newly introduced Ethiopian IF services are vulnerable to cumbersome tax costs – impediments covering imposition of stamp duty and capital gains on intermediary activity in trade intermediation and *Islamic* security investment); (b) legislation provides similar taxation to CB and IF transactions and allow deductibility of costs to both; (c) parity treatment of CB and IF by existing tax law breaches the *sharia* compliance that leads to IF's reputation risks; (d) applying current tax law provision without necessary changes removes cumbersome costs and (e) IF incomes rates of taxation are clear for earning, fees, markups, lease rents and return payments arising from purchase and resale agreements, rent agreements and intermediation agreements and IF corporate tax.

3.1. Accommodation of IF Products under Ethiopian Tax Law

Contrary to the principle of clarity, certainty and legality, until April 2024 Ethiopian tax law does not make any reform to remove tax obstacle to IF and the law remains uncertain whether or not IF providers intermediary activity and its customers would pay sales tax or eligible for CB loan exemptions from sale taxes.[107]Such uncertainty leads to revenue compromise or IF sector victimisation by cumbersome taxes.[108]IFBs complain legal barrier including tax obstacle regarding taxability of IF transactions *(murabaha, lease, mudarabah, musharakah),* intermediate activity and non-deductibility of IF finance costs.[109]The customers also complain the uncertainty of markup cost deduction and subjection to costly intermediary stamp duty and property

[107]Mohammad, *supra* note 16.
[108]Ali Idris, *supra* note 16.
[109]Zamzam Bank, *supra* note 15, p.15-16.

transfer taxes.[110]Thus, taxability and non-taxable alternative transaction, sales, returns and way to reduce IF's costly tax expense remain vague. [111]

The 2016 Ethiopian Income Tax Proclamation (ITP) and its subordinate laws (regulations, directives, circulars and tax rulings) do not adopt principle which eliminates cumbersome tax costs against IF.[112]Ethiopia neither introduces the UK's legislative neutrality to religious expression nor Malaysia's expressive recognition of IF. That is, none of tax legislations (ITP No.979/2016, tax administration code Pro.No.983/2016 and their respective subordinate legislations) entail rule for taxing income (a) alternative finance like profit sharing agency to CB, (b) trade based finance products like *murabaha*, *ijara*, *istisna, salam*; (c) equity related bank products like mudarabah and *musharaka*h and (d) taxable IF incomes including markup, profits, returns, management fees, etc arising from trade intermediation and investment finance.[113] The meaning of dividend in Art.2 (6) and interest in Art.2 (16) of ITP No.979/2016 remain silent regarding the applicability of CB loans cost deduction rule for investment partnership returns and markup of IF products. Such silence poses tax obstruction to IF or opens the room for its tax avoidance. Despite peculiarity of Ethiopian tax law that prescribes special tax rule for taxing business disregarding commercial code, it does not cover deductibility of IF costs, exemption of intermediary transactions and taxation of returns peculiar to IF in definition of words like income, dividend, interest, capital gain, etc. Thus, the Ethiopian tax law does not recognize whether or

[110]Kemal Shallo, Customer of Awash Bank and CBE (Jan. 17, 2023) complains that series of IFB transactions make more costly than CB.

[111]Taddese Lencho, To Tax or Not To Tax: Is That Really The Question? VAT, Bank Foreclosure Sales, and the Scope of Exemptions for Financial Services in Ethiopia, Mizan Law Review Vol. 5 No.2, (2011), p.279.

[112]Arts.3, 6, 7(1)(c), 8(1)(d), 12, Art.28 & 45-48 ITR and Art. 23, 26, 59(7)(c), ITP Art.18, and 19 of ITP *supra* note 40.

[113] The ITP, Art.18-21.

not any of IF services should be categorized under CB loan, commercial relation or any other scheme for tax purpose.

Ethiopian tax law reform has to consider either of the following approaches. First option is UK's tax law neutral or non-discriminatory treament for IF and CB and use of alternative finance arrangement without the need to mention specific *sharia* compliant IF products. The second option is Malaysia and SA tax law approach which expressly recognise *sharia* compliant finance services like *murabaha*, mudarabah, *musharaka*h, *ijara*, etc. Ethiopian tax reform should adopt Malaysia's expressive approach of recognizing alternative IF services and define *murabaha*, *musharaka*h, mudarabah, etc with ways of taxing incomes arising from IF because Malaysia approach is simple, clear and promotes *sharia* compliance of alternative finance. This requires amendment of Article 2, Arts.18-27, 34-35, 51-64, 66-72, etc of Ethiopian ITP No.979/2016. Thus, ITP No.979/2016 with its regulation, Tax administration Proclamation No.983/2016 with its regulation and other subordinate legislation amendment should include the list of IF products and their respective meaning that simplify taxation of incomes attributable to IF.

Although ITP No.979/2016 fails to make express reference to IF services, there are general rules which can positively be interpreted to establish Ethiopian jurisdiction to tax IF incomes. Accordingly, Art.6 (4) establishes Ethiopian source jurisdiction which can be interpreted to tax IF profits paid to any person by resident, markup received from clients, and gain arising from sale of share or bonds issued by resident company. But the application of such tax law for taxing IF incomes by interpretation is inconsistent with the principle of legality that prohibits taxation without firm legal basis and tax law reform should expressly recognize IF and indicate tax rules applicable to charge IF incomes and facilitate tax relief for costs and intermediary activity.

Moreover, the Ethiopian tax law does not clearly stipulate incomes of IF which subjects to schedule D incomes (5% or 10% CB interest incomes) or 30% corporate income tax. Nor does ITP in schedule C expressly includes principles which enable the taxation of IF incomes and deductibility of its costs.[114] Similarly, schedule D remains silent regarding taxability of *mudarabah* depositors income and any IF income that attract withholding tax.[115] Besides, there is no clear rule regarding ways of separation of taxable return and how capital recovery is exempted except Art.24 which addresses the recognition of gain and loss and deductible expenses for lease business. Thus, no legislative amendments have yet been made for the accommodation of IF taxable return and non-taxable capital.

3.2. Intermediary Transactions Taxability

Intermediary transactions involve the activities of SPV, such as buying, selling and similar behaviors involved in IF contracts for *sharia* compliance of IF services. Taxing such activity exposes IF to cumbersome tax costs. But the Ethiopian law does not provide clear tax rule that prescribes taxability or otherwise of intermediary transactions. This opens the room for different interpretations: chiefly regarding the taxability of intermediary activity by tax law. This means that the application of existing Ethiopian tax law to IF services imposes two taxes on IF: stamp duty and capital gains.

