

AFRICA RISK CONSULTING

Ethiopia Monthly Briefing June 2016

Ethiopia Summary 17 June 2016

Ethiopian and Eritrean forces exchange heavy fire along the Tsorona Central Front. The exact trigger for the incident is unclear but it follows a United Nations Commission of Inquiry on Human Rights in Eritrea (UNCIHRE) report critical of Eritrea. The government begins its second Growth and Transformation Plan (GTP 2) house-building programme. The finance ministry and the Ethiopian Revenues and Customs Authority (ERCA) open consultations with foreign investors over proposed reforms to the income tax and tax administration proclamations.

Ethiopian and Eritrean forces clash in Tsorona

Ethiopia and **Eritrea** have exchanged claims of responsibility after cross-border violence on 12 and 13 June. Continued fighting between security forces along the mutual border is probable, increasing the risk of damage to nearby mining and infrastructure operations. The fighting involved heavy artillery fire in a disputed region in the **Tsorona Central Front (Tigray Regional State)**.¹ Both sides have blamed the other for the fighting, and both have claimed substantial casualties. According to the Ethiopian account, Eritrean forces made aggressive movements outside their trenches, before Ethiopian forces launched a counterattack deploying artillery and tanks.² Tsorona was the site of fierce fighting during war between 1998 and 2000. The never accurately demarcated mutual border, which remains closed, is a regular flashpoint due to the contested status of the town of **Badme**. Tens of thousands of Ethiopian and Eritrean troops remain at post along each side of the border. Since the 2000 ceasefire, the border issue has remained unresolved, and it is a high-risk area due to the close presence of both militaries.

“There are hard-liners in both Ethiopia and Eritrea who would resume fighting given the chance. However, full-scale war between Ethiopia and Eritrea remains unlikely, over the next five years. The war had enormous human and financial costs for both countries, and destabilised both governments. However, the proximity of the two armies makes any skirmishes a potential flashpoint.”³

The exact trigger for the incident is unclear, but comes amid increased tensions between Ethiopia and Eritrea. The Ethiopian government has allegedly resumed contact with the **Eritrean National Council for Democratic Change (ENCDC)**, the Eritrean opposition parliament in exile.⁴ The Ethiopian government has reportedly extended offers of logistical and financial support to the ENCDC.⁵ The resumption of support came after the Ethiopian government claimed that it foiled Eritrean mercenaries planning an attack in southern Ethiopia on 6 May after they crossed into the country from **Moyale (Kenya)**.⁶ Local media reported that Eritrea-backed Ethiopian opposition group **Ginbot 7** had claimed responsibility an attack in **Arba Minch** in which it reportedly killed 20 **Ethiopian National Defense Force (ENDF)** soldiers.⁷ This was further south than the majority of

¹ www.awate.com

² VOA, 14 Jun 2016.

³ Source, political analyst, East Africa

⁴ Source, business consultant, East Africa

⁵ Source, business consultant, East Africa

⁶ www.awate.com

⁷ www.awate.com

Eritrea-related security incidents, which are typically concentrated along the heavily militarised border. There was no independent verification of the incident or Ginbot 7's claim of responsibility.⁸ In February, the Ethiopian government accused Eritrea of backing the **Oromia Regional State** protests (see *ARC Briefing Ethiopia February 2016*).

A possible explanation for the Tsorona violence is the Eritrean government wanting to distract attention from a critical **United Nations (UN) Commission of Inquiry on Human Rights in Eritrea (UNCIHRE)** report.⁹ The UNCIHRE published a report on 8 June alleging the involvement of senior **Eritrean Defence Forces** in crimes against humanity.¹⁰ The UNCIHRE documented alleged human rights violations in the state's indefinite national service, including the use of conscripts as forced labour.¹¹ The UNCIHRE called for the **International Criminal Court (ICC)** to open investigations and consider possible prosecutions.¹² The **UN Security Council** is scheduled to vote in November whether or not to extend sanctions on Eritrea. Despite persistent allegations, the **UN Monitoring Group on Somalia and Eritrea** has not found any substantive evidence that Eritrea has provided support to **Somalia-based militant group al Shabaab**. The report may encourage the UN to retain sanctions, extending Eritrea's international isolation. Ethiopia will assume a non-permanent seat on the UN Security Council in 2017/2018, meaning Eritrea has only a small window in which to ensure sanctions are lifted.

