

Research Article

# The Nature, Function, and Independence of the National Bank of Ethiopia: A Comparative Analysis in Light of International Practices

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## Abstract

A central bank is an autonomous institution that is mainly bestowed with the mandate to ensure the maintenance of price stability by formulating and implementing monetary policy. To fulfill its purposes, the law should make sure that the CB is independent of external influence. Accordingly, the NBE is established to act as the central bank of Ethiopia, empowered to deliver on multiple objectives, including price and exchange stability. Nonetheless, it is evident under its legal framework that the requirements for institutional, functional, and personal independence of the NBE are disregarded. Hence, having this problem in mind and considering the research gap in the particular area, the study attempted to review relevant legal instruments of the NBE, assessing them against parameters of institutional, functional, and personal independence; selected countries' laws, and the expert opinions of NBE officials and IMF expert to make the required analysis about the nature, functions, and independence of the NBE. Consequently, the study revealed impediments related to the institutional, functional, and personal autonomy of the bank. Thus, concerning institutional independence, there is a lack of clear provisions protecting the bank from government and other entities' influence. The absence of hierarchy between its objectives, the dominance of government representatives in the BoD, the absence of legal limitations on the advances to be provided to the government, and ambiguity as to the role of monetary policy formulation and oversight roles of the BoD are the manifestations of the absence of functional independence. Whereas, in terms of personal autonomy lack of provisions stipulating the security of tenure, qualification criteria, and procedure for the appointment and dismissal of the BoD members, Governor, and Deputies are evident. Having identified these concerns under the current laws, the researcher recommends the relevant revisions of the laws to address the enumerated impediments in line with the best practices of central banks.

## Keywords

Monetary Policy, Fiscal Policy, Institutional Independence, Functional Independence, Personal Independence

## 1. Introduction

A Central Bank is an independent institution that goes by different naming, for instance, Reserve Bank, National Bank, and Monetary Authority. It is mainly responsible for the

formulation of monetary policy, currency management, regulation, and supervision of FIs [11].

The institution first known in history to act as a CB is the

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**Received:** 5 March 2024; **Accepted:** 16 April 2024; **Published:** 29 July 2024



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Swedish Riksbank. This bank was established in the year 1668 with the power of lending to the government and acting as a clearing house. It was after this bank that several others started to be established in Europe and other continents to issue currencies and deal with monetary stress [15].

Mostly, Parliaments determine that the CB is supposed to control the implementation of monetary policy to achieve its goals without the direct intervention of the Executive. This will play a great role in somehow avoiding the conflict between the decisions of the CB with the goals of the government [11].

The NBE is established as an autonomous institution by Order No.30/1963; which made NBE to only have the mandate of Central Banking, unlike the previous ones. [2]. Following this, different laws were promulgated to govern the formulation and mandate of the NBE. The currently effective Proclamation is the NBE Establishment (as amended) Proclamation No.591/2008; which states that the NBE is an autonomous institution vested with the responsibilities of a CB. Though its autonomy is declared under this Proclamation [6], the law does not seem to stipulate detailed provisions in this regard. It is declared under this law that the bank is accountable to the Prime Minister [6]; that might create conflict between the bank's objectives and the government's [11] political goal. Besides this, the majority of the board members of the bank are government officials; which might give the government a chance to influence the board's decision. These natures of the NBE as reflected under relevant laws may seem to indicate that the Bank's institutional, functional, and personal independence could be in question.

## 1.1. Statement of Problem

The Independence of CBs is imperative to efficiently achieve their goals and create a stable financial sector and economy; since the most effective economic policies may not align with governments' political goals [11]. The intervention and influence of the Executive could manifest itself in different ways including via the function of CB, governance structure, and budget and finance. Thus, the nature of the CB and the functions assigned to it are also paramount in dictating its relationship with the government [18].

As mentioned earlier, Proclamation No.591/2008 reaffirmed the autonomous existence of NBE [6]. However, Art. 77 of the FDRE Constitution gives the administration of the NBE to the CoM and the Proclamation provides that the Bank is accountable to the PM. Hence, the fact that, the administration is reliant on the will of the executive and that the law seems to be shorthanded to provide for the protection of the NBE from the potential influence of the government in its operation, might have its reflections on the autonomy of the NBE.

