# The 1976 Monetary and Banking Proclamation: Innovations and Implications

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## INTRODUCTION

Although money in Ethiopia has a long history dating back to the Axumite Empire,[1] comprehensive legislation and institutions are of relatively recent origin. The first bank in Ethiopia was the Bank of Abyssinia, a branch of the National Bank of Egypt which opened its doors for business in February 1905 with a capital of £500,000. This Bank was purchased in October 1931 by the Ethiopian Government, renamed the Bank of Ethiopia, thus becoming not only the first bank to be owned wholly by the nation, but also one of the first indigenous central banks in Africa.

The Bank of Ethiopia was closed in 1936, legally liquidated in 1945 and until 1942 no Ethiopian bank was in existence, although banking services were provided by four branches of Italian banks, namely Banco d'Italia, Banco Nazionale del Lavoro, Banco di Roma and Banco di Napoli, of which the latter two continued to do business until January 1975, when they were nationalized. In 1941 Barclays Bank of Britain followed in the footsteps of the British troops, and established a branch which operated until 1943. The first Ethiopian postwar bank was established by proClamation in 1942 (Proclamation No. 21 of 1942) and was named "State Bank of Ethiopia." It combined the functions of commercial and central bank until 1963.

The Monetary and Banking Proclamation (Proclamation 206, hereafter referred to as MBP1) of 1963 separated commercial and central banking, entrusting the latter responsibility to the National Bank of Ethiopia (hereafter referred to as NBE) which was created by an order in the same year. Although prior to 1963 there were a number of legislations on money and monetary affairs, MBP1 for the first time defined the national monetary policy and institutionalized its management in the NBE.

In December 1975 the Provisional Military Government articulated its policy as the development of a socialist society, and issued an economic policy that was

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1 Fo the history of banks and banking in Ethiopia, see *Ethiopian Observer*, Vol. VIII No. 4.

deemed to be consistent with and necessary to the realization of this intention. The policy, among other things, declared (PMAC, 1974) that those resources that were either crucial to economic development or were of such a character that they provide an indispensable service to the community would have to be brought under government control or ownership.

On 1 January 1975 the Government exercised its intention of controlling the commanding heights of the economy when it nationalized three commercial banks, about eleven insurance corporations and two financial intermediaries, and subsequently reorganized them on lines considered to serve the best interests of the society. The nationalized insurance companies were merged with those owned by the Government to form the Ethiopian Insurance Corporation. The two financial intermediaries were amalgamated to form the "Housing and Savings Bank" and assigned to cater to the financial needs of the construction industry. The Government-owned "Agricultural and Industrial Bank" was re-established and given the task of providing credit for industry and agriculture. The reorganization of the commercial bank was completed in two stages. The first phase saw the merger of the three nationalized banks into "Addis Bank" while the last phase was implemented when this commercial bank was absorbed into the Government-owned "Commercial Bank of Ethiopia." The development in the financcial sector culminated in the repeal of the 1963 proclamation, which was replaced by the Monetary and Banking Proclamation of 1976. This paper attempts to delineate the differences between the MBP1, the 1963 Charter and Proclamation 211 of 1963 and the MBP2, along with the economic implications of the major innovations. Part I presents a comparative overview of the 1963 and 1976 legislations, with an accent on their differences, using the structure of the latter for ease of exposition. Part II discusses the implications of the important innovations.

## 1. Major Changes introduced by the 1976 Monetary Proclamation

The post-1963 monetary policy and its management was articulated in 78 articles spread over two proclamations[2] and an order[3] dealing with money and banking, regulation of foreign exchange, and the Charter creating the NBE respectively.[4] With the four articles that created the Bank of Abyssinia in 1905 and the three articles that established the State Bank of Ethiopia in 1942, the sheer size of the 1963 legislations must appear awesome. But the difference in the number of articles at one and the same time reflected the complexity of the nation's monetary policy and its management. While, through its three articles, the 1942 proclamation is for example content to informing us of its title in the first, the establishment of State Bank in the second, its capital, (one million Maria

2. "Monetary and Banking Proclamation, 1963" (Proclamation 206 and Foreign Exchange Proclamation 1963" (Proclamation 211).
3. "National Bank of Ethiopia Charter 1963" (Order No. 30)
4. Both the Charter and Proclamation 206 have been amended over the years, and the final version is used in this paper.

Theresa dollars, a legal tender along with the East African shilling until July 1945 and February 1946 respectively) in the third, the 1963 proclamations go much further than this both in detail and scope, defining the objectives of the domestic and external monetary policy, along with the powers and instruments available to the NBE.

In 74 articles, the 1976 Monetary and Banking Proclamation consolidated the three different legislations of 1963 into one body of law, expanded some of the chapters, deleted and amended others, and as a whole developed comprehe-hensive and less vaguely defined goals and instruments.

### The Legislation

Chapter 1 of MBP2 is definitional, dealing with general provisions.

Chapter II defines the legal status, powers and duties of the NBE, amalgamating Chapter I of MBPI and Chapters I and II of the Charter. The 1976 provision recereates the National Bank, bestows on it legal personality and defines its powers and duties. The NBE is to regulate and control the monetary and banking regime of the nation. However, with regard to both purpose and power of the NBE, MBP2 is much more explicit than its predecessor. The 1963 provisions make it the monopoly source of notes and coins[5] and grants it the power to regulate money supply, fix interest rates, manage the nations international reserve, licence and supervise banks[6] with the goal of fostering monetary stability, credit and exchange rate, conditions conducive to the balanced growth of the economy;[7] but MBP2 goes much further than this, and explicitly states the objectives under which it shall exercise these (and other powers) which should be in accordance with the national plan, to achieve high rates of growth with high employment and stable prices.[8] The powers of the NBE are given in the 16 subarticles of Article 9, which, in addition, grants NBE the right to require the socialised sector[9] to maintain accounts which are open to its inspection,[10] as well as to direct banks and other financial institutions to deny credit to enterprises which misuse financial resources at their disposal,[11] with the objective of increasing the efficient utilization of resources.[12] In general, MBP2 defines the purpose less vaguely and amplifies the power of the NBE more clearly.

Chapter III deals with capital, reserves and financial statements of the NBE, which matters were treated previously in the Charter;[13] the important differences being the increase in the capital[14] and the distribution and management of the profits.[15]

5. Charter, Article 8.
6. Article 2 of MBP1.
7. Charter, Art. 3.
8. Art. 6.
9. Defined under Articles 2(5) (a) and (b).
10. Art. 9(8)
11. Art. 9(7)
12. Art. 9(6)
13. Chapter 3, section 9-14
14. Charter Art. 9 and MBP2, art. 10, respectively.
15. See Art. 12(1) of MBP2 and Art. 11(1); Art. 12(2) of MBP2 and Art. 11(2); Art. 12 (3) (a) and (b) of MBP2 and Art.11(3) (a) and (b) of the Charter, respectively.

Chapter IV deals with organization and administration of the NBE, and again this was part of the Charter.[16] Under both systems the NBE is to be administered by a Board of Directors. The remaining Articles detail the general organizational and administrative aspects.

Chapter V defines the relations between NBE and the Government, a subject treated in Chapter III of MBP1, some of which was amended in 1969.[17] The NBE serves the Government as its fiscal agent and banker. In this respect it can extend credit, accept deposits and make payments on its behalf.

With respect to credit, MBPI (as amended) forsees that the Government can borrow from NBE on the bases of (a) direct advance, (b) treasury bills, and (c) bonds.[18]

Secondly, as far as the size of credit goes, MBP1 (as amended) limits direct advance to 20% of the ordinary revenue collected during the previous fiscal year, subject to interest payment, the exact rate of which is to be negotiated between the Ministry of Finance and NBE, but should never be less than 3% per annum. It also specifies the payment of any debt previously contracted under this heading as a condition for further extension of credit.[19] MBP2 increases the size to 25% makes the 3% interest the maximum and rules out repayment as a precondition for further extension.[20]

The Government can acquire credit from or through the NBE by selling treasury bills[21] the amount of which is limited to 12% of the ordinary revenue collected during the previous fiscal year under MBP1 (as amended), while under MBP2 this ratio is increased to 20%.[22]

The third credit instrument available to the Government is bonds, limited to three times the capital plus the general reserve fund of the NBE plus 82 million Birr,[23] while under MBP2 the base is changed to ordinary revenue collected in the previous fiscal year and the ratio is 50%.[24]

Chapter VI deals with relation of the banks and other financial institutions, and has three parts: (a) regulation and control of credit, (b) credit transactions, deposits and related matters, and (c) transactions in international reserve assets. The latter point does not concern us here, nor is it different from its predecessor,[25] endowing the NBE with a monopoly involving foreign exchange transactions, along with its power to delegate this authority to others.

(a) Regulation and Control of Credit. This part is similar in both legislations,[26] and grants the NBE the power to direct its own credit as well as those of other banks and other financial institutions, to set the interest rate at which it is to lend to other banks and other financial institutions, and to control the purpose,

16. Chapter IV, Art. 15-21.
17. "Monetary and Banking Proclamation (Amendment) Decree (Decree No. 54, 1969." Hereafter referred to as the Decree).
18. Art. 13(3); (4); (7)
19. Decree Art. 2(a) and MBP1 Art. 29 and 26(3) (a).
20. Art. 26(3) (a).
21. Decree Art.2(6)
22. Art. 26(3) (b) (3).
23. Decree Art. 2(c).
24. Art. 26(3) (c).
25. Compare Chapter IV part 3 Arts.
26. Art. 20-35 of MBP2 and Art. 15-20 of MBP1.

size, period and interest rate they are to charge and pay on deposits of different kinds. Two important points of departure between the two legislations concern reserve and liquid assets requirements. Both legislations[27] require banks and other financial institutions to deposit in cash or other liquid assets, including treasury bills,[28] a certain proportion of their deposit liabilities. The crucial difference is that, under the MBP1, a bank is limited to a maximum of 20% of its deposit liability, while under MBP2 the limit is left to the discretion of the NBE. Similarly, both legislations empower the NBE to require banks and other financial institutions to keep a certain proportion of their short-term liabilities in liquid assets. However, under MBP1 it is limited to a maximum of 30%, while under MBP2 the ceiling is left to the NBE's direction.[29]

(b) Credit Transactions and Deposits. Both MBP1 and MBP2 prescribe the conditions under which banks and financial institutions may borrow from the bank.[30] The NBE may discount, rediscount, purchase or sale bills of exchange, treasury notes, etc., from banks and other financial institutions.

Chapter VII deals with supervision and control of banks and other financial institutions. While Chapter V of MBP1 deals with licensing and supervision of banks, MBP2 does not include licensing, since this matter has been succinctly dealt with by granting the NBE the monopoly power to establish, consolidate or dissolve banks and other financial institutions.[31] A point worth mentioning here is that, while the result of inappropriate financial management by banks would lead the NBE under MBP1, depending on the gravity of the situation to (a) suggesting corrective action, (b) prohibiting its receipt of desposits, (c) suspension of business in whole or in part, and (d) liquidation[32], under MBP2 it would simply lead to "appropriate measures" to be taken [33]

Chapter VIII deals with the monetary unit, the legal tender and administration of foreign currency; this had its counterpart in Chapter Two of MBP1. MBP2 changes the monetary unit from the Ethiopian dollar[34] to the Birr[35] with the same gold parity, i.e. 0.355468 gm. of fine gold. The gold content of the Ethiopian dollar (devaluation or revaluation) was to be effected by the Emperor upon the recommendation of the Council of Ministers,[36] while under MBP2 it is to be done by the Government upon the recommendation of the NBE.[37]

A rather significant ammendment is one which deals with the distribution of the assets of the NBE. While both legislations require the NBE to hold part of its assets in an international reserve fund, consisting of gold, foreign currencies and

27. Art. 18 of MBP1 and Art. 33 of MBP2.
28. Art. 13 (5) of MBP1 and Art. 26 (3) (b) (2) of MBP2.
29. Art. 38 (1) of MBP1 and Art. 50 of MBP2.
30. Art. 21-23 of MBP1 and Arts. 36-38 of MBP2.
31. Art. 9(3).
32. Art. 37.
33. Art. 49
34. Art. 3(1) of MBP1.
35. Art. 51
36. Art. 3(3).
37. Art. 52.

securities, etc.,[38] MBP2 drops the specific provision from MBP1 which required the NBE to hold an amount equal, at a minimum, to 25% of the notes (but not coins) it issued and its liabilities payable on demand.[39] On the other hand, MBP2 requires the NBE to hold part of its assets in an international reserve fund, enough to meet (a) the import needs of the country, (b) foreign debt servicing, and (c) the imports of essential services.[40]

Chapter IX deals with the regulation of foreign exchange, which like the proclamation it repealed, contains the definition of the conditions and circumstances governing foreign exchange transactions. It specifically underlines that the NBE or authorized dealer(s) are the only persons (physical or juridical) to hold and deal with foreign exchange, while others have the obligation to surrender all the foreign currency in their possession.[41]

Chapter X of MBP2 deals with general provisions, and includes laws that are repealed, those still in force, its precedence over others in case of conflict, delegating the NBE to issue regulations, penal clause in case of contraventions, the effective date of the proclamation, etc.[42] An interesting article is that which introduces a secrecy provision into the banking operation.[43] Although secrecy is considered a traditional characteristic of the banking industry, the Ethiopian Law, for the first time after 1963, states this obligation clearly.[44]

## II. Implications of some of the major innovations of the MBP 2

MBP2 is the product of the revolution that introduced novel philosophical and economic factors into the country, and it was meant to adjust the monetary and banking policy into the new system as well as providing the necessary instruments for the attainment of its objectives. Consequently, the difference between MBP2 and the legislations that it repealed must be viewed as reflecting the differences between the systems, conditions and objectives under and for which they were produced.[45]

The fulcrum on which MBP2 was developed is the national goal of developing an independent economy, the essence of which is selfreliance. Instead of depending on external factors, the nation is to rely on its own resources to provide it with the necessary developmental baselines. This goal is reflected in MBP2 in the articles that deal with (a) the issue of notes, (b) control of money supply and credit, and (c) Government credit from the NBE.

38. Art. 8(1) of MBP1 and Art. 60 (1) of MBP2.
39. Art. 8(2) of MBP1.
40. Art. 60 (1) and (2).
41. Arts. 61-67.
42. Arts. 69-74.
43. Art. 68.
44. Secrecy of the individual's account was first introduced into the country explicitly under the 1943 charter of the State Bank of Ethiopia, Art. 5 (11). However, this was not carried into MBP1.
45. This paper does not treat the problematics of MBP2 and the effectiveness of the monetary policy, a subject treated in another work. See Befekadu Degefe, *Monetary Policy for the Mobilization and effective Utilization of Financial Resources*, pp. 80-158.

### (a) Issue of Notes by the NBE

An innovation that could be considered as a watershed in the development of the nation's monetary policy is introduced into MBP2 under Article 60. This article, while governing the distribution of the assets of the NBE, is a landmark in that for the first time in the nation's monetary history, it breaks the link between the issue of domestic legal tender notes from its foreign assets. To appreciate the significance of this provision it may be helpful to review the pre-1976 conditions under which the country's legal tender notes were issued along with their economic repercussions.

Although the Government vested the exclusive power of issuing notes and coins to the State Bank of Ethiopia in 1945,[46] it was at the same time required to back all issues of notes (i.e. excluding coins) with capital in the international reserve fund consisting of gold, silver, foreign currencies, foreign bank balances or prime securities readily convertable into foreign currencies or foreign bank balances to the minimum extent of 75%, and the remaining 25% by Imperial Treasury obligations.[47] At the same time the country operated under the free exchange system.[48] It should be clear that under such an agreement, the amount of notes issued, and thus the quantity of money floating in the economy, depended on the balance of trade (strictly speaking the balance of payment), and not on the needs of the domestic economy. With reference to the Imperial treasury, obligations, we may, consider in this instance an exporter who sold coffee abroad to the value of 1,000 Birr, which sum would be released by the State Bank when it was in receipt of foreign exchange of an equal value. If this exporter (or other importer for that matter) imported goods whose value in foreign exchange equalled 1,000 Birr, then this amount of money had to be handed over to the State Bank. Again for example, abstracting from the 25% Treasury obligation the amount of notes to be issued by the State Bank and consequently the volume of money (i.e. currency outside banks plus net demand deposit plus saving and time deposit floating in the economy) would be equal to the excess of the value of exports over imports. Where the value of exports equalled that of imports, no additional notes would be issued, as the amount issued due to exports would be cancelled out by the notes absorbed by the State Bank to finance imports, etc. This in essence meant that the domestic money supply was a function of the international reserve fund held by the State Bank, to the exclusion of domestic needs. No matter what the requirements of the domestic economic activity was, and regardless of the purpose, the State Bank of Ethiopia could not issue notes that were not backed, at the minimum, by 75% in foreign assets.

The economic implication of such an arrangement was that it incapacitated the nation from developing an independent economic policy, for the simple

46. Art. 3 of Currency and Legal Tender Proclamation (Proclamation No. 76 of 1949).
47. Art. 4
48. There was no Foreign Exchange Control until 1949. See Currency Amendment Regulations (Legal Notice No. 127), 1949.

reason that the command over the pursestrings, so to speak, was held by external factors. The direction and tempo of the national economic activity was thus dictated and controlled not by policies that were developed in the country, but by the international economic environment. The fact that the amount of money floating in the economy was determined by the balance-of-payment position, and since future production of exportables and non-exportables was a function of past performance as well as future expectations, the growth of output and employment were brought under the effective control of the demand for the nations output by the rest of the world, as well as the demand for imports by the country.

Such a system of issuing notes, notwithistanding the position of the balance of trade, was also dangerous to the domestic economic stability. If the balance of trade is positive, this increases the domestic money supply and thus demand, and, in the absence of tools and mechanisms for demand management, proves inflationary. If, on the contrary, the balance of trade is negative, it decreases the domestic money supply as well as demand, and this decreases prices and eventually output. In the broader context, such an arrangement required the domestic economy to adjust "ex post" to an "ex ante," external activity, a situation that is impossible.

It was not until 1949, when as a result of the decline in the price of coffee and the ensuing problems whose nature were discussed above, that the Government perceived the need to change the base on which domestic notes were to be issued, and at the same time to institute a system of foreign exchange control. Between 1949 and 1950 two important laws were enacted, the one introducing foreign exchange control[49] and the other reducing the dependence of the domestic note issue from a minimum of 75% in foreign assets to a maximum of 30%, with Imperial Treasury obligations carriying the balance.[50] This amended definition of the relationship between the domestic legal tender notes and foreign assets continued to be operative until 1963, when MBP1 reduced the ratio to a minimum of 25%,[51] Thus between 1950 and 1963 the dependence of the issue of domestic legal tender notes (and by implication the domestic money supply) on the country's foreign assets was gradually attenuated.

Under MBP2, the NBE is granted the monopoly of notes issue, and is at the same time required to hold part of its assets in an international reserve fund.[52] However, the significance here is that it excludes any relationship between the amount of legal tender notes to be issued and the assets held in the international reserve fund. While, by presumption, the quantity of notes to be issued is to depend on the needs of the domestic economy, the amount of assets to be held in international reserve at any time is to be sufficient to pay for imports of goods and

49. Currency Amendment Regulation (Legal Notice No. 127), 1949.
50. Art. 3 of the "Currency (Amendment) Proclamation 1950 (Proclamation No. 112 of 1950).
51. Art. 8 (1) of MBP1.
52. Arts. 7 and 60 respectively

services as well debt-servicing, Thus MBP2 separated the linkage that existed between the issue of domestic legal tender notes, and thus the money supply and the nation's international reserve, completing the metamorphosis of developing an independent, domestically managable monetary policy, a *sine qua non* for the development of an independent domestic economic policy, started a quarter of a century earlier

### (b) Control of Money Supply and Credit by the NBE

While the dissociation of issuing domestic legal tender notes (and thus the money supply) from the vagaries of the international economic environment, over which the country does not have any control and with which its interest may not conform, is welcome, MBP2 at the same time has broadened the responsibility of the NBE to include (1) the fostering of balanced and accelerated economic development, (2) the promotion and maintainance of a high level of production, employment and real income, and (3) encouraging and promoting the full development of the productive forces of Ethiopia by using monetary instruments to adjust the quantity of money to what is required. The money supply has its primary base in the quantity of legal tender notes issued, and its secondary base how they are used by the three important institutions, namely the Government, other banks and other financial institutions, and the non-banking public. Whether the NBE, independent of external controlling factors, can successfully adjust the quantity of money floating in the economy to what is actually desired depends on how it controls itself, as well as dealing with these three institutions. Two of these problems can be dealt with easily. With respect to controlling itself, the NBE is assumed to have come of age and to have grown sufficiently responsible to take measured and prudent actions in all its dealings. Secondly, with respect to the non-banking private sector, which is otherwise completely outside the direct control of NBE (and which as of December 1979 accounted for 76% of the money supply in the form of currency outside banks),[53] it is expected to influence the management of their monetary resources through the interest rate it allows banks and other financial institutions to pay or charge their customers, and by encouraging them to use the monetary institution to a greater extent than they do at present. Monetary control through banks and other financial institutions, as well as the NBE's relation with the Government, is more complicated.

(1) **Banks . Other Financial Institutions and the NBE.** A monetary policy that is not directly linked to external variables becomes a sensitive undertaking that calls for prudence and vigour. The equilibrium in the domestic economy can be wrecked if there is too large or small amount of money floating than is required, resulting either in recession or inflation or both. As a result, the close and constant monitoring of the money supply with the objective of maintaining a balance with the needs of the current economic activity becomes crucial.

53. NBE, *Quarterly Bulletin*, Vol. 6, No. 1, March 1960.

Under both MBP1 and MBP2,[54] the NBE is entrusted with the responsibility of regulating the money supply which is defined in the case of Ethiopia as currency outside banks plus net demand deposit. While the instruments of control are the same under both legislations, the NBE is in a more powerful position under MBP2 relatively to MBP1, as a result of an important provision dealing with banks and other financial institutions. Briefly, the more important policy instruments available to the NBE to control money supply are (a) open market operations, (b) discount rate, and (c) reserve requirement. To illustrate how the NBE uses these instruments (separately or in any combination), let us assume that the amount of money as defined above is more than what the economic activity requires. Then the policy objective calls for decreasing the extra amount of money floating in the economy. If it opts to use open market operation, then it will exercise its power[55] to sell government securities (bonds, treasury bills, promissory notes etc.) to banks, financial institutions and individuals.[56] When the NBE sells securities, it releases certificates of government debt and collects money. Since the money in the NBE is not considered to be part of the money supply, this action automatically decreases the money supply, in the first instance by the amount that financed the purchase from currency outside banks and demand deposit. When the NBE feels that the economy needs more money than is currently floating, it reverses the process.

On the other hand, the NBE can use discount rate[57] to control the money supply. This instrument functions either by encouraging or discouraging banks and financial institutions to borrow from it to increase or decrease their credit-creating capacity; which has a potential to increase money supply. If the NBE feels that the amount of money floating in the economy is sufficient or greater than what the economy needs, and if at the same time banks and other financial institutions want to borrow money from it to lend to their customers, it will increase the interest rate at which it would grant them credit to a level high enough to discourage them. When and if it feels that the money supply should increase, but the banks and other financial institutions are short of cash, it will encourage them to borrow from it by decreasing the discount rate.

However, while the open market and discount rate are necessary instruments, they are not sufficient, in and by themselves, to make possible an effective adjustment of the money supply to the needs of the economy. This is so because of two basic characteristics of the banking industry. The first is that the effectiveness of these two instruments is possible if and only if the banks and other financial institutions are willing to purchase (or sell as the case may be) government securities and/or want to borrow money, and there is no way in which the NBE can otherwise enforce compliance. Secondly the interest of the NBE

54. Arts. 2 (9) and 9 (1) respectively.
55. Art. 26 (1) (b) and Art. 26 (3) (c).
56. Art. 26 (3) (b) (4), in addition to those in footnote 57.
57. Art. 31.

and that of the banks and other financial institutions might be at variance. While the former is interested in adjusting the money supply to the needs of the economy, the latter is interested in maximizing profit. Thus, if the NBE wants to decrease money supply by selling securities and/or increasing the discount rate, the banks and other financial institutions can increase the money supply by recycling the financial assets deposited by their customers to satisfy their profit motive. The reserve reauirements and liquidity ratio (along with quantitative and qualitative credit control)[58] are the instruments by which the NBE controls the money supply by controlling the loanable funds of the banks and other financial institutions; hence the importance of these two instruments.[59]

The reserve requirement is available to the NBE,[60] and when it uses this instrument, it requires banks and other financial institutions to deposit a certain percentage of their deposit liabilities in its account; this money is therefore not available to them to lend out or use otherwise.[61] Similarly, the liquid assets that are assigned to cover the required liquidity ratio cannot be used for any other purpose.

While the open market operation and discount rate provisions are carried into MBP2 from MBP1 whithout change,[62] the reserve requirement and liquidity ratio provisions have undergone important revisions. Although the NBE was granted the powers under MBP1, it was however limited to raising the reserve requirement to a maximum of 20% and the liquidity ratio to a maximum of 30% of their deposit and short-term liabilities respectively.[63] This meant that, even under conditions of inflationary pressure, the banks and other financial institutions could lend out 80% and 70% of their deposit and short-term liabilities, thus frustrating the policy of tight money which the interest of the economy would prescribe. Perhaps cognizant of this problem, the drafters of MBP2 gave the NBE 100% control over the loanable fund of the banks and other financial institutions[64] when they left the percentage that could be imposed as required reserve and liquidity ratio to its discretion; this puts the NBE in a relatively better position than before. As a result of these provisions, the NBE can vary the required reserve as well as the liquidity ratio to a level it feels would produce the desired results.

(2) *Credit Control.* The NBE under MBP1[65] could, through regulations, issue conditions under which it would extend credit to banks and other financial

58. Art. 50 and Art. 9 (2) along with Art. 34 of MBP2 respectively.
59. Another objective of the reserve requirement and liquidity ratio is partial insurance for depositors, in case of bankruptcy of the banks and other financial institutions' bankruptcy.
60. Art. 33.
61. Currently the reserve requirement is 10% of the on-demand deposit, and 5% of the savings and time deposit.
62. Compare Art. 13 (2) (b); 13 (4); 13 (5); 13 (6) and Art. 16 of MBP1 with the relevant articles of MBP2, cited supra.
63. Art. 18 (1) and 38 (1) of MBP1, respectively.
64. Arts. 15-23.
65. Arts. 30-35.

institutions, vary the interest rate it and banks and other financial institutions would charge for different lines of credit they extend to their customers, and determine the direction, duration, purpose and limit of credit. While all of these powers are carried into the MBP2,[66] it includes, albeit by implication, the important implementational provision of examining the books of public enterprises to ascertain that they are using financial resources at their disposal in a socially beneficial manner.[67] Where the NBE feels that public enterprises are misusing resources, it can direct the banks and other financial institution not to extend any credit.[68] Thus, not only can the NBE direct credit to activities that would contribute to the development of the country, and limit the amount when the general interests of the economy so dictate, it can also ensure the proper utilization of the resources.

### (c) The Relation Between Government and the NBE.

The relations between the Government and the NBE are better integrated under MBP2. While under MBP1 the relationship between the NBE and the Government is a relationship between a bank and a client, under MBP2 the NBE becomes an active participant in the formulation of the financial plan of the Government with the view to (a) ensuring monetary stability and balance of payment equilibrium, and (b) making available financial resources to cover its deficit.[69]

Secondly, the Proclamation has standardized the base on which the size of the Government credit from NBE is to be calculated in the three cases of direct advance, treasury bills and bonds. Henceforth the base is to be the actual ordinary revenue collected during the previous fiscal year. It has also increased the coefficients relating the ordinary revenue to the size of credit to 0.25 in the case of direct advance, 0.20 in the case of treasury bills, and 0.50 in the case of bonds. The change in the base, the increased coefficients, and the maximum of 3% interest payment on direct advance are all designed to increase monies to be made available to the Government to finance its needs.[70]

The increase in the flow of financial resources from the NBE to the Government is understandable, considering the fact that the latter is the prime mover of the economy, a responsibility that will require an expenditure far greater than its revenue, at least in the foreseeable future.

## Anomalies Between the Law and the Goals of the Society

One objective of the Ethiopian revolution has been unequivocally defined as the development of a socialist society, whose achievement would require the

66. Art. 9 (8).
67. Art. 9 (8).
68. Art. 9 (7)
69. Arts. 9 (15) and 26 (2).
70. As of December 1979, Government internal debt was 1.2 billion birr of which 26% was direct advance, 24% was treasury bills (including promissory notes) and the 50% balance in bonds. See *Quarterly Bulletin* (NBE), Vol. 6 No. 1, March 1960.

subordination of all institutions to these objectives. The 1976 monetary and banking proclamation presents certain anomalies or discrepancies of which the two major ones are pointed out below.

(a) The competitive nature of the Law. The basic assumption of the NBE's relationship with banks and other financial insititutions, and especially with the Commercial Banks, is that there will be more than one of them, and that they will be operating in harmonious competition. However, the classic organization of banks in socialist or socialist-oriented societies is one in which there is only one central bank (with specialized banks under it) and no competition. Development in the Ethiopian banks suggests a move in this direction, with only one commercial bank. While the legislation is not against consolidation, it is nevertheless at variance with the goals and objectives of the society by assuming (tacitly) the legality of competition among banks and other financial institutions.

(b) second and more serious anomaly is the relationship between the NBE and the Government. Since a socialist economy operates under a central plan, the issue here is whether the plan should be subservient to financial resources that can be made available, or whether the money should be made available in order to fulfil the plan. The latter alternative does not seem to be operative in Ethiopia, since the Government is limited to the amount of financial resources that can be made available to it from the NBE, or even from banks and other financial institutions, since they are under the control of the central bank.

## CONCLUSION

Although MBP2 inherited most of its provisions from the legislation that preceded it, it has nevertheless introduced important innovations into the nation's monetary policy and its management. For the first time, it has liberated the domestic monetary policy from external dependence, increased the monetary resources that can be made available to the Government, and at the same time it has increased the power of the NBE to control the domestic monetary scene. However, this increased capacity, while very welcome, is limited to banks and other financial institutions, and, through the interest rate and selective credit control system to their customers. While these powers are perhaps sufficient in economies that have a low ratio of currency outside banks to total money supply, it may not be sufficient in the case of Ethiopia, where more than three-quarters of the money supply is outside banks (and beyond the control of the NBE), and an effective monetary policy must create instruments capable of harnessing this wild giant. Until such time, the NBE's capacity to control the money supply remains incomplete.