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The Ethiopian Revenues and Customs Authority (ERCA) announces that it met 97.8% of its revenue collection target for the first half of the 2014 – 2015 financial year. Investors remain concerned by Ethiopia's opaque tax legislation and obstacles to repatriating profits. The government introduces new regulations to improve the business environment through simplified tax and customs regimes. Egypt returns to the Nile Basin Initiative, increasing the possibility of a resolution to the Grand Ethiopian Renaissance Dam dispute. An internal inspection panel criticises management of World Bank project amid allegations of human rights abuses.

Government accelerates efforts to improve business environment

Despite the increasing efficiency of the **Ethiopian Revenues and Customs Authority (ERCA)**, Ethiopia's opaque tax legislation and obstacles to repatriating profits continue to trouble investors. In January, the ERCA announced that it met 97.8% of its revenue collection target for the first half of the 2014 – 2015 financial year, a 20% improvement on the equivalent period of 2013 – 2014.¹ The ERCA's revenue collection target for the current financial year is 134 billion birr (ETB) (\$6.58 billion) compared to ETB126 billion (\$6.19 billion) in 2013 – 2014. The ERCA failed to meet its 2013 – 2014 target, collecting only ETB106 (\$5.21 billion).² More than half of the current revenue collection target comes from domestic taxes, including Value Added Tax (VAT) that Ethiopia introduced in 2003, with customs duties accounting for 43%.³ Revenue collection figures show impressive growth: in 2008, the ERCA collected ETB19 billion (\$933m).⁴

The ERCA is an autonomous federal agency formed in 2008 through amalgamating the revenue ministry, the **Ethiopian Customs Authority** and the **Federal Inland Revenues Authority** as the government sought to improve the efficiency of its revenue collection at both federal and state level to reduce its dependence on external aid. This has delivered some successes. According to the most recent **World Bank** figures, tax revenue as a percentage of GDP increased from 8.2% in 2010 to 9.2% in 2011.⁵ The ERCA estimates that tax revenue currently accounts for 12.6% of revenue, compared to the **sub-Saharan Africa** average of 18%.⁶

Despite increases in revenue collection, problems persist. These include a lack of ERCA capacity at branch level, tax fraud, a reliance on bank statements to determine income, and limited use of cash register machines.⁷ Collection efficiency varies markedly across cities and municipalities. Revenue collection in **Addis Ababa** missed its target by approximately 25% with the ERCA claiming that half of businesses reported zero sales or losses. There are accusations that the ERCA is overly focused on maximising returns from Ethiopia's narrow tax base rather than looking to broaden it.⁸ In 2012, the ERCA noted that approximately 78% of Ethiopia's tax revenue came from fewer than 1,000

1 Capital, 3 Feb 2015.

2 ERCA figures.

3 Addis Fortune, 3 Feb 2015.

4 Addis Fortune, 3 Feb 2015.

5 World Bank figures

6 Addis Fortune, 3 Feb 2015.

7 Addis Fortune, 26 Oct 2014.

8 Addis Fortune, 2 Nov 2014.

individuals.⁹ The tax base remains small as city administrations and municipalities have failed to update their records adequately, while informal businesses and properties are excluded.¹⁰ Currently, only Addis Ababa and **Dire Dawa** have introduced the **Standard Integrated Government Tax Administration System** at city level. Tax coverage is also a problem with a failure to revise and update fixed charges and fees, and is subject to political pressure (see below).¹¹ Payment procedures are slow and inconvenient, while enforcement mechanisms for defaulters are limited.¹² The politically motivated **Federal Ethics and Anti-Corruption Commission of Ethiopia (FEACC)** investigation that resulted in the dismissal of ERCA director general **Melaku Fenta** in May 2013 (see *ARC Ethiopia May 2013 Briefing*) damaged the ERCA's reputation.

