

LEGAL Alert

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Ethiopia's New SEZ Proclamation: Unlocking Investment Opportunities

Background

The strategy of mobilizing capital from foreign investors through setting up effective industrial parks has been adopted as government economic policy for some time. It was formally introduced as part of Ethiopia's first Growth and Transformation Plan I. Fostering industrialization was also one of the development priorities under GTP-II, (2016-2020). The Ethiopia 2030: The Pathway to Prosperity - Ten Years Perspective Development Plan (2021 – 2030) targets an annual growth rate of 13% over the ten years with the manufacturing sub-sector constituting 20%. The Ethiopian Industrial Development Strategic Plan (2013-2025) also provides a policy direction to establish an industrial zone development program. The Strategic Plan focuses on the development of integrated economic development zones that build and develop industrial parks, business centres, as well as residential areas for employees.

As part of these strategic growth plans for economic development and industrialization, the Government embarked on a program to develop industrial parks backed by incentives such as tax exemptions, one-stop government services, and regulatory concessions, in several manufacturing sectors including textile, garment, leather, light and heavy industry, agro-processing, and pharmaceuticals.

The legal framework that anchored these policies and strategies consisted mainly of the Industrial Park Proclamation and Regulation, issued in 2015 and 2017 respectively, and relevant directives issued from time to time by the institutions in charge of their implementation. Recently, the Ethiopian Parliament has approved a new proclamation regulating Special Economic Zones (SEZ(s)) which will replace the existing legal framework of industrial parks. This law marks a significant milestone in the country's efforts to create a conducive environment for businesses to thrive and drive industrialization in the country. The Proclamation will become effective once it is published in the Negarit Gazette.

The new law aims to encourage private sector participation in the economy, trade, services, and other productive investments. It aspires to strengthen the country's efforts to attract foreign direct investment, promote economic clusters, create jobs, enhance trade, improve export performance, and substitute imports. The law deploys a comprehensive SEZ regime to bolster Ethiopia's capacity to compete effectively in regional and international trade and global value chains. It further establishes a regulatory framework to guide and enable the designation, development, operation, and regulation of special economic zones, as well as the activities, rights, and obligations of SEZ end-users.

SEZs are designated geographic areas within a country that are subject to unique economic regulations and incentives aimed at promoting industrialization, economic growth, and foreign direct investment. These zones are typically established by governments to attract domestic and foreign businesses by offering various incentives such as tax breaks, reduced regulations, customs benefits, streamlined administrative procedures, and infrastructure development. The definition given to SEZs in the new Proclamation aligns with these objectives.

Expanded Scope of Application of the SEZ Proclamation

Unlike the previous law which used to apply only to industrial park activities of the Federal Government, the new law will apply uniformly throughout the territory of Ethiopia, regulating all activities within SEZs and any endeavors associated with them. This includes regulating the actions of individuals or entities engaged in activities within or related to these zones, ensuring consistency and adherence to the established framework across the board. All existing industrial park investments will be subject to the provisions of the new Proclamation and regulations thereunder, and oversight of the Ethiopian Investment Board and the Ethiopian Investment Commission.

The law has also introduced a policy change by the Government by expanding the sectors within SEZs to embrace, in addition to industries, free trade and logistics zones, science and technology parks, service parks, agriculture and livestock zones, and similar investments. The Ethiopian Investment Board is entrusted with the power to decide on the specific investment areas that should be reserved for joint investment with the government, or joint investment between domestic and foreign investors, or domestic investors, and annually publish a bulletin on the National Negative List of Foreign Investments applicable in respect of the SEZs. This will allow foreign investors to invest in the SEZs in any sector that is not included in the negative list issued by the Board.

Investment in SEZs can be made by private investors (domestic or foreign), government, or public-private partnership (PPP) arrangements. The establishment of Ethiopian Investment Holdings as an investment wing of the Government together with the recent amendment of the PPP Proclamation allowing joint venture arrangements between a public enterprise and a private investor (or foreign government or a public enterprise of a foreign Government) and introducing a direct negotiation mechanism whereby the PPP Board may endorse the implementation of a project proposal with a direct negotiation also promote the implementation of the PPP arrangements within the framework of SEZs.