CBs in Sub-Saharan Africa regions of which Ethiopia is a part are considered to have one of the lowest scores of autonomy on average while measured against the parameters.

Moreover, though it is evident that the independence of a CB is crucial for its effective operation [10], to the best of the knowledge of the researcher there is a lack of works of literature that specifically examine the autonomy of the NBE and measure it against institutional, functional, and personal independence. Therefore, having this gap in mind, the major focus of this paper was assessing the relevant laws regarding the NBE in terms of its nature, functions; and institutional, functional, and personal autonomy while assessing it with selected countries' experiences and indicators of independence of a CB.

## 1.2. Literature Review

CBs are public policy institutions with the main responsibilities of safeguarding monetary and financial stability, issuing currency, and managing the nation's gold and foreign exchange reserves [11]. It is claimed that although the objectives given to a specific CB have changed over time, macroeconomic stability including price stability, stable exchange rates, and the promotion of maximum sustainable growth remains a primary focus [27].

The nature, organizational structure, and autonomy of a CB are considered to be the backbone of the effectiveness of targeting its assigned mandates [23]. In terms of ownership structure, CBs could be publically owned or under private ownership, or hybrid. Moreover, the clarification of these concepts under the establishing Acts is significant in the realization of the independence of CBs to enhance their operations [23].

Throughout the years the objectives and functions of a CB and its relationship with the government and different stakeholders are changing. These changes are considered to call for gradual alterations on the nature of the CB through amendment of existing laws, though the changes are different in every country's context [13].

At first, CBs were more focused on being a lender to the government and commercial banks, and supervisors. However, after the end of the 1970s they started to emphasize on price stability and inflation control [13]. The mandate of a CB is determined among others by the type of monetary system, the political environment, and the level of development of the Country; thus as it is in the case of structure, the function of a CB differs from one country to another [23]. Some CBs hold on double responsibility for monetary policy issuing and supervision, but others tend to give the supervisory role to an independent government entity. Thus, among other things, the structure or nature of the CB seems to be shaped by the role assigned to it as well [31].

For the CBs to function properly, the authority granted to them to execute their tasks is fundamental. This raises the concern that a given CB's independence relies on the circumstances in which it performs its functions that are related to the CB's relationship with the government. Ajayi S. I state that the CB should be an institution filled with experts who could well

control and explain the monetary policy and be free from political influence. This is because the interest of the government in the market is different from the CBs as the government is said to focus more on the sole growth of the economy even at the cost of inflation [23].

As stipulated under literatures focusing on CBs' autonomy, the independence of a CB shall mainly be assessed against the indicators of institutional, functional, personal and financial independence. Institutional autonomy tends to shield the CB from the intrusion of the government in its execution. Functional independence is mainly manifested by empowering the CB to limit the advances to the government and by stipulating the mandates of the CB clearly and in a hierarchical manner. The personal independence of a CB is measured in reference to the tenure, grounds, and procedures of appointment and dismissal of the management [32].

Having this as a background and considering the lack of detailed studies on the area of the NBE, the major focus of this paper was assessing the relevant laws regarding the NBE in relation to the its nature, functions, and institutional, functional and personal independence while evaluating it against selected countries' experiences and manifestations of autonomy of a CB.

### 1.3. Research Methodology

#### 1.3.1. Type of Research and Data Collection

This study analyzed the existing legal framework of NBE in terms of its nature, function, and autonomy by referring to literatures; and to make a comprehensive assessment, a comparison with selected countries' legal frameworks and parameters of independence was conducted. Therefore, this study followed the Doctrinal and Comparative Research Method.

To understand the existing legal framework and address the research questions, a Qualitative Research was conducted. Accordingly, both primary and secondary source of data were employed. As to primary data, laws that govern the NBE were identified and scrutinized. Besides these, the legal development of the NBE was explored to understand the historical background and development of the current laws. CB laws of selected countries were also assessed for the necessary comparison. Furthermore, to elaborate the legislations secondary source of data was assessed including previous researches, articles, books, policies, and reports related to the area of study.

Moreover, to better explain the laws and works of literature in the area, the researcher conducted interviews face-to-face and via electronic means with selected experts as another primary source. To this end, a semi-structured interview guide was prepared in English and was translated into the local language when needed. The interviews lasted for about 45 to 60 minutes. The researcher made sure that the questions were clear enough in such a way they could be understood easily by the participants. Based on the interview guide, open and fol-

low-up questions were used during the interview to solicit the desired information.