Western governments are increasingly reaching out to Eritrea as part of a strategy to address the migration crisis in the **Mediterranean**. The UNCIHRE estimates that 5,000 Eritreans flee the country each month, mostly to avoid national service.¹³ The **European Union** in late 2015 agreed a \$226m bilateral development package to Eritrea despite human rights concerns about the government.¹⁴

Eritrea is increasingly concerned about lifting sanctions as it looks to develop its nascent mining sector. Eritrean president **Isaias Afewerki** (1993- present) is struggling to manage the economic ambitions of his senior military personnel who want an end to Eritrea's international pariah status so that they can benefit from investment in its mining sector.¹⁵ In February, director general of the Eritrean mines department **Alem Kibreab** said four gold, zinc, copper and potash mines will come online before 2018.¹⁶ Eritrea currently has only one mine in **Bisha**, which is a joint venture between state-owned **Eritrean National Mining Corporation (ENAMCO)** and **Canada-based Nevsun Resources**. Allegations of forced labour have deterred mining companies from entering Eritrea, as has the structure of mining agreements that provide for the state holding an initial 10% stake free and the right to purchase an additional 30%.¹⁷

Government begins house-building programme

Despite the Oromia protests, the government has embarked on a house-building programme in terms of its second **Growth and Transformation Plan (GTP 2)**. The government has committed to the construction of 2.45 million houses between 2015/2016 and 2020/2021.¹⁸ The real estate sector has grown rapidly in recent years on the back of Ethiopia's economic growth.

*"Move around the city centre or step into the outskirts of the Ethiopian capital, **Addis Ababa**, and you will notice how this city of five million has transformed over the years, especially in the past 10 years. Skyscrapers now dominate the central Addis Ababa skyline and thousands of new*

⁸ www.awate.com

⁹ www.ohchr.org

¹⁰ www.ohchr.org

¹¹ www.ohchr.org

¹² www.ohchr.org

¹³ www.ohchr.org

¹⁴ www.EUBULLETIN.com

¹⁵ Source: Western diplomat, Addis Ababa

¹⁶ Reuters, 26 Feb 2016.

¹⁷ Reuters, 26 Feb 2016.

¹⁸ Source, journalist, Addis Ababa

houses are mushrooming in the vicinities, thanks to the prevalence of a booming construction sector that now constitutes a chunk of the country's economic activity.”¹⁹

However, the issue of affordability, quality and displacement of farmers in the outskirts of the capital persists. Violent clashes between police and student protesters have recently claimed the lives of more than 400 Ethiopians, triggered in part by anger towards the government's plans to expand the city's outskirts into the adjacent Oromia Region.²⁰ The government was planning to expand the city so as to provide more land for industries and housing projects. A series of recent building collapses in some parts of the country has raised the issue of quality, which some say is completely disregarded. Besides, many Ethiopians complain that most of the real estate developers' properties are beyond the means of the majority in Ethiopia, mainly catering for the rich and the diaspora.

Despite the Oromia protests, the urban development and construction ministry has confirmed that it has started implementing its housing plan. **Mohammedzain Kedir**, policy and programme bureau officer for the ministry told an ARC researcher that the construction involves 750,000 houses in urban areas and 1.7 million houses in rural areas and will result in 600,000 jobs.²¹ These are all part of the government-owned housing projects.

Private real estate developers are also trying to benefit from the construction boom by embarking on massive projects. The major local players are **Yotek, Sunshine, Tsehay, Ayat, Country Club Developers** and **Ropack**. Major international real estate companies are also entering the local market, such as the **Egypt-based Arab Contractors Company**.²² It is currently building two projects in Ethiopia at an investment of more than \$111m. It is also studying a plan to build a new affordable housing project in Addis Ababa, mainly residential units of seven, nine and 12 floors each.²³

“Private real estate developers have continued to put their mark on the city in the past decade and many of them are accredited for the emergence of new neighbourhoods on the outskirts of the capital. But many critics say this sub-sector remains an exclusive club to the high-income group and the high-end property market. And they do not seem to be going down the income ladder anytime soon. Many say the private developers market has ended up in supplying an exclusively luxury accommodation whose average selling price is far beyond the middle-income consumer.”²⁴

According to **United Nations Habitat**, approximately 70% of Ethiopia's population lives in poor housing amid unhygienic conditions.²⁵ Over 80% of the homes are “*Chika houses*” – made of mud walls and wood.²⁶ Over 35% of the solid waste generated by the city is not collected. According to its latest findings, only 9% of urban areas are connected with a sewer system and about 71% of households do not have adequate sanitation.²⁷ Data from the **African Housing Finance Handbook 2015** indicate that the price of the cheapest developer property sold in Addis Ababa is \$34,000, with a price per square metre of \$567.