Unlike UK, Malaysia and SA which presume non-involvement of financer in purchase and resale to disregard intermediary activities for tax purpose, Ethiopia does not provide tax legislative response that exempts intermediary activities from taxes. This allows the imposition of an obligation on the

[114] The ITP, Arts.19-50, *supra* note 40.
[115] The ITP, Arts.51-64, *supra* note 40.

supplier and bank to withhold stamp duty on activity. Article 3 of the stamp duty law provides that the following instruments shall be chargeable with stamp duty: bond, security deeds; power of attorney; and documents of title to property. This stamp duty during approval of customer's power of agency to purchase asset on behave of financier and property transfer from supplier to the financier and then to customer shall apply to frequent intermediary activities of IFB services of trade intermediation and Islamic bond purchase contracts for resale to customers.[116]Such intermediary taxation of multiple transfers is barrier for asset backed trade intermediation activity which is vulnerable to more tax that increases the cost of acquisition and supply of asset. As Mohamed rightly found stamp duty poses a difficulty to the IFB transactions when title deed transfers twice in single financing transactions in *murabaha* and *ijara* in which transaction attracts double asset transfer tax.[117]This results in costly tax expenditure to IF that receives less favorable tax treatment and becomes less competitive than CB [118]breaching the principles of equity and neutrality making IF less competitive and unviable than CF.

Secondly, Ethiopian tax law provides a gain on the disposal of certain investment property subjects to tax at 15% for immovable property and 30% for a share or bond provided the amount of consideration in sale exceeds the cost of asset acquisition.[119]Besides, tax law includes taxable activities like the acquisition of assets, title disposal, exchange, cancellation, redemption, relinquishment, destruction, loss, expiration, surrendering or passing of legal

[116] The Ethiopian Stamp Duty Proclamation No.110/1998, Art 3.

[117]Mohammed Ibrahim Ahmed, Islamic Banking in Ethiopia and Its Legislative Challenges, 16 J Int'l L Islamic L (2020), p.62.

[118]Mzee Mustafa Mzee, 'The Legislative Challenges of Islamic Banking in Tanzania' 45 JL Pol'y & Globalization (2016), p.131.

[119]The ITP Art 58, and The ITR Art 6, *supra* note 40.

title for consideration to another.[120]Application of these provisions likely impose capital gain tax on all IF intermediary transactions with rate ranging from 15 to 30 percent while its counter CB incomes might be subject to lower income tax rates (5% for resident and 10% for dividend and non-resident interest income earners). This imposes extra tax on cost plus markup transactions or trade intermediation of IFB services as Ethiopian income tax law does not provide any clue for an exemption and disregarding of underlying transactions of IF.

Moreover, Ethiopian tax law does not recognize loss and profit sharing characters of IF which requires the recognition of loss as expense that should be deducted as cost of finance. Instead Ethiopian law has general remedy for carrying loss forward and provides permissibility of off setting loss against future gain and carrying loss forward infinitely for offsetting in the future until loss fully offsets gains income when substantiated by reason that satisfies revenue authority.[121]Article of 71 of ITP No.979/2016 seems to address the rule for deferral of recognition of gain and loss on the disposal of asset but deny the recognition of gain or loss for exchange between related person, spouses or transfer of asset to executor on death and replacement of asset on its loss, destruction or compulsory acquisition of asset. However, rule does not make express reference to IF nor it includes rule that exempts capital gain during purchase for resale to customers. Thus, there is no clear deferral of recognition of gain or loss for IF nor indication of applicability of an existing tax law for carrying loss forward for IF.

Furthermore, Ethiopian Income tax law not only impose cumbersome costs on IF but it also marginalizes some employees who do not consume fringe

[120]The ITP Arts 66-70, *supra* note 40.
[121] The ITP Art.59 (4) and Art.26, *supra* note 40.

benefits that entail interest charge as Art.8 (1) (d) and 12 of Council of Minister's Income Tax Reg.No.410/2017 (CMITR) provides a discounted interest loan provision to employees as fringe benefits without alternative *sharia* compliant benefits like provision of asset with discounted markup. The tax law does not recognize the deductibility of employee's discounted financing fringe benefits in determining the firm's tax. These employee fringe benefits should be reformed by introducing asset finance supply to employees with discounted markup that should be deductible for both CF and IF.

One of the most significant obstacles to IF is article 72 of ITP No.979/2016 which prohibits regulator from accepting, registering and approving of transfer or disposal asset unless it is satisfied that tax required under this law is paid. ITP empowers revenue and document authentication authorities to impose extra tax costs on IF which is exposed to capital gain tax as per Art.71 (recognition of gain or loss) and Art.21 (capital gain on disposal of asset).

Finally, the market lending rate applicable for CB loans and NBE discounted facilities to commercial banks included in Article 7 of CMITR No.410/2017 does not indicate the IF rate of markup and profit of investment account holders. This implies absence a level playing field for CB and IF services income tax in Ethiopia.

Ethiopia can take lesson from UK, Malaysia, and SA that: (a) disregard taxation of underlying or intermediate activity like purchase and resale transaction of *murabaha*, lease, progressive release of fund against future delivery, forward sale and SPV (trade in security); and (b) presume financier's non-involvement in intermediary activity and direct client's asset acquisition from supplier to provide similar tax treatment for CB and IF for

stamp duty purpose.[122]The exemption of intermediary transactions from capital gain and asset transfer stamp duties should be introduced to ensure equal tax treatment of any form of finance.[123]

3.3. Taxation of IF Markups and Profits

Ethiopia tax rules remain silent on the rules applicable for the taxation of markup of trade related IFB and profits on investment intermediation, Islamic capital market and other IF services. None of tax laws provide differential or similar tax treatment of IF and CB. Unlike comparative experiences, Ethiopian income tax law does not address the tax treatment of IF services nor does the law consider IF services as loan relationships for the coherent tax purposes. Nor does the law clarify *sharia* compliance implication of tax treatment of markup or profit as if it were interest by tax law although experience of other nations reveal the use of word interest for tax purpose does not affect the *Sharia* compliance of *murabaha* and other IF services. Nor does the tax law avoid the uncertainty relates to the issue of distinguishing taxable income and non-taxable capital characterization with respective deductible costs of finance for IF.

The existing tax law application to CF and IF exposes the latter to additional costs. For instance, Ethiopian tax law provides CB interest income is subject to a rate of 5% for resident and 10% for non-resident according schedule D. However, the prohibition of interest in IFB creates uncertainty of the rule for taxing income arising from IF. This uncertainty would either cause some IF incomes to escape the tax (religious activity exemption argument and the difficulty of distinguishing between recovery of capital and taxable lease

[122]Bhupalan Renuka, *supra* note, 91, and Omar Salah and Christa Rautenbach note 100, p.509-511.
[123]Id.

finance income) or more excessive tax costs to IF. This exposes IFB to extra tax costs that makes it less competitive, systemic failure or bankruptcy and consequent marginalization of some investors and customers from the financial market.

The inherent nature of the Ethiopian schedular tax model may worsen the uncertainty of extending CB rules for taxing IF services (*murabaha*, lease, mudarabah, forward sale) incomes since (a) CB or financial company incomes might be simultaneously subject to schedule C's 30% flat rate when it loans fund to other businesses and 5% interest withholding income under Schedule D interest from deposits in a bank, (b) the law is silent on IF subjection to capital gain, the person responsible for capital gain or exemption.[124]Thus, the taxability of IF income is subject to open interpretations (some gain subjection to schedule C while other subjects to schedule C) although the principle of certainty and legality respectively require a clear and strong legal base for taxation.