#### 1.3.2. Sampling Methods

To collect primary data the researcher used a purposive sampling technique and selected the participants based on their expertise, exposure to the area of study; and official responsibility. Using this technique the respondents were selected from current and former officials and experts in the NBE. Accordingly, a total of four participants were selected from the Legal Service Directorate; External Economic Analysis and International Relations Directorate of the NBE and the former Senior Macroeconomic Advisor of the Governor and the current Senior Economist at the IMF. The participants are Directors, Chief experts and Senior Advisors in their area with more than 10 years of experience.

Moreover, the researcher reviewed various countries' legal frameworks in relation to the purpose of the study and selected Kenya, Brazil, and Japan. In this regard, to get a glimpse of diversified experiences, the aforementioned States were selected based on their representativeness of the developing and developed countries, the difference in socio-economic and political development as it determines the nature, functions, autonomy, and ownership structure of the CB; and most importantly, the strength of the legal framework of the CBs in terms of their nature, mandate, governance, and autonomy was scrutinized.

## 2. The Organization and Functions of NBE in Light of International Practices

### 2.1. Overview of Central Banks' Organization and Functions

Depending on the legal system and the governmental structure, it could fairly be said entirely CBs in the world are established by separate legislation in which the structure, mandate, function, management, and relationship with the government are clarified [11].

History shows us that the ownership of CB by private shareholders was the rule and government ownership was the exception; though things are reversed contemporarily. This situation is said to commence changing as CBs were nationalized starting from the year 1935. The effect of economic depressions, the relevance of the participation of the government in financial sector supervision, and monetary policy control were some of the reasons stated for such changes [33]. The involvement of the government in the ownership of CB is further explained as a desire by the government to regulate the public's money since the private sector might be focusing on its agenda of profit-making than policy regulation [36].

CBs ownership could be held entirely by the government,

all by private shareholders, and banks, or they could own it together. The CB of South Africa and Greece could be good examples of CBs which are still held by private shareholders and banks. Italy's CB is characterized by having all bank shareholders, and in Japan, the CB is held by the government (55%) and private shareholders. Turkey and Switzerland are considered good examples of the model of CB where government, banks, and private shareholders are included [33].

Despite exceptional countries, gradually private ownership started to be dominated by State which are established as autonomous government institutions; either entirely or keeping private ownership with a limited share. Those CBs that are still composed of private shareholders are regulated by both company law and specific laws issued to regulate the CB. The specific laws which govern CBs may empower them to formulate and implement monetary policy, the power to make quasi-legal judgments, and restrict private shareholders from participating in the monetary policy mandate of the CB [11]. The ownership of CBs entirely or with a certain percentage is said to be advantageous in the sense that they will not directly be exposed to the influence of the government. However, this argument is challenged by stating the fact that, individual shareholders may be fixated on profit maximization than the interest of the public [11].

With regards to the ownership of the CB, on an interview conducted with Mr. Mesfin, he elaborated that the entire share of the CB shall remain in the hands of the government. This is because, the CB holds the power to regulate a country's monetary policy and financial stability which encompass a lot of confidential matters. This might stand against the inherent interest of private shareholders that is, maximization of profit. He goes on and explains that, if the intention of involving the private sector in the ownership structure of the CB is to ensure its independence and representativeness, then that could be done through the participation of the private sector in the BoD [36]. Whereas, while he emphasizes that the government should hold the majority stake, Mr. Habtamu states on an interview that it is preferable for the government and private shareholders to jointly own a CB. He supports his claim by pointing out that, a CB that is fully owned by the government will be vulnerable to political influence from the government, and tilting it towards advancing government objectives rather than its mandate. On the other side, he notes that full private ownership of the CB is also not advised because they can be more motivated by the desire to maximize profits. Therefore, he reiterates that hybrid ownership will balance both interests and will contribute to the effectiveness of the CB [35].

On this concern, on an interview conducted with Mr. Efreem, he argued that the ownership of a CB by a private or public entity is not a problem by itself; rather, the issue is more about how the law governs the main manifestations of autonomy. So, even if a certain CB is fully or partially controlled by private shareholders, it still may be subject to government interference if the law does not ensure the CB's autonomy. Because of this, it is difficult to state either type of ownership is better

than the other; it all depends on the authority granted to it by the law [34].