Despite government concessions, there are ongoing tensions between international investors and the ERCA about the framework of transaction, income and capital gains taxes. Between 2014 and 2015, Ethiopia fell three places on the World Bank's *Doing Business* ranking for 'paying taxes' from 109 to 112. Nevertheless, Ethiopia is doing better than the regional average.

	Ethiopia	Sub-Saharan Africa avg
Payments (number per year) ¹³	30.0	38.2
Time (hours per year) ¹⁴	306.0	310.8
Profit tax (%)	26.2	17.6
Labour tax and contributions (%)	4.8	14.0
Other taxes (%)	0.8	14.7
Total tax rate (% profit)	31.8	46.2

The government has attempted to reassure investors that the tax regime is not overly burdensome. In July 2014, the government wrote off approximately 60% of disputed funds that the ERCA was demanding from several companies.¹⁵ This followed intense lobbying by the **Ethiopian Chamber of Commerce & Sectoral Associations**, the **Public Private Consultation Forum** and the **Addis Ababa Chamber of Commerce & Sectoral Associations**.¹⁶ On 2 February, the government resolved a dispute between the ERCA and the **China** state-owned **ZTE Corp**, forgiving ERCA imposed penalties on alleged tax arrears.¹⁷ ZTE agreed to pay the owed taxes within three years.

New regulations to improve the business environment are coming into force. In September, the government simplified procedures both to determine outstanding tax penalties and to reduce the burden of appeals processes, which currently require companies to deposit 50% of their claim.¹⁸ In November 2014, parliament discussed a bill amending the anti-corruption proclamation to

⁹ The Guardian, 7 May 2013.

¹⁰ Ethiopian Civil Service University, 2014.

¹¹ Ethiopian Civil Service University, 2014.

¹² Ethiopian Civil Service University, 2014.

¹³ The indicator reflects the total number of taxes and contributions paid, the method of payment, the frequency of payment, the frequency of filing and the number of agencies involved for the standardized case study company during the second year of operation. (World Bank, *Doing Business*)

¹⁴ The time it takes to prepare, file and pay (or withhold) the corporate income tax, value added or sales tax, and labor taxes, including payroll taxes and social contributions (in hours per year) (World Bank, *Doing Business*)

¹⁵ Addis Fortune, 20 Jul 2014.

¹⁶ Indian Ocean Newsletter, 5 Sep 2014.

¹⁷ Capital, 2 Feb 2015.

¹⁸ Capital, 19 Sep 2014.

strengthen the FEACC.¹⁹ Additionally, in December 2014 a new customs proclamation replaced 2009 regulations while a new income proclamation is expected in the first half of 2015.²⁰

The complex tax regime nevertheless remains an obstacle to those doing business in Ethiopia. In September 2014, the **European Union (EU)** permanent representative in Ethiopia, **Chantal Hebberecht**, met with the deputy prime minister responsible for finance, **Debretsion Gebremichael**.²¹ Hebberecht listed obstacles facing EU businesses in Ethiopia including the complexity and opaqueness of ERCA regulations and obstacles to repatriating profits, which first requires a **National Bank of Ethiopia** audit. Wider concerns include the persistent shortage of foreign currency, difficulties in licensing, and the administrative challenge of clearing goods at **Addis Ababa Bole International Airport**.²² In February, the ERCA launched a tender to supply a new customs management system to replace the outdated existing automated system for customs and data.²³