Key Government Institutions in SEZ Operations

Ethiopian Investment Board, Ethiopian Investment Commission, Ministry of Trade and Regional Integration, National Bank of Ethiopia, and Ministry of Labor and Skills and Ministry of Industry play pivotal role to realize the effective implementation of the Proclamation. The designation of SEZs, licensing of SEZs and monitoring of SEZs will be managed by the Investment Board and Investment Commission based on the Proclamation. Industrial Parks Development Corporation (IPDC) has broader powers under its establishment regulation (in addition to being an industrial park developer) to promote the use of industrial parks, attract investors and hold the land to be used for industrial parks based on the national industrial parks master plan it prepares. These additional roles of IPDC are not regulated/clearly recognized under the new Proclamation and the role of IPDC going forward (at the implementation stage of the new Proclamation) does not seem to be clear at this stage. However, the establishment regulation of IPDC setting out its powers will remain valid until amendments are made (if necessary) based on the new Proclamation.

Key Parties in SEZ Operations

The SEZ Proclamation delineates several key actors, ranging from the Investment Board, responsible for designating SEZ areas, to the Investment Commission, tasked with issuing investment permits and business licenses and concluding agreements. Additionally, SEZ residents, certified by the Commission, are authorized to operate or reside within these zones. However, for licensing and operation, four major end-users emerge.

No.	Participant	Type of Entity
1.	SEZ Developer	an entity licensed to engage in the design, construction, finance, operation, and/or ownership of a SEZ.
2.	SEZ Sub-developer	an entity licensed to engage in the design, construction, finance, operation, or ownership of a part of a SEZ based on a sub-developer agreement with the SEZ Developer and EIC.
3.	SEZ Operator	an entity licensed to operate, maintain, repair, service, and/or promote SEZ based on zone operator agreement.
4.	SEZ Enterprise	an entity licensed and possessed a developed land or building of any type within an SEZ through sub-lease or rent to engage in economic activity for profit by the Proclamation and enterprise agreement.

The Proclamation adopted similar arrangement with the existing industrial parks and the parties have also the same rights and obligations stated in the existing legal framework to the extent applicable to SEZs.

Investment Incentives

Fiscal incentives

Standard investment incentives under the Investment Regime

Incentives are generally available to investors in the form of tax holidays, tax exemptions, and duty-free import of various goods. The Incentives Regulation provides income tax holidays and duty-free import privileges for investors engaged in the eligible sectors. Thus, SEZ participants engaged in the eligible sectors are also beneficiaries of these investment incentives based on their investor status.

Fiscal incentives for SEZ participants

No.	Incentive Type	Exempted Income/exemption description
1.	Import/Export Taxes Exemption	Customs duties, value-added tax, and other indirect taxes for imports into and exports from the special economic zone.
2.	Domestic Indirect Taxes Exemption	Zero-rate value-added tax and full exemption from all domestic indirect taxes for goods and services entering the special economic zone from the customs territory.
3.	Duty-Free Import of Construction Materials	Import construction materials duty-free and tax-free for use within the special economic zone, subject to an approved bill of quantity.
5.	Capital Goods Tax Exemption	Customs duty and other indirect taxes for all capital goods entering the special economic zone.
6.	Dividend Income Tax Exemption	Dividend income tax for incomes derived from investing in the special economic zone.
7.	Withholding Tax Exemption	Withholding tax on income during tax holidays.
8.	Income Tax Exemption for Foreign Employees	Income tax on salary for foreign nationals employed by an enterprise undertaking export activities for 5 years.
9.	Personal Effects Import	Duty-free import of personal effects for individuals residing or working in the special economic zone.
10.	Transfer of Personal Effects	Ability to transfer personal effects to another person with similar rights without payment of customs duty and tax.