Most CBs are known to be administered by a BoD and managed by Governors and Deputy Governors. In the majority of the cases, CBs tend to have one single BOD; though some CBs are seen to contain multiple BODs. These boards could be arranged as executive and supervisory BODs or based on specific functions like a board focusing on monetary policy issues, BOD focusing on financial sector supervision, and yet others have a BOD focusing on CB's management. Among others, policy-related BODs are responsible for decisions associated with the monetary policy formulation and implementation; except in some countries like Madagascar and New Zealand which make the Governor responsible for the monetary policy decisions [17].

Mostly multiple BOD structure is preferred if the CB is bestowed with several objectives which are prone to conflict and need specific attention. This is said to be an advantage when we think of it in terms of allowing different professionals to work on their areas of expertise. For instance, the supervisory board is responsible to check out the conduct of the CB in general on behalf of the public and make the leaders accountable. Such type of BOD is preferred to be chaired by a person other than the Governor and shall contain external stakeholders. Nonetheless, in countries that do not have multiple BODs, supervisory acts are not taken care of by a specified BOD; rather it is conducted by the Senates or Public Auditors. Moreover, in such countries, to create a check and balance within the CB governance, the responsibility of the Governor of the CB is made to be separated from that of the chair of the BOD [36].

The number of BOD members varies considerably across nations; generally speaking, states with larger, more complicated economies, populations, and regional structures have more BOD members. To make well-rounded decisions, it is important to guarantee that all population segments are represented. A notable example of such an economy is the US, which has 19 members; while Switzerland, which has 3 members on the BOD, is a good example of a less complex economy.

During the early days of CB establishment its major mandate used to be being the government's banker; mainly when it comes to financing wars. Slowly the mandate extended to ensuring the stability of the financial system up to the point where the contemporary focus of CBs became the formulation of monetary policy [35].

The CB statutes may explicitly define its mandate or leave it up to inference from general terms of objectives, depending on the legal traditions. Though CBs are known to engage more in providing loans, they are said to have three major functions, the formulation of monetary policy to address macroeconomic issues, being the lender of last resort to different FIs and overall stabilizing the financial system [28]. Generally speaking, it is claimed that CBs in developing States are mandated to take care of more functions than de-

veloped ones [28]. In this regard, the interviews conducted with Mr. Efreem and Mr. Melessee showed that in developing countries the CB is better-off to have the mandates of price stability, FIs regulation and supervision, and employment. Nonetheless, these functions need to be stipulated under the law in a hierarchical manner; though such hierarchy should be flexible enough to empower the CB to deviate from such hierarchy in exceptional situations. This would allow the CB to prioritize one mandate from the other to handle a certain event with justifiable reason and only for a specified period. For instance, in a time of deflation which could lead to an increment in unemployment rate and a reduction in economic activity, the CB could give priority to maximize employment by injecting money into the market [34, 37].

CBs are preferred to handle monetary policy mandates as they are not like elected officials who are infamous for giving priority to short-term economic booms. In addition, the government is said to lack the necessary expertise as that of the CB to handle monetary policy issues. In terms of monetary policy, CBs are recognized to perform a variety of tasks including, issuing legal tender and overseeing its circulation, managing the nation's gold and foreign exchange reserves, and monitoring FIs [28].

On a similar note, most CBs are known to take the majority of responsibility when it comes to ensuring financial stability; because of the lack of another fit institution to take care of such mandates. However, it is stressed that in most cases, this function is not directly stated under the establishing instruments of CBs. Rather they are indicated via other functions like FIs supervision, provision of loans to FIs to solve liquidity issues, and facilitation in the payment and settlement system [22, 31]. One way for the CB to stabilize the financial system is being the lender of last resort when financial institutions face liquidity problems; though such means should be used only in exceptional circumstances. Furthermore, the supervisory mandate of the CB will be an asset to gather data on the status of FIs to easily analyze which institution needs the intervention of the CB using such a last resort [17].