“According to government figures, Ethiopia currently has 50 licensed companies operating in the market, exclusively catering for high-income group and availing exclusively high-end luxury accommodation.”²⁸

All land in Ethiopia is under state ownership. Although land legislation is the responsibility of the federal government, it has delegated key powers to regional states. However, not all states have

¹⁹ Source, journalist, Addis Ababa

²⁰ Human Rights Watch, 16 Jun 2016.

²¹ Source, ARC investigator, Addis Ababa

²² Source, ARC investigator, Addis Ababa

²³ Source, ARC investigator, Addis Ababa

²⁴ Source, journalist, Addis Ababa

²⁵ Source, ARC investigator, Addis Ababa

²⁶ Source, ARC investigator, Addis Ababa

²⁷ Source, ARC investigator, Addis Ababa

²⁸ Source, journalist, Addis Ababa

passed the corresponding laws or regulations on how to implement government policies (which are sometimes unwritten), leading to confusion and a high level of informality in the sector. There are two systems of property management in Ethiopia: a permit system, under which landholders pay generally low annual rents, and a separate 2002 land lease system that covers a range of practices from negotiated land payments to leases allocated by auction. City and municipalities often have overlapping responsibility for land parcels and maintain property records using poor and complex systems.

Government opens tax talks with private sector

The finance ministry and the **Ethiopian Revenues and Customs Authority (ERCA)** are consulting with foreign investors over proposed reforms to the income tax and tax administration proclamations.²⁹ While tax rates in Ethiopia are approximately in line with the regional average, inefficient bureaucracy results in business delays, increasing concerns about repatriation of profits and encouraging tax evasion.³⁰

The new income tax boundaries reflect Ethiopia's rapid economic growth since it established the current tax framework in 2002. According to the draft tax table, individuals earning up to 585 birr (\$26.9) a month are exempt from income tax. Individuals earning over 10,833 birr (\$498) will pay 35%.

Income tax applies to residents with respect to their worldwide income, and non-residents with respect to their Ethiopian-sourced income. An individual is considered resident if the person has a domicile, has a habitual abode, or stays continuously or intermittently in Ethiopia for a period of more than 183 days in a period of twelve calendar months.

Finance ministry legal service director **Wassihun Abate** has said the reforms will address ambiguous provisions in existing tax regulations to increase revenue collection efficiency. Problems 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.³¹ Collection efficiency varies markedly across cities and municipalities. Tax coverage is also a problem with a failure to revise and update fixed charges and fees, and subject to political pressure.³² Payment procedures are slow and inconvenient, while enforcement mechanisms for defaulters are limited.³³

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.³⁴ This followed intense lobbying by the **Ethiopian Chamber of Commerce & Sectorial Association**, the **Public Private Consultation Forum** and the **Addis Ababa Chamber of Commerce & Sectorial Association**.³⁵ In September 2014, 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.³⁶ Wassihun said that the new law will be in line with **International Financial Reporting Standard**.³⁷

Implications

Eritrea is in an increasingly strong position to secure the lifting of sanctions. For western governments, it is now a key partner in the Mediterranean refugee crisis. For **Saudi Arabia** and the **United Arab Emirates**, Eritrea's **Red Sea** coastline is strategic for the **Gulf-led** intervention in

²⁹ The Herald, 12 Jun 2016.

³⁰ Source, business consultant, Addis Ababa

³¹ Addis Fortune, 26 Oct 2014.

³² Ethiopian Civil Service University, 2014.

³³ Ethiopian Civil Service University, 2014.

³⁴ Addis Fortune, 20 Jul 2014.

³⁵ Indian Ocean Newsletter, 5 Sept 2014.

³⁶ Capital, 19 Sept 2014.

³⁷ The Herald, 12 Jun 2016.

Yemen. This means that Eritrea has more international backing than in previous incidents with Ethiopia, increasing the possibility of a diplomatic resolution to contain the cross-border violence. Nevertheless, until the two parties reach agreement over boundary demarcation, further similar incidents are probable.

State control of the property market and corruption will continue to deter risk-averse investors. There is little transparency in the pricing or allocation of land during the auctions and prices fluctuate with little explanation.

Businesses will welcome increased tax transparency. However, Ethiopia's tightly controlled economy results in a heavy bureaucratic workload and this will not ease soon.

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