Moreover, the position of Ethiopian tax law is not clear whether the rule of taxing CB depositors' interest income is applicable for IFB mudarabah saving account depositors' profits and *murabaha* markup. The main limitations include the silence of tax law on ways of taxing mudarabah investment account holders return/profit sharing, withholding duties of financiers, lack of government tax law response for taxing IF incomes, lack of clarity in the law on permissibility of deduction of *murabaha* markup as cost of business and uncertainty as to whether the return on certain Islamic finance products will be characterized as a capital or revenue gain or loss.

[124] Taddese L. Gemechu, The Ethiopian Income Tax System: Policy, Design and Practice PhD A Dissertation submitted to Graduate School of the University of Alabama, (2014), p.373.

IF incomes (*ijara* return and mudarabah investment incomes) may escape tax due to the unsuitability of existing tax legislation. The comprehensive provision which can positively be applied to IFB is Article 63 of ITP No.979/2016 that provides a person who derives any income that is not taxable under Schedule A, B, C, or the other Articles of Schedule D shall be liable for income tax at the rate of 15% on the gross amount of the income. Revenue authority can apply Art 63 to tax any IF incomes including trade intermediation markup, equity finance incomes, and fund management fees. But it may either impose more or less tax treatment on IF breaching the principle of equality and neutrality which provides similar treatment of incomes and person in similar situation.

The other uncertainty of Ethiopian tax law relates to taxing *ijara* incomes contrary to other nations varying experience in which some states exempt the capital part of *ijara* payment and impose tax only on profit (considering profit as interest loan income) that goes to financier while some entirely exempts lease finance and *sukuk* transactions from tax except profit (recognized as interest) earned by the investor (issuer) of IF.

Consequently, the Ethiopian government has not made any tax policy response to the birth of IF as of April 2024. The interview with officials reveals that Ethiopia has not introduced any changes to tax law for accommodation of IF.[125]Tax authority faces difficulty in treatment of IF or it imposes less favorable tax treatment to IF due to its inherent unique characters.[126] The practice of newly established full-fledged IB institutions reveals *murabaha* markup incomes subjection to 30% corporate income and

[125]Interview with Wondissen Fikadu, Tax Officer of FDRE Ministry of Revenue (October 18, 2023).
[126]Mohammad, *Supra* note 16.

there is no practice of presuming or equivalence of markup incomes of IF if it were CB interest incomes which are subject to 5%.[127]This practice implies lack of clarity of tax law that imposes expensive tax costs on IF which would be less competitive than CB which pays less tax on interest incomes. IF subjection to 30% corporate tax contrary to CB which subjects 5% interest rate tax discriminates similar incomes although they have the same economic substance and consequences to tax payers.

The other issue is whether or not Ethiopian tax law provides finance incomes exemption for policy considerations. Contrary to the experience of other nations, which extends interest income withholding exemptions to underlying transactions in IF, Ethiopia does not provide financial intermediary exemptions available for certain asset backed arrangements such as a commodity *murabaha*h and an asset based securitization arrangement provided the arrangement meets the public offer test and is economically equivalent to either a debenture or a debt interest that is currently eligible for the interest withholding tax exemptions.

Furthermore, the distribution of partnership finance (mudarabah investment depositor, investment agency account holders and *musharaka*h contributors) return that relies on profit sharing is taxable in other nations as per rate provided by corporate and individual tax payers. But whether such new incomes can be subject to dividend or corporate interest rate income is uncertain in Ethiopia. Thus, the Ethiopian corporate and individual business tax laws do not have the rule for IFB or alternative finance arrangement incomes' taxation.

[127]Siraj A and Abdulahi Abdulkadir, Workers at Hijra Bank, (October 17, 2023).

Ethiopian tax reform can learn the following lessons from the UK, Malaysia and SA to settle uncertainty on the applicability of existing income tax laws for IF services.

First, the lack of clarity in Ethiopian tax law regarding *sharia* compliant security income should be resolved via disregarding the taxation of incomes from special purpose vehicle - intermediary transactions to avoid alternative security finance vulnerability to cumbersome tax costs.

Second, the law should introduce trade intermediation related deferred payment markup and similar IF returns taxation as if it were interest received by the CB lender implementing the presumption of equivalence of IFB returns and CB interest. The reform should also include the UK's IF similar treatment with CB-CF products - the taxation of IF products should present 'no obstacles nor special treatment': in other words, a 'level playing field i.e. neutral tax treatment for CB and IF in income tax, withholding tax; and property transfer tax.

Third, taking lesson of treating -taxation of IF returns as if it were interest on CB loans (presumption of IF return as interest) for tax purpose never contradicts *sharia* compliance of IF provided parameters of constructive or actual possession, joint ownership, risk and profit sharing are satisfied. Presuming IF return as interest for tax purpose may erode IF's sector reputation temporary. However, such reputation loss can be mitigated via awareness creation strategies: training, media advertisement and *sharia* scholars' education.

Fourth, Ethiopia tax law may consider lessons of the UK, Malaysia and SA laws which presume trade intermediation relation between financer and buyer as loan relation between lender and borrower in order to tax markup of IF as if

it were CB interest income. The amendment to Ethiopian tax law should encompass any reference to interest in tax law shall apply, making necessary change, to gains or profits received and expenses incurred, in IF transactions conducted in accordance with the principles of *sharia.* The law should also include the principle of economic substance that dictate equal economic outcome of interest and markup or return on mudarabah depositor's investment account, agency investment account of IF should be prioritized over form of finance transactions (as loan, trade, investment, financial instrument investment) since most IF products mirror the economic effects of CF products.

Consequently, the Ethiopian income tax law should draw lessons from UK, Malaysia, and South Africa which tax incomes arising from IF as if it were interest. That is markup from asset merchandise, lease, progressive finance combination with deferred asset delivery, forward sale and return from *mudarabaha* investment account holders should be taxed as if they were interest incomes of CB. This is because the tax law should provide similar treatment to comparable CB interest incomes and IF profits. Thus, CB 5% for resident and 10% for non-resident interest rate should apply to markups and profits of IF in order to eliminate less favorable tax treatment to IF since the tax law should adhere to the principle of equality, neutrality and fair treatment of finance.

3.4. Deductibility of IF Costs

The Ethiopian tax law differentiates deductibility of debt and equity cost of finance which increases IF costs. The Ethiopian tax also law permits interest expense deductibility as finance cost if ratio of debt to equity finance is not

more than 2:1 but expressly denies the deduction of dividends.[128]This is disadvantageous to equity centered IF because *shariah* does not recognize interest in IFB.

The remedy is Ethiopian tax law reform should introduce rules of allowing deduction of IF business cost comparable with interest cost deduction. The law should allow deductibility of cost related to financing IF like mudarabah investment depositors' profits and investment agency fees paid to financers who provide fund to IB. The economic substance doctrine suggests similar cost of finance deduction allowance for IF and CB.