There are arguments that the function of monetary policy formulation and implementation conflicts with financial institution supervision. It is said that there may come a time when the CB will be forced to make tradeoffs if such situations so require. With this in mind, several countries decided to transfer the function of supervision to an independent institution; for instance, Korea, the UK, Japan, and Switzerland. However, still most countries make CBs supervisors of FIs or make CBs advisors to an independent supervisory institution. This is because it is believed that CBs are fit to handle financial crises with the expertise and information they have in hand and such information could be an asset in making crucial monetary decisions [20].

Mr. Mesfin opposes the idea that the mandate of financial stability and FI supervision being separated from the CB, especially for developing nations where the CB's authority and structure are still in their infancy. In his opinion, having

the authority to oversee the soundness of the nation's financial system would make it simpler for the CB to implement monetary policy tools. However, if it is designated for a separate entity, then it might require the consent and willingness of such an entity. In this regard, Mr. Melessee reiterates that there is no harm in leaving the supervision mandate under the auspices of CB but the law should clarify the hierarchy between the mandates [36, 37].

CB laws also state that the bank is an advisor to the government when it comes to economic policy issues; since the relevant experts are found in an organized manner in CBs. They also collaborate with the government when the need arises to tackle a certain issue that requires the cooperation of both monetary and fiscal policy. Furthermore, the CB takes care of payments of the governments, facilitates security exchanges, provides short and long-term loans and advances; and acts as a debt manager to the government [11].

Moreover, CBs are involved in conducting various studies that could be useful in taking decisions related to general economic, monetary, and financial stability. They are also seen to be responsible for the promotion of the development of the financial industry through a variety of strategies, such as financial literacy and consumer protection [11].

It should be emphasized, nonetheless, that CBs do not typically offer banking services to the general public other than the government and FIs. This is because the primary objective of commercial banks is to increase their profits from their operations, but the monetary activities of CBs should be isolated from commercial banking services. However, this should not be interpreted to suggest that the CB does not generate revenue, as this is not the case. In particular, CBs that are wholly or partially owned by private shareholders tend to generate revenue while pursuing their mission. And this revenue should be utilized mainly to support the fiscal policy of the government as a source of income and reinforce the financial capacity of the CB itself to take care of its mandates [16].

## 2.2. Assessment of the Organizational Structure and Functions of NBE in Light of International Practices

After reviewing NBE's legal framework in terms of its organizational structure and function, it is believed that analyzing it with international practices is of paramount importance for better understanding. Hence, this section is dedicated to providing a glimpse of three countries' CB legal frameworks that is, Kenya, Brazil, and Japan.

### 2.2.1. Central Bank of Kenya

The Central Bank of Kenya was established in the year 1966 after the dissolution of the East African Currency Board which undertook the role of currency issuance in the entire East African region throughout the colonial period. The Bank was known to succeed well in keeping the inflation low that is,

up to 3% throughout the first decade of the Country's independence [25].

The CBK's share is owned by the Permanent Secretary to the Treasury on behalf of the government and it has an authorized capital of five billion shillings. This amount may be decided to be increased by the consultation of the BoD and the Minister of Finance. Hence, as is the case for NBE the whole shares of the CB in Kenya are held by the government making it a public entity.

The CBK is managed by Governor, two Deputies, and a BoD. The fact that the CBK is ruled by a Governor and a BoD resembles the case of NBE. Except in the case of Deputies where Regulation No. 172/2009 states that the NBE could have more than one Vice Governor and practically the NBE has three Vice Governors. The BoD of the CBK is composed of the chairperson, Governor, the permanent secretary to the Treasury, and eight other non-executive directors; in general eleven members are included in the BoD. Moreover, as in the case of the NBE, the Governor of CBK is an ex-officio member of the BoD [9].

On another note, unlike the NBE's case where the mandate of the BoD is stipulated under the law in general terms, the CBK's BoD is bestowed with various responsibilities. Among others, the duties of the BoD include the determination of policies and objectives of the bank, the responsibility to oversight the financial management and performance of the Governor in particular, and the bank in general. As in the case of NBE's legal framework, CBK's Governor is also expected to act as the CEO and manage the bank per the decisions of the BoD. Furthermore, s/he is mandated to be involved in issues related to the organizations, appointment, and dismissal of staff members and represent the Bank in a different capacity as stipulated under the law. The deputies shall perform such functions as the Governor may from time to time assign to them [9].