Non-fiscal incentives

No.	Incentives	All Investors	SEZs
1.	Ownership of Immovable Property	A foreign investor has the right to own immovable property necessary for its investment and may also be allowed to own one dwelling house if it has invested a minimum of USD 10,000,000.	Applicable for SEZs
2.	Expropriation	Guarantee against nationalization or expropriation of the assets of an investor except when the public interest requires it, in compliance with the law and upon payment of adequate compensation corresponding to the prevailing market value.	Applicable for SEZs. This has also been regulated under the new and the existing laws.
3.	Remittance of Funds	The right to remit payments and earnings outside of Ethiopia in convertible foreign currency.	National Bank to issue special directive regulating remittance of funds especially dividends from the investment in SEZs. The existing legal framework generally refers to the investment laws.
4.	External Loan and Foreign Currency Account	Any investor may acquire an external loan for its investment and operate a foreign currency account in Banks in Ethiopia for its investment.	Applicable to SEZs. National Bank to issue special directive regulating the opening of foreign currency accounts for SEZs. The existing law allows Industrial Park developers/operators/enterprises to take loans from foreign and domestic financial institutions.
5.	Employment of Expats and Work Permits	Any investor may employ duly qualified foreigners necessary for the operation of its investment in positions of higher management, supervision, trainers, and other technical professions.	Applicable to SEZs.
6.	Transactions in foreign currency	No entity can transact using foreign currency in Ethiopia except with the special approval of NBE.	NBE to issue a special directive regulating the currency that can be used for transactions between SEZ end users. Based on the existing legal framework, NBE issued a directive allowing industrial park investors to transact in foreign currency with another industrial park investor within the same park or with an investor from another industrial park.
7.	One stop service	NA	EIC to establish a one-stop service within each SEZ.

Land Acquisition

The Proclamation, similar to the existing legal framework, provides that the other legal or administrative regimes defining the terms of access to land, tenure of land, and use of urban or rural land and bidding system shall not apply in respect of special economic zone land, and land acquisition for SEZs will be regulated by a Directive to be issued by EIC. Unless otherwise exceptionally approved by the EIB, the minimum land size for a single SEZ is 75 hectares.

SEZ developers can apply to acquire land held by the Industrial Parks Development Corporation, regional administrations, or private holders. Based on the existing industrial park laws, land which will be used for industrial parks shall first be transferred to IPDC's Land Bank and provided to another developer through an agreement with IPDC. IPDC used to serve as the national industrial parks land bank. The new Proclamation considers the possibility whereby an SEZ developer can directly receive land from regional administrations or private/public leaseholders without going through IPDC. Leasehold certificate will be issued by EIC. SEZ enterprises will sublease land from developers and title deeds for the buildings on the land will be provided by EIC. The details of the procedures of land acquisition are yet to be determined by directives to be issued by EIC and EIB. Given that the land holder will not solely be IPDC under the new Proclamation, regulating the land acquisition process in detail is crucial.

Given that IPDC is also a developer, allowing IPDC to continue having the land bank for the lands to be acquired by SEZ developers might raise a conflict-of-interest issue. IPDC (especially if it becomes privatized) will likely be considered as a competitor and it will be prudent if an independent entity becomes the right holder of the land bank. Land is the key resource for the successful implementation of the SEZ project.

Would the new law have a substantial impact?

The SEZ Proclamation is a key positive development to achieve the Government's objective of accelerating the economic transformation through the establishment of industrial zones in strategic locations and attracting foreign direct investment by creating conducive operating environment. The law comprehensively regulates the setup and operation of SEZs, expands the incentive schemes, and makes administrative procedures easy and clear. While the new SEZ law holds great promise, there are other key areas that need to be addressed for its successful implementation such as infrastructure development, regulatory transparency and implementation capacity, and skilled labor availability.

The effectiveness of the legal and institutional setup needs to also be continuously measured based on clear performance indicators and the challenges need to regularly be identified, assessed, and resolved to secure a higher degree of private participation and maximize the benefits from the SEZs. In 2021, reports show that there were 18 operational industrial parks in Ethiopia, of which 13 were state-owned, and 5 were privately owned and their performance has not been up to expectations. Hence, the introduction of a rigorous monitoring and evaluation system is important to ensure that the new legislative and regulatory reforms are most effective.

Given that the investments in SEZs are capital intensive, it is also important to streamline the legal and regulatory framework for debt financing and collateralization. The debt-to-equity ratio requirement under the existing external loan directive, the implementation challenges around the collateral registry office, and the limited types of securities allowed under the new Proclamation (which does not include securing the lease right on undeveloped land) are worth noting for further considerations by relevant stakeholders. The various implementation directives promised to be issued under the old law as well as by this new law by institutions such the EIC, NBE, etc. need to see the light of day to ensure optimal implementation of the laws.

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