Furthermore, whether or not conventional bond interest cost deduction is applicable to Islamic bonds (*sukuk*) holders, who claim ownership in underlying asset for *sharia* compliance, remains unresolved under Ethiopian tax law. Whereas IF's equity nature denies deductibility of finance costs according to Art 23 and 47 of Ethiopian ITP No.979/2016, *sukuk* exchange in capital market might attract additional stamp duty costs. Denial of cost deduction and imposition of stamp duty for IFB result in less favorable or competiveness of IFB compared to CB which receives interest cost deduction and exemption from stamp duty. Ethiopia should adopt UK and Malaysia lessons of allowing deductibility Islamic bond costs of finance, risk sharing loss and expenses alike conventional bond expenses.

However, the deductibility of interest costs is subject to the following legal limitations. Primarily, Art.23 of ITPNo.979/2016 states that interest debt is deductible only if the debt is used to drive business income. Art.23 also allows the deductibility of debt financing costs for term loan and debt instruments (debentures) that involve deductible interest expenses. Such a tax

[128]Arts 23 and 47 of ITP, *supra* note 40.

advantage is not available for equity financing - raising capital through the sale of shares in a company as Article 27 (1)(d) of ITP No.979/2016 does not allow the deductibility of loss recoverable by insurance, dividend distribution and pay-out profits to shareholders as cost of financing except depreciation of assets. This implies equity model of financing bank investment is more expensive than debt model of financing financial investment. The favorable treatment of debt finance than equity finance creates less favorable treatment to IF which (a) prohibits interest and (b) uses merchandise and equity finance modes including risk-loss bearing and profit-sharing ways of finance whose tax law does not allow deduction of dividend distribution as cost of finance.

Article 23 (2) (a) of ITP No.979/2016 provides that an interest cost paid or payable to bodies or financial institutions recognized by national bank of Ethiopia (NBE) and foreign bank permitted to lend to persons in Ethiopia shall be deductible even when interest rate for paid or payable interest exceeds 2% points used between NBE and commercial banks. However, Article 23 (2) (b) of same prohibits deductibility of interest cost paid or payable to related person who is resident of Ethiopia except interest included in schedule D related person who may claim deduction. The law seems to prohibit the deductions of interest finance costs for individuals when interest rate exceed 2% points of rate used between NBE and commercial banks under Article 23 (2) since individuals are not recognized by NBE. However, tax law hardily covers deductible and non-deductible finance costs of IF.

Further, the deduction of charitable donation is recognized in Art. 24 of ITP No.979/2016 when donation is made for: Ethiopian charities and societies as defined in sub article 3 of this provision and development, an emergency call by the government to defend sovereignty and integrity of country, to prevent or provide relief in relation to man-made or natural disaster or epidemic or for

any other similar cause. This deductibility of charitable donations is a positive move friendly to IF requires to payment *zakah* (alms giving) responsibility.

The Ethiopian tax law lacks rules for (a) the deduction of IFB costs in the acquisition of assets for deferred payment arrangement; (b) recognition of financial cost and its deductibility for borrower, (c) extending schedule C business deduction to IF services; and (d) identification of taxable capital gains and tax-exempt intermediary activity. The remedy is the tax law should be amended to ensure that the finance gain or cost of finance in respect of Islamic deferred payment arrangements is treated in the same way as interest cost for CB.

Conclusion

The article concludes the following points. Primarily, it finds a lack of clear tax law applicable for taxing IF incomes (markup and profits) as an obstacle to the progress of IFB products in Ethiopia, contrary to the law's promise to ease the business environment.

Secondly, the status quo application of existing Ethiopian tax legislation to IF would result in a more onerous tax treatment of IF than CF-CB in Ethiopia. Thirdly, in contrast to other nations like Malaysia, the UK and South Africa who have IF friendly tax law, no tax legislative measures have been made to facilitate IFB transactions in Ethiopia so far. Thus, Ethiopia needs to modify its tax laws in order to facilitate conducive environment for IF adapting Malaysia and SA model of tax laws reform that provide similar tax treatment to IF and CB to have IF friendly tax law that allow deduction of costs, loss in IF and disregarding of intermediary activity to remove anti-competitive tax costs.

A Note on the State of Judicial Immunity in ANRS: Alarming Instances

Abenezer Nahome Mengesha*

Abstract

An independent judiciary is an essential element of a democratic state. To guarantee this, the legislature and the executive wings of the government should have a minor impact on the judiciary and the judiciary should be equipped with special provisions allowing it to defend itself from political pressure.[1] *The concept of judicial immunity, which protects judges and other judicial officials from civil or criminal liability in connection with their official duties, has been recognized as an important tool to assure full-fledged judicial independence. This article aims to examine the state of procedural judicial immunity in the context of Amhara Regional State. In addition to a critical review of applicable legislations and case analysis, the author conducts unstructured interviews with purposively selected judges working in the region. The article concludes that judges in the region lack legal protection to function independently. It, in particular, underlines that fact arbitrary detention of judges by the police has negatively affected judicial independence as well as public confidence in the judiciary. Based on these findings, the article recommends to the concerned organs to assure*

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[1] Charles M. Cameron, "Judicial Independence: How Can You Tell It When You See It? And, Who Cares?" in Judicial Independence at the Crossroads. An Interdisciplinary Approach, ed. Stephen B. Burbank and Friedman Barry (Cali-fornia: Sage, 2002), 42-55 and Christopher M. Larkins, " Judicial Independence and Democratization: A Theoretical and Conceptual Analysis," American Journal of Comparative Law, 1996, vol. 44 no. 4, pp. 605-626.

procedural immunity for judges in the region to ensure the functional independence of the judiciary and the fair administration of justice.

Key Words: Judicial Immunity; Judges; Alarming Instances; Amhara Region; Ethiopia.

1. Introduction

Judicial immunity is a legal principle that protects judges and other judicial officials from civil or criminal liability in connection with their official duties.[2] This principle is recognized in various legal instruments at the international, regional, and national levels. At the international level, judicial immunity is recognized by the United Nations through the Convention on the Privileges and Immunities of the United Nations, which grants immunity to UN judges and other officials, and the United Nation Basic principles on the independence of the judiciary,[3] and the International Bar Associations Minimum Standards of judicial independence.[4] The International Criminal

[2] Jeanne F. Pucci, Immunity Doctrines and Employment Decisions of Judges, Fordham Law Review, 1987, vol. 55. Pp. 621; see also Randolph Block, Stump *vs* Sparkman and the history of judicial immunity, duck law journal, 1980, pp.881. see also Marie Adornetto, Monahan, "The Problem of "The Judge Who Makes the Case His Own": Notions of Judicial Immunity and Judicial Liability in Ancient Rome," Catholic University Law Review, 4th ser., 49, No. 2 ,2000, pp. 430. see also D. Thomson, judicial immunity and the protection of justices, modern law review,1958, vol.21, no.5,pp.517-533.

[3] The Prevention of Crime and the Treatment of Offenders,1985, reprinted in Marie Adornetto, Monahan, "The Problem of "The Judge Who Makes the Case His Own": Notions of Judicial Immunity and Judicial Liability in Ancient Rome," Catholic University Law Review, 4th ser., 49, No. 2 ,2000, pp. 435.

[4] The international Bar Associations Minimum Standards of judicial independence, 1982, Art. 43.

Court also recognizes judicial immunity for its judges and prosecutors.[5] Under international law, judicial immunity applies to all acts performed by judges in the course of their official duties, including decisions given in court, administrative actions related to the administration of justice, and other functions related to the judicial process. This immunity is not absolute under international law, however, and judges may still be held accountable for acts that are outside the scope of their official duties, such as acts of corruption or other criminal acts.[6]

At the regional level, there are several regional legal instruments that deal with judicial immunity. To this evidence, one can refer to Article 12 of Declaration of Minimal Principles about judiciary and judges' independence in Latin America (Campeche Declaration) which provides procedural immunity to judges as long as they are not cache in flagrant crimes.[7] It is also interesting to mention Article 14 of Europeans Charter of Judges which guarantees immunities to national judges in a good manner.[8]

At the national level, most countries recognize judicial immunity although its scope and extent vary depending across legal systems. [9] The general principle is that judges should be able to perform their duties without fear of reprisal or harassment.[10] From the above discussion, one can safely understand that

[5] Rome statute of international criminal court, 2002, Art. 48.
[6] Id.
[7] Declaration of minimal principles about judiciaries and judges independence in Latin America, 2008, Campeche, Article 12.
[8] European charter on the status of judges, 1998, Art. 14.
[9] Goda Ambrasaitė, Comparative analysis on the High Councils for Judiciary in the EU member states and judicial immunity, October 2015, pp. 28. See also, Article 86 of The Constitution of Czech Republic, Article 134 of The Constitution of Slovenia , Article 153 of The Constitution of Estonia , Article 122 of the Constitution of Croatia Article 181 of The Constitution of Poland , Article 153 of The Constitution of Estonia.
[10] 1d.

judicial immunity has been incorporated into different international, regional and national legal instrument as a means of securing judicial independence as well as public trust and legitimacy in the judiciary.

In Ethiopia, the judiciary has historically been subject to political influences and interferences that in turn undermine judicial independence and impartiality.[11] This has further led to a lack of trust in the legal system and has made it difficult for judges to uphold the rule of law and protect human rights. Similarly, in the Amhara national regional state, there have been concerns about the protection of procedural judicial immunity.[12] The judiciary has faced challenges in maintaining its independence and impartiality, and judges have been subject to harassment and intimidation by government officials and the police departments.[13] In recent years, there have been efforts to strengthen the protection of procedural judicial immunity in Ethiopia at federal level.[14] However, there are still much works to be done to ensure that judges can make decisions free from external influence or reprisal.

The purpose of this article is to examine t*he state of procedural judicial immunity in the context of Amhara Regional State*. This article is organized in five sections including this introduction. In the second section, it discusses

[11] K I Vibhut, The judicial system of Ethiopia: from empire to military junta to federal democratic republic : A legal perspective, Christ university law journal, 2015, vol.4, no.1 , pp.4 see also Assefa Fisseha, Some Reflections on the Role of the Judiciary in Ethiopia, Ethiopian Bar Review, Vol. 3, No. 2, 2009, pp. 122-123. See also, Tsegaye Regassa, Courts and the Human Rights Norms in Ethiopia (Proceedings of the Symposium on the Role of the Courts in the Enforcement of the Constitution, Civil Service College, 2000, p. 116.

[12] All the interviewee's judges express their concerns about procedural immunity protections and its importance in the region.

[13] Id.

[14] The Federal judicial administration Proclamation, 2013, *NEGARIT GAZETA*, Proc. No. 1233, 27th year, No. 18, Article 34.

about procedural judicial immunity protection in general and its relation with judicial independence and accountability. The third section reviews relevant legal instruments in Ethiopia and the region. The fourth section continues to see the state of procedural immunity protections in practice. The fifth section suggests some legal and practical safeguards for judiciary that would make the concept of judicial independence practicable in the country and the region.

2. The Concept of Judicial Immunity

2.1. General Remarks

The notion of judicial immunity is part of the wider concept of judicial independence. There are different types of immunities. The most famous division is the one that divides immunities into civil and procedural judicial immunity.[15] The former can also be called civil immunity since it declares total impunity for certain actions as long as they were undertaken in the performance of duties. A person enjoying this privilege shall never be tried or sentenced for such an action even if it constitutes liability. In English literature, this immunity is also called non-liability or non-accountability.[16] On the other hand, procedural immunity, sometimes called inviolability, is seen as an obstacle in the trial. If procedural immunity can be lifted then we call it a relative immunity. In other words it is a hindrance in criminal procedure, which may be removed if a specific authority agrees. That is to say, consent is needed in order to continue with the prosecution of the judge. The other related concept is procedural immunity, which is a legal doctrine that provides protection to government officials who are carrying out their official duties by preventing them from being sued or prosecuted for actions

[15] *Supra* note 8.
[16] Id.

related to their official duties.[17] This type of immunity applies to individuals who are involved in the judicial or administrative process, such as judges, prosecutors, and witnesses. The purpose of procedural immunity is to ensure that government officials can carry out their duties without fear of reprisal or retaliation. This protection helps to ensure that the judicial system can function effectively and efficiently, as officials are able to carry out their duties without worrying about the potential legal consequences of their actions. Totally, procedural immunity is an important legal doctrine that helps to ensure that government officials can carry out their duties without fear of legal consequences. However, it is important to balance this protection with the need to hold officials accountable for their actions, particularly when those actions violate the rights of individuals or are outside the scope of their duties. In the same way, this immunity is intended to ensure that judges can perform their functions independently and without fear of being sued for their decisions or actions. However, the justification for procedural immunity for judges cannot be to protect the judge from prosecution, but only from false accusations that intend to exert pressures.

2.2 Judicial immunity, Accountability and Independence

The natures of judicial independence are divided into two conceptions. The first concept of judicial independence is the personal independence of judges, in this concept; it is often analogous to the concept of "authors of their own opinions."[18] The judiciary has realized its independence if the judges can make decisions without fear of internal (vertical) or external (horizontal)

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[17] Id.

[18] Ewis A. Kornhauser, "Is Judicial Independence a Useful Concept?", in Judicial Independence at the Crossroads:An Interdisciplinary Approach, (2002), pp.45 ff.
An Interdisciplinary Approach, ed. Stephen B. Burbank and Friedman Barry, (California: Sage, 2002), 42-55.

pressure to resolve cases with certain conditions. In other words, personal independence can be achieved when the output of the judicial process can reflect its judicial preferences.[19] The second concept of judicial independence is institutional independence. It appears that judicial independence depends on other branches of power, especially if it is associated with decisions that are routinely ignored or poorly implemented. This concept is often interpreted as collective independence of institutional independence, or referred to maxim what judge's think is what they produce and what they produce controls the outcomes of legal conflicts.[20]

Accountability is the same as the judicial independence, both of which are important foundations for the rule of law. The word 'accountable' as defined in the Oxford Dictionary means 'responsible for your own decisions or actions and expected to explain to them when you are asked'. [21] Now coming to judicial accountability, it means the responsibility or answerability of the judiciary as an institution and judges as individuals for their own decisions.[22] The judiciary being the justice delivery system of the State is a well empowered organ which performs significant and noble functions. It is, therefore, annexed with some level of accountability. Judicial accountability is, in fact, a corollary of judicial independence.

[19] Id.

[20] Charles M. Cameron, "Judicial Independence: How Can You Tell It When You See It? And, Who Cares?" in Judicial Independence at the Crossroads. An Interdisciplinary Approach, ed. Stephen B. Burbank and Friedman Barry (Cali-fornia: Sage, 2002), 42-55 and Christopher M. Larkins, "Judicial Independence and Democratization: A Theoretical and Conceptual Analysis," American Journal of Comparative Law, 1996, vol. 44 no. 4, pp. 605-626.

[21] Henry Campbell Black, Black's Law Dictionary, 9th ed., West Publishing Co, United States: 2009, pp. 818.

[22] Muro Cappellite, Who Watches the Watchmen? Comparative Study on Judicial Responsibility, American Journal of Comparative Law, Vol.31, p. 2.

When we come to their relation, judicial independence aim to ensure that judicial decision-making is unencumbered by other components of government; neither protects judges from lawsuits stemming from the exercise of such decision-making by the public. For a legal system to flourish, its judiciary must be able to make decisions without the menacing cloud of potential litigation lingering overhead. Fear and intimidation have no more of a place in just judicial decision-making. So, ensuring principled and fearless decision-making forms the basis for judicial immunity. Judicial immunity, specifically procedural judicial immunity, is a doctrine that aims to protect judges from the harassment of personal litigation in respect of their judicial functions, precluding lawsuit or prosecution except under the authorization of appropriate judicial authority.

Although judges are generally not detained or arrested without prior authorization of appropriate judicial authority, the legal systems make judges accountable through other methods. For example, judges remain criminally liable for fraud, conspiracy, or any other crimes, even when they commit those crimes in connection with the judicial office, under an authorization of appropriate judicial authority. In addition to liability for their criminal behavior, society can hold judges accountable for their misconduct through several other methods. These methods include impeachment or removal from office and disciplinary measures imposed by organizations that regulate judicial conduct.

Society, therefore, holds judges accountable to the public in a number of ways. The legal system is designed to correct itself either through a system of appeals or through a few limited circumstances when litigants can hold a judge liable for his or her conduct through criminal prosecution or disciplinary proceedings. These accountability measures ensure that the legal system supports both individual and societal reliance on the judicial process.

Therefore, while the doctrine of judicial immunity greatly protects judges from the harassment of personal litigation in respect of their judicial functions, the practices of judicial accountability help to preserve the integrity and workability of the legal system.

3. Review of Pertinent Ethiopian laws

In Ethiopia, the FDRE constitution asserts judicial independence in more than one provision and in different tones.[23] Judicial independence is the principle that judges or courts shall be free from any external interference or influence when making decisions. It requires that judges be impartial and make decisions based solely on the law and facts presented in each case, without any pressure or influence from other branches of government, political parties, or from any other source.[24] Thus, it is a critical aspect of the rule of law and is necessary for ensuring that the justice system remains fair, impartial, and transparent.

Then, depending on these provisions of the constitution, HPR proclaimed detailed law that helps to protect the independence. So the proclamation which establishes the federal judicial administrative Council goes to the detail in elaborating upon what was stated in general terms in the constitution. Basically, this proclamation is destined to regulate matters such as the

[23] Article 78(1) of the FDRE Constitution proclaims that the judiciary established under the Constitution is independent. Article 79(2) asserts that all courts are required to be 'free from any interference or influence of any governmental body, government official or from any other source'. Article 79(3) mandates a judge to exercise his judicial functions in 'full independence' and to be 'directed solely by the law'. With this spirit, Article 79(4) assures a judge of full tenure of service and provides him a constitutional safeguard against arbitrary removal. See also The Constitution of The Federal Democratic Republic of Ethiopia, 1995, Article 78 and 79, Federal *Negarit Gazeta*, Year 1, number 1(here in after called FDRE constitution).

[24] TFDRE constitution Article 79(2) (3).

organization of the judicial council, power and duties of council, judicial appointments, training, tenure, termination, judicial immunities, and the likes of these.[25] Nevertheless, the discussion in this sub-section will be limited to the immunities and right of judges as the article is not meant to serve as a commentary for the proclamation.

Concerning the judicial immunity of judges, Article 34 sub articles 1 of this proclamation stipulate that as if judges may not take civil liability for action taken in their official capacity. This is basically what we call it judicial civil immunity protection because it clearly guarantees non liability for judgments handed out by judges.[26] In addition to this, article 34 sub articles 2 of this proclamation, interestingly mentions no judges to be arrested, detained and prosecuted so far as its immunity is lifted by the judicial council.[27] This sub article is articulated so as to recognize procedural judicial immunity since it protects judges from prosecution and arrest until the immunity is lifted. Furthermore, sub article 3 of this article makes judicial independence practicable by giving's of right to promulgate directive on the procedure, which helps to lift immunity, to the Supreme Court. It is genuine and plausible to say that, proclamation no 1233/2021, is quite shine since it guaranty the judiciary both types of judicial immunities. That is civil and procedural judicial immunity.[28]

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[25] The Federal judicial administration Proclamation, 2013, *NEGARIT GAZETA*, Proc. No. 1233, 27th year, No. 18.
[26] Id, Art. 34.
[27] Id.
[28] Id, Art. 3.

3.1 The State of procedural Judicial Immunity in ANRS constitution

The FDRE Constitution clarifies the structure of the organ of the state as comprising the federal government and state members.[29] And also specified that both the federal and states have three wings of government, namely, legislative, executive and judiciary.[30] The Constitution further provides the respective powers and functions. .[31] Moreover, the Constitution allows for the state to establish a state administration that best advances self-government and gives the power to design and adopt their own constitutions so as to offers an excellent opportunity for the accommodation of their regional matters.[32]When it comes to Amhara National Regional State sub national constitution, the regional Constitution provides both institutional and functional independence of the judiciary.[33] Looking at this while the ANRS constitution seems on the way to qualifying the minimum standards requirements for judicial independence by settings up institutional and functional independence; it is silent and says nothing about procedural judicial immunity, which is the base for practicability of functional independence.

Procedural judicial immunity is an important protection for judges that helps to ensure the fair and impartial administration of justice. By shielding judges from personal liability and other forms of retaliation, this immunity helps to preserve the independence of the judiciary, prevent frivolous lawsuits, and ensure that judges are able to make decisions based solely on the law and the facts of the case. However, the lack of constitutional protection for procedural judicial immunity in the Amhara national regional state is a cause for concern.

[29] Id.
[30] Id.
[31] FDRE Constitution, Art 50(2).
[32] FDRE Constitution, Art 52; Article 52(1) (a)(b).
[33] ANRS Constitution, Article 66 sub Article (2) (3).

Recently, the Amhara region is known for its political instability[34], and the lack of protection for procedural judicial immunity has made it difficult for judges to maintain their independence and uphold the rule of law. In the absence of such protection, judges in the Amhara region are vulnerable to political pressure, harassment, and intimidation.

3.2 The State of Procedural Judicial Immunity in ANRS Courts Establishment Proclamation

The federal constitution has clearly authorized regional states to issue their own constitutions and other laws. [35] In the same fashion, according to article 49(3)(1) of the Revised Amhara National Regional State Constitution it is the council of Amhara national region which is given the power to enact laws within the region context.[36] Following this, the state council proclaimed laws that established Amhara regional courts. The council amended its regional courts establishment Proclamation No 153/2000, 169/2002, and 223/2008 and came out with recent applicable Proclamation No 281/2015. The main objective of these laws is to ensure in a fundamental way that the courts exercise their judicial functions in an efficient, effective and accessible manner plus to make judicial service based on the principle of rule of law, transparency and accountability.[37] However, all these judiciary establishment laws repeatedly ignored the issues of procedural judicial immunity. So that, in the ANRS there is no law which guarantees procedural judicial immunities for the judges. This means that judges are not protected from personal

[34] Thompson Makahamadez and Muluken Fikade, popular protest in the Amhara Region and political reform in Ethiopia, 2016-2018, journal of eastern Africa studies, 2022, vol.16 No.1, pp. 115-137.

[35] FDRE Constitution, Article 50(5)

[36] ANRS Constitution, Article 49

[37] Amhara National Region State Court Establishment Proclamation, 2015, ZIKRE HIG, Proc. No. 281/2015, 27th year, No. 21, preamble.

consequences for their official actions while performing their duties. The Amhara national Regional state Government needs to address this issue and provide procedural judicial immunity for judges. This will not only ensure the independence and impartiality of the judiciary but also promote public confidence in the judicial system.

4. Practical challenges of procedural judicial immunity: Alarming instances

The absence of procedural judicial immunity for judges in the Amhara national regional state has significant practical impacts for functional judicial independence, especially in a situation where judges are being detained arbitrarily simply for doing their job. The following cases are selected and discussed to identify the state of procedural judicial immunity and its impact in the region.

4.1 Instance One

Judges play a crucial role in the legal system, as they are responsible for interpreting and applying the law to resolve disputes and maintain social order. However, the decisions that judges make may not always be accepted, particularly in cases where one party feels they have been wronged or treated unfairly. In such situations, judges may be at risk of being detained or facing other forms of retaliation for their decisions. To this evidence, now let us see the case that has happened at *Ayna bugna woreda*.

The case was raised by an individual and a criminal investigation police officer. Then the investigating police officers have asked the court to grant them a 14 days remand in order to investigate the case that they suspected an individual of the crime of willful injury. The court that heard the case also ordered that since the police complaint was not enough to allow remand , the suspect would be released from prison when he paid 2000 birr cash for the

preserved bail right. After it was said that he would be released from prison when he posted financial bail, the suspected was fulfilled what ordered by the court and the court issued order to the police to release the suspect and the case was closed. After that, due to the fact that the police did not free the suspect, the relatives of the suspect filed a complaint to the court and the court ordered the police to do it according to the order. Then when the police was not willing to release the suspect as per previously given order the court fined the detective who was holding the investigation file with 1000 Birr for contempt of court due to his refusal to not to set free the suspect. After that, the policeman who was punished for court contempt together with other policemen waited for a judge when she came home from work, then they beat her up in public and took her to jail, saying that they were arresting her because of what she done to the police officer.[38]

This kind of arbitrary detention of judges for their actions in the courtroom is a serious threat to the rule of law. If judges are subject to arbitrary detention or other forms of harassment by the police because they are perceived to be acting contrary to their interests, this can have a chilling effect on the judiciary. Judges may be reluctant to make decisions that go against the government or the police, even if those decisions are in line with the law, for fear of retaliation. This can lead to a situation where the rule of law is undermined, as judges may not feel free to make decisions based solely on the law and the facts of the case. Instead, they may be influenced by external pressures, which can compromise the integrity of the judicial system. However, judges are tasked with upholding the law and ensuring that justice is served in a fair and impartial manner.

[38] Interview with Meseret Andargachew, Judge at *Ayna bugna woreda* in ANRS, on the case happened in her, 12 march, 2023.

When judges are arbitrarily detained for their actions in the courtroom, it sends a message that the rule of law can be disregarded and that those in power can act with impunity. This undermines the rule of law in several ways. First, it undermines the independence of the judiciary. Judges should be free to make decisions based on the law and the facts presented in court, without fear of reprisals or retaliation. When judges are arbitrarily detained, it sends a message that they are not truly independent and that they can be targeted for their decisions. Second, arbitrary detention of judges undermines the public's trust in the judicial system. If judges can be detained for their decisions, it suggests that the system is not fair or impartial and that justice can be undermined by those in power.

4.2 Instance Two

The starting point of the case was the search warrant submitted by the investigating police officer, and after looking at their complaint, the court ordered them to amend, stating that the complaint submitted by the police is to general and should be written again in a specific manner. Later on the same day, when the same detective asked for an additional 14 days remand for the youths who were suspected of being dangerously ill, and then the court warned that suspected bail rights should be protected so far as the police did not do the work they repeatedly scheduled for. Then the policeman who was at the trial said that the court was disrupting our work to the bench judge, and following this statement, he was ordered not to leave the courtroom by the judge, however, he left by neglecting the court's order.

After that, the court decided to sentence the investigating police officer to one month's simple imprisonment for his action of court contempt. The police then appealed against the lower court's decision, but the High Court upheld the lower court's decision. After that, other policemen came to the judge's

office and brought a summons to the judge saying that you are wanted at the police station for investigation. After they brought him a summons, they arrested him and took him to the police station.[39]

These kinds of arbitrary arrest of a judge by the police for simply doing their job can have serious implications on judicial impartiality. When judges are arrested without cause, it sends a message that their decisions can be influenced by external factors, such as political pressure, police or personal vendettas. This can lead to a culture of fear and intimidation among judges, compromising their ability to make impartial decisions and undermining the fairness of the judicial system. One practical solution to prevent such arbitrary arrests of judges is to provide them with procedural judicial immunity protection. This would ensure that judges are protected from arrest and other forms of retribution for their decisions, and would help to safeguard their independence and impartiality.

4.3. Instance Three

The root cause of the issue was an execution case between the individual and the government. In the case, the individual who is the judgment debtor said that he was willing to release the 2 meters that he had received in the judgment, but the land demolition task force that was executing said that you should release 5 meters and they pushed and demolished 3 meters of the judgment debtor property against what stated in the judgment. Following this, when an individual submitted a petition to the judge holding the record stating that it was done outside of his judgment, the judge ordered the member who is the chairman of the land demolition task force to appear in court and

[39] Interview with Adem Mohamed, judge at *Kalu Woreda* in ANRS, about the case happened on him, 30 April 2023.

explain the matter. Subsequently, the district Administrator, who is the chairman of land demolition task force, appeared in court and when asked why he acted outside of the judgment, he showed inappropriate behavior and gave an answer. For this reason, he was punished in a court of contempt and sent to a prison. After that, the members of the district administration cabinet organized a mob, carrying stones and sticks, and the district police chief along with some armed policemen surrounded the court and arrested the judge who gave the order in front of the public and took him out of the courtroom and taken to the police station. After that, when they told to release the judge by presiding judge, they said that he would not be released if the district administrator is not released, then after they released the judge when the district administrator was released by negotiation.[40]

When judges are arbitrarily detained for performing their duties, it can create fear among the judiciary and lead to a threat to judicial independence. Judges can feel pressured to make decisions that please the executive or police instead of making independent and impartial judgments based on the law. In order to ensure practicable judicial independence, it is important that judges are granted procedural judicial immunity. Without this protection, judges may be subject to external pressures and influences, which can compromise their ability to act independently and uphold the rule of law.

4.4 Instance Four

The cause of the case is a newly opened civil dispute, and after the file was opened by the registry office and brought to a judge, the party who filed the case was called and told to deliver the summons to the defendant. Then the lawyer who appeared on behalf of the plaintiff said that the trial was

[40] Interview with Yohanes Meheretu, judge at Dawent *woreda* in ANRS, about the case happened on him, 25 April, 2023.

problematic because he raised the decision of the trial in another case, but the trial reprimanded him, but the lawyer could not stop insulting the judge. Since the lawyer could not stop, the court sentenced the lawyer to three months of simple imprisonment, saying that he had contempt of court. After that, the lawyer turned to the judge and when he was invited to a fight, the judge decided to add five months to this additional act of court contempt and to sentence him to a total of eight months. Following this, after the judge resumed his normal work, the police came to the court and took him to the prison in handcuffs, saying that he was suspected of abuse of power. Then bringing him to Dessie from Akesta and torturing him for a long time in prison, he was presented with a formal charge of abuse of power, and after a long time of trial, he was sentenced to two years of simple imprisonment by the High Court.

Subsequently, although an appeal was submitted to the Supreme Court, it upheld the decision of the High Court. After that, he appealed to the cassation bench division, claiming that a fundamental error of law had been committed, and the cassation bench acquitted him of the charge, saying that it was an action related to his work and that it was not an abuse of power. Plus, by justifying that the judge sentenced attorney to an additional five months for his additional conduct which is literary additional court contempt, and it is not considered as an overturn of his own decision.[41]

These kinds of arbitrary detention of judges can lead to delayed justice. If judges are detained for performing their duties, it can create a backlog of cases since there may not be enough judges to handle the caseload. This can lead to delays in the resolution of cases and a lack of access to justice for the

[41] Interview with Demise Assefa, during that time judge at Akesta *woreda* in ANRS, about the case happened on him, 25 April, 2023.

people. Taking into account the solution there is also a case similar to this, which happened at another *woreda*, which basically shows the magnitude of the problem: now let us see it,

The origin of the case was an execution between two individuals. After execution claim is presented to the court by the judgment creditor the individual who was the judgment debtor was repeatedly served with a summons in the case so as to present to the court, however, the person failed to appear, so the court ordered the district police to arrest and present to the court the execution defendant. After taking the order of the court the police officer was not willing to present the execution defendant to the court, then considering this the court again ordered the police officer who received the order to appear to the court to explain why he did not present the execution defendant, then the police officer appeared to the court to explain orally. Since the police officer did not answer the questions put to him in the trial and also threatened the judge, in addition, he entered the trial armed with a weapon. The judge sentenced the policeman to two months of simple imprisonment for contempt of the court. Following this, the policemen immediately leave the court room. After this, an order was written for the district police office to arrest the policeman and present him in court, but the police institution refused to present the policeman and head of the police office was ordered again to appear and explain the reason why they did not present the policeman in court. Following this order the head of the police institution gave an order that the judge should be arrested and the police were able to arrest the judge from 3 o'clock to 7 o'clock taking him from workplace publicly.[42]

To sum up, there is the lawlessness of the police officers and the institution, this all in effect shows the failure of the justice system as a whole. And these

[42] Interview with Abeselom Tebeje, Judge at Armachiho *Woreda* in ANRS, about the case that happened to him, 18 March, 2023.

has practically created a situation where judges are being arbitrarily detained simply for performing their duties, which in effect has significant impacts on the independence, impartiality, efficiency, competence, and public confidence in the judiciary. Therefore, it is important to ensure that judges are protected from retaliation for performing their duties to uphold the rule of law and ensure a just society. So, it requires giving judges procedural judicial immunity protection. In addition to this, it demands taking fundamental measure of the government to reform the police institutions in building professional ethics of the police.

5. Concluding Remark

Judicial independence is the doctrine founded on the premise that decisions of the judiciary should be impartial and not subject to influence from the other branches of government or private or political interests.[43] The recognition of full-fledge judicial independence is assessed on the basis of formal compliance with certain minimum standards among which judicial immunity can be mentioned as the vital one. The concept of judicial immunity is an important part of international law that reflects the need to protect judicial independence and ensure that the judicial process is free from external pressures that may interfere with the administration of justice. In Ethiopia at federal level, the concept of procedural judicial immunity is recognized under the federal judicial administration proclamation. Whereas at sub national level, In ANRS, judges within the region have no such protection. Its absence has practically created a situation where judges are being arbitrarily detained simply for performing their duties and this has significant impacts on the independence, impartiality, efficiency, competence, and public confidence in the judiciary. With regard to this, one of the primary impacts of arbitrary

[43] *Supra* note, 6.

arrests on judges is the potential for fear and intimidation. When judges are aware that they may be subject to detention or other forms of punishment by the executive branch, they may be reluctant to make decisions that could be perceived as critical of the government or its policies. This can lead to self-censorship and reluctance to take bold or controversial actions, even when they are necessary to uphold the rule of law. Another impact of arbitrary arrests on judges is the potential for reputational damage. When judges are detained or subject to other forms of retaliation by the executive branch, this can create the impression that they are not independent or impartial actors. This can damage public trust in the judiciary and erode the legitimacy of the legal system as a whole. Additionally, arbitrary arrests can have a chilling effect on the willingness of judges to take on high-profile or politically sensitive cases. When judges know that they may be subject to retaliation or punishment for their decisions, they may be more likely to avoid cases that could put them in conflict with the government or other powerful actors. This can undermine the ability of the judiciary to act as a check on executive power and ensure that justice is served fairly and impartially. Therefore, it is possible to say that, the absence of procedural judicial immunity protection in the ANRS can make judges who work in the region vulnerable to the impacts of arbitrary arrests by the executive or police.

To address the legal and practical challenges in the ANRS and the resulting impacts on judges, several measures should have to be taken. Among that,

- First, the regional government should establish and codify procedural judicial immunity protection through legislation. This could include providing clear guidelines for when immunity applies, when it is lifted, by whom it can be lifted and establishing a process for investigating and addressing any alleged misconduct by judges.

- Secondly, it demands serious commitments from the regional government to take fundamental measures or reform the police institutions to build discipline and professional ethics of the police.

- Third, efforts should be made to provide training and support for the police and executives there in all levels to ensure they are aware of separation of power and its importance in clear sense.

- Fourth, legal mechanisms should be put in place to monitor and prevent arbitrary arrests of judges by the police or other executives. This could include, within the law, establishing legal provision that provides criminal liability of individuals who fails to respect procedural immunity protection.