The CBK is mandated to foster liquidity, solvency, and stability of the banking sector, issue legal tender, and provide banking services to the Government and FIs; which is also the case for NBE [9]. The formulation of monetary policy is conducted by the Monetary Policy Committee which is composed of the Governor, a Deputy Governor, two members appointed by the Governor from the staff, four other members who have expertise in finance, banking, fiscal and monetary policy<sup>1</sup> and the permanent secretary to the treasury (non-voting member). The members are meant to serve for three years though reappointment for one term is possible [9].

Nonetheless, in the case of NBE, there is no such committee of expertise dedicated to specifically formulating a monetary policy. The NBE's legal framework does not stipulate a clear provision as to a designated body to formulate monetary policy. We could only assume by referring to Art.5 of Regulation No.172/2009 that such responsibilities are bestowed on the BoD. Furthermore, the CBK is a fiscal agent, banker, and advisor to the Government. The bank may provide advances

to the government to offset fluctuations between receipts from the budgeted revenues and payments of the government [9].

### 2.2.2. Central Bank of Brazil

The process of creating the Central Bank of Brazil started around 1808 when the initiative to establish a bank responsible for issuing money, the government's bank and commercial bank was at its pick. When it was first established as the Bank of Brazil its function was not only that of central banking rather it also played the role of a commercial bank. Nonetheless, this did not last long since the country was not able to catch up with the complexity of the world financial system; hence the creation of the CBB became inevitable [12].

Accordingly, in the year 1964 National Financial System Law No.4595 was issued to declare the establishment of the CBB as a section of the National Financial System. However, the transfer of responsibilities related to monetary policy from the Bank of Brazil to the CBB took a while that is, up to the year 1988. Some duties which were considered to be handled by the CB like the management of public debt were delegated to the National Treasury of Brazil rather than the CBB [12]. In the year 1988, the country's Constitution clarified that the CBB has the sole power to issue the country's legal tender. After the declaration of the National Financial System Law the Constitution allowed for the amendment of laws now and then to make different changes, especially in relation to its function [29].

In accordance with National Financial System Law, Brazil's financial system is composed of the National Monetary Council, the CBB, Banco do Brasil S. A, the National Bank of Economic Development, and other Financial Institutions. As in the case of NBE, CBB's capital is also entirely owned by the government. It is considered a semi-autonomous federal agency mandated to ensure compliance with the National financial system law and other acts issued by Council. It has several functions including the issuance of the county's legal tender. However, the issuance is subject to the limits stipulated by the National Monetary Council which makes CBB a semi-autonomous entity since some of its decisions are reliant on the consent of the Council. Besides this, the CBB is also responsible for the regulation and supervision of FIs; which is also the case in NBE's situation. Moreover, regulation of foreign currency, acting as the agent of the federal government for the allocation of loans, and clearance services are seen as the duties of the CBB as well [7].

The CBB is stipulated to be administered by a BoD composed of five members and the Governor of the bank is also a member. The BoD members are appointed by the NMC. In contrast to the case of NBE, the law of CBB does not leave room for deputies. Furthermore, the law does not specify the duties of the Governor of the CBB even in general terms (as in the case of NBE); rather it left it to the internal laws of the CBB [7].

In the Brazilian financial system, the NMC is the highest

<sup>1</sup> appointed by the minister and at least two of them shall be women

decision-making body. As stated under Art.2 of National Financial System Law No.4595, this Council is mandated to formulate the country's monetary and credit policies to attain price stability and economic growth. Thus, in contrast to the NBE's case, the CBB's legal framework assigns the monetary policy formulation mandate to the NMC which contains the representative of the Ministry of Finance as a chairman, the Ministry of Planning, Development, and Management, and the Governor of the CBB. The CBB is considered as the permanent executive secretariat of the Council and is mandated to propose policies that would pass through the deliberation of the technical advisory body to be approved by the Council. Besides this, the CBB is responsible to implement the decisions of the Council. The decisions of the Council are structured in general terms therefore, the CBB is expected to issue detailed laws and regulations [19].