Possible agreement on the GERD increases access to international financing

Ethiopia may find it easier to secure international financing for the **Grand Ethiopian Renaissance Dam (GERD)** if **Egypt's** return to the **Nile Basin Initiative (NBI)** leads to a political agreement over the dam's development. Egypt remains concerned that the construction of the GERD on the **Blue Nile**, a source of the **Nile River**, will negatively affect its water supply. On 21 February, Egypt attended an NBI summit of the Nile's riparian states²⁴ in **Khartoum (Sudan)**. The NBI may provide a legal and regulatory framework to facilitate a political and economic agreement about the GERD. Nine of the Nile's riparian states formed the NBI in 1999 to facilitate the codifying of a treaty covering equitable use of and benefit from the river. In May 2010, five upstream states²⁵ signed a cooperative framework agreement to replace colonial era treaties that allocate Egypt a disproportionate amount of the Nile's waters and allow it to veto upstream projects that would impact on its "*historical and natural rights*".²⁶ Egypt responded by suspending its participation in the NBI. The NBI is a key source of financing for river infrastructure projects and has leveraged \$6.5 billion in financing.²⁷

Ethiopia is currently financing the \$4.6 billion GERD internally, signaling the government's commitment to its state-led financing model that increases the country's exposure to debt and squeezes out private sector finance. Ethiopia privately blames Egypt for lobbying international creditors and donors not to finance the GERD.²⁸ International NGO criticism about the environmental impact of the GERD has further deterred external investment.²⁹

*"Many of the problems related to financing the GERD could be reduced with regional cooperation with downstream countries and potential co-financing from Egypt and Sudan that would help cooperation and bring about true collaboration."*³⁰

There is no concrete study as to how much the GERD has affected Ethiopia's economy. The dam was costing ETB40m (\$2m) per day during the concrete filling process in 2014, one example of the tremendous amount of state capital it is consuming. The government has mobilised financial resources through a number of means.

¹⁹ Addis Fortune, 23 Nov 2014.

²⁰ Capital, 24 Dec 2014.

²¹ Indian Ocean Newsletter, 5 Sep 2014.

²² Indian Ocean Newsletter, 5 Sep 2014.

²³ Addis Fortune, 7 Feb 2015.

²⁴ MENA, 23 Feb 2015.

²⁵ Ethiopia, Kenya, Uganda, Rwanda and Tanzania (Burundi signed in February 2011)

²⁶ 1929 treaty with Great Britain

²⁷ Ethiopian foreign ministry statistics

²⁸ Source, journalist, Addis Ababa

²⁹ Source, journalist, Addis Ababa

³⁰ Source, hydroelectric expert, Addis Ababa

“The government is busy these days selling government bonds, advertising lottery ticket draws and collecting money from public servants and private sector employees alike. Some even say the government has channeled the country’s foreign exchange deposit to the GERD project, thereby affecting other sectors of the economy.”³¹

The government may launch additional government bonds through state-owned Ethiopian banks both domestically and in the diaspora. Without foreign investment, the government will continue to look to harness patriotic enthusiasm.

“The Ethiopian government has fashioned the GERD as a national project to promote patriotism that will bring ordinary Ethiopians out of poverty and allow Ethiopia to develop further.”³²

In Ethiopia, every civil servant contributes a month’s salary to a national bond to fund it in tribute to late prime minister **Meles Zenawi** (1995-2012).³³ The government denies that the scheme is compulsory and claims that it will remunerate civil servants at an unspecified date in the future. This approach has resulted in criticism that the GERD is an **Ethiopian People’s Revolutionary Democratic Front (EPRDF)** project rather than a national one.³⁴ A number of EPRDF connected state-owned enterprises are involved in the development of the GERD. **Metal & Engineering Corp (Metec)** subsidiaries are overseeing the electro-mechanical engineering work. Metec chairman **Kinfe Dagneu** – an ethnic **Tigray** – additionally benefits from the dominant position of the **Tigray People’s Liberation Front (TPLF)** in the ruling EPRDF. The TPLF dominates government decision-making. This economic and ethnic influence has led to a perception of Kinfe as “*untouchable*”.³⁵ Under Kinfe, the government has allowed Metec to challenge the position of other state-owned enterprises. In 2013 Metec acquired two maritime vessels from the **Ethiopian Shipping Lines** to transport materials to the GERD despite the **Ethiopian Maritime and Logistics Enterprise** officially having a monopoly on maritime transport.³⁶

Human rights criticism forces World Bank rethink

The **World Bank Group** has tightened its risk management strategies to working in Ethiopia, highlighting the sensitivity of projects involving land displacement. The World Bank board of executive directors on 27 February discussed the results of an internal independent inspection panel investigation into its **Promoting Basic Services (PBS)** programme in **Gambella Region**.³⁷ The World Bank has implemented the PBS since 2006. The local **Anuak** community claim that the PBS is linked to the government’s **Commune Development Program (CDP)**, which in turn is linked to alleged human rights abuses and forced displacements as part of the government’s ‘villagisation’ relocation programme. The Anuak claim they claim they have been forcibly evicted and their land is now being leased to foreign firms and local investors for large-scale commercial agricultural development.³⁸ According to a leaked copy of the report, the inspection panel concluded there was an “*operational link*”³⁹ between the PBS and forced displacements,⁴⁰ but the World Bank board said that any forced displacements were not directly the consequence of the PBS.⁴¹ The panel criticised the PBS for not sufficiently assessing and mitigating risks around the implementation of the government’s CDP. According to the inspection panel, the World Bank

³¹ Source, journalist, Addis Ababa

³² Source, hydroelectric expert, Addis Ababa

³³ FT, 19 June 2013.

³⁴ Source, journalist, Addis Ababa

³⁵ The Africa Report, 13 Jun 2014.

³⁶ Addis Fortune, 19 Oct 2013.

³⁷ Press Release, 27 Feb 2015.

³⁸ Source, East Africa security analyst

³⁹ www.icij.org

⁴⁰ www.icij.org

⁴¹ Press Release, 27 Feb 2015.

“...did not carry out the required full risk analysis, nor were its mitigation measures adequate to manage the concurrent rollout of the villagisation programme.”⁴²

The World Bank approved a **Management Action Plan** to improve PBS processes for citizen engagement, safeguards, and financial management. The World Bank said its panel’s findings would not deter it from further engagement in Gambella. The World Bank will submit an \$80m **International Development Association** operation to improve public finance management for board approval later this year.⁴³

There has been an increase in attacks on commercial developments in Gambella, which are believed to be linked to the forced removals. In March 2013, security forces killed Ethiopian-born **United States** national, **Omot Odol Ojulu**, who had been on Ethiopia’s most wanted list of terrorists in Gambella’s **Agnwak District**.⁴⁴ Authorities said Ojulu was behind an attack in 2012 on the **Saudi Star Rice Farm**, an agriculture company owned by **Saudi-born** Ethiopian billionaire **Mohammed al-Amoudi**.⁴⁵

Implications

Ethiopia’s domestic revenue performance will increase as the ERCA broadens the tax base and improves compliance. Ethiopia’s state-led fiscal model is expected to remain unchanged in the medium term. For businesses, the result of Ethiopia’s tightly controlled economy is a heavy bureaucratic workload and this will not ease soon.

The regional benefits of the GERD’s power exports – especially to Egypt, which is facing an acute power shortage – will ensure that pragmatic cooperation continues until a final agreement is in place. This is likely to be connected to the riparian states renegotiating the 2010 cooperative framework agreement.

The controversy of ‘villagisation’ in Gambella is indicative of wider tensions around state displacement of communities for commercial projects. The allegations are similar to the reported relocation of **Ogaden** populations in areas of **Somali Region** earmarked for oil exploration, and the displacement of **Bodi** and **Kwegu** communities in the **Lower Omo Valley** for the **Gibe III** hydroelectric dam and state-owned sugar cane plantations. Companies can mitigate reputational risks through effective community liaison and engagement strategies.

⁴² www.documentcloud.org/documents/1505022-world-bank-inspection-panel-report.html

⁴³ Press Release, 27 Feb 2015.

⁴⁴ Source, East Africa security analyst

⁴⁵ Source, East Africa security analyst