### 2.2.3. Bank of Japan

In the 19th c and the beginning of the 20th c, the BoJ was focusing on the provision of liquidity to boost the growth of the economy and finance wars; which resulted in a high level of inflation and government debt. Starting from the 1970s the BoJ shifted its attention to strive for economic stabilization. There were several laws that regulated the objective, functions, and operation of the bank before BoJ Act No. 89 of 1997 was promulgated; for instance, the National Bank Act of 1876, BoJ Act of 1882 and BoJ Act of 1942 [30].

The CB of Japan was formed as BoJ for the first time by the Act of 1882; the main purpose of the Act was to ensure the centralized issuance of the country's legal tender. This Act was amended in the year 1942 to restructure the operation of the CB to deal with war time issues; control the supply of legal tender and facilitation of credit [30].

Dissimilar to NBE's case the financial regulation and supervision mandate is left to Financial Services Agency which is an independent entity. Whereas, in the process of ensuring the stability of the financial system, the BoJ could provide temporary loans to FIs and conduct onsite supervision based on an agreement with the FI; and share such information with the Agency [17].

In this regard, Mr. Efram emphasized that the NBE should continue to be in charge of overseeing and regulating financial institutions because they are instruments for carrying out monetary policy. However, he goes on to say that some financial institutions, such as insurance, micro-insurance, payment instrument issuers and operators, and lessee companies, should not fall under the NBE's purview. He justifies this claim by stating that, these institutions do not collect deposits from the general public and they will not be much used as monetary policy tools. Mr. Habtamu, expounded this issue by stressing that, if we say the financial supervision mandate should remain in the hands of the NBE, a lot has to be done on human and material enhancement to provide the attention that the work deserve; if not it is better to forward it to a separate entity which could present the necessary exper-

tise and the attention it deserves [34, 35].

In contrast to the NBE's case, the BoJ is not only owned by the government alone but rather by private individuals as well. Hence, the government of Japan owns 55% of the BoJ's share and the rest is owned by individuals and juridical persons. Nonetheless, though private individuals have a share in the bank, the profit distribution is limited to prevent the diversion of the aim of the BoJ to profit maximization. Therefore, the profit per share that the BoJ could pay out cannot be more than 5% per the value of the shares [8, 21].

The management of the BoJ is taken care of by a Governor, two Deputy Governors, and a Policy Board. The Governor's job is to represent the bank and carry out the Board's decisions, and the deputies' responsibility is to support the Governor in carrying out the bank's duties. Furthermore, the BoJ's board has nine members; where the Governor and Deputies are considered as member similar to the case of the NBE. The Board is in charge of the various BoJ responsibilities related to monetary policy matters as set forth by law [17].

All in all when we see NBE's institutional design, it could be fairly understood from the above sections that the NBE is a State owned CB as it is the case in most countries. The NBE is accountable to the Prime Minister and is managed by a BoD dominated by government representatives in contrast to the experience of exemplified countries' CB. It also has a Governor and three Vice Governors to head the administration of the bank. In terms of function it could be asserted that the NBE is mainly focused on the maintenance of price and exchange rate stability, financial sector regulation and supervision which is the case in various countries and taking different actions to support the economic growth of the country.

## 3. Assessment of the Independence of the NBE

### 3.1. Review of NBE's Legal Framework in Light of the Independence

Having the background of independence as reviewed in the above sections, this part would try to overview the NBE's legal framework in light of the different parameters of independence focusing on institutional, functional, and personal independence.

The assessment of NBE's legal framework is mainly focused on Proclamation No.591/2008, and CoM Regulation No.172/2009. The Proclamation was enacted to make sure of the autonomous existence of the bank, which is a continuation of its establishment by Order No.30/1963 [6]. This indication under the Proclamation seems to declare that the NBE is an independent entity entrusted with the duties of a CB; though the institutional independence could not be measured just by the declaration of autonomous status in general.

Regarding functional independence, when we refer to Article 4 of Proclamation No.591/2008, it states that:

“The purpose of NBE is to maintain stable rate of price and exchange, to foster a healthy financial system and to undertake such other related activities as are conducive to rapid economic development of Ethiopia”.

It could be understood from this provision and Art. 5 of the same Proclamation, that the NBE has multiple objectives. And it is involved in monetary policy formulation and financial institution regulation as it is mandated to work towards a healthy financial system. Thus, the stipulation seems to give these entire objectives an equal footing as it does not provide for a hierarchy.

Concerning policy formulation mandates, though the NBE's law does not really specify who should formulate policies, according to Mr. Habtamu's statement, the process of policy formulation primarily has two paths. The first one is when the initiative comes from concerned NBE directorates, especially from the Monetary and Financial Analysis Directorate or the External Economic Analysis and International Relations Directorate. These Directorates are expected to conduct the necessary study; and the BoD will serve as a discussion and decision-making platform. The second and most typical method is for the BoD to provide a proposal and instruct the aforementioned directorates to conduct research and analysis prior to the subject being discussed. On this point Mr. Melessee stipulates, it could be said that the NBE has some level of functional autonomy to the extent that its choices do not contradict with government objectives [35, 37].

As has been discussed in the previous section, the relationship of a CB with the government mainly concerning government advances is another major indicator of functional autonomy. In this regard, the NBE's Proclamation provides that the bank will provide advances and credit to the government. The advances are extended to the government for each fiscal year; which shall be defined in consultation with the bank. These advances and loans are expected to be consistent with the maintenance of price and exchange rate stability [6]. It could be articulated from this provision that the NBE is mandated to finance the government when required so, as long as it is in line with the maintenance of price and exchange rate stability with no specific limitation.

Furthermore, when we see the NBE's legal framework in relation to personal independence, the NBE is said to be managed by BoD, Governor, and Vice-Governors who are appointed by the government [4]. Accordingly, it is evident that the entire management of the NBE is appointed by the government and there is no stipulation as to the criteria and procedure for appointment and dismissal. Moreover, the tenure of the Governor, Vice-Governors, and BoD members is not also governed under the law.

### **3.2. Analysis of the Independence of the NBE Against International Practices**

The basic principles to determine the independence of the

CB could be similar, but, how a given country's CB is structured could be different depending on the specific political, historical, economic, and legal environment [11]. Therefore, this section is intended to go through the legal frameworks of three selected countries' CB and NBE laws to assess them against parameters of institutional, functional, and personal independence.

The institutional independence of a CB could be manifested by the clear stipulation of the law to protect the CB from the influence of the government in its operation [14]. In this regard, the Central Bank of Kenya's Act provides that the MoF is expected to stipulate the price stability targets in a discussion with the CBK at the start of a new financial year [9]. As in the case of the CBK, Mr. Habtamu states that NBE's target is set by the government with the consultation of the bank; though the interest of the government is given precedence mostly [35].

Moreover, when the CBK formulates monetary policy it has regular consultation with the MoF. During these discussions, if the MoF believes that the monetary policy formulated by the CBK is not in line with the price stability objective, upon the approval of the Cabinet, the Ministry may order the bank to change such defying policies [9].

Assessing Kenya's CB law which requires the approval of monetary policy from the MoF, it could be considered at some level to affect its institutional autonomy. Nonetheless, though a clear stipulation as to the monetary policy control from the government is absent under Proclamation 591/2008, the fact that the BoD of the NBE is dominated by government appointees could be an indication somehow. This is because in principle the participation of the government in the BOD is suggested to be limited to reduce conflicts of interest. Moreover, it would be good to mention the experience of the National Bank of Rwanda in relation to institutional autonomy, as the law clearly defines that, the NBR has administrative autonomy; and is shielded from any directives directed by any person or institution while taking care of its responsibilities [3].

When we refer to the Central Bank of Brazil, it is bestowed with the exclusive mandate of formulating a monetary policy to attain the targets set by the National Monetary Council. Besides this, the law clarifies that the CBB will need to inform the NMC if a given monetary policy might have an impact on fiscal operations [12]. Thus, having the autonomy to decide on the monetary policy formulation without the interference of the government is an indication of the institutional autonomy of the CBB; unlike the case of NBE which did not clarify who should be responsible for monetary policy formulation and the prohibition of the government and other entities from meddling in such process.

Furthermore, the Bank of Japan is given the assurances of its institutional autonomy when it comes to its major objectives of monetary policy control; nonetheless, it is stressed that the bank should work in cooperation with the government to make sure that the monetary policy and the fiscal policy

goes hand in hand [17]. Be this as it may, it is argued that the 1997 BoJ Act does not really ensure the independence of the bank with respect to issues other than monetary policy control [26].

The clear stipulation of the objective of the CB with the necessary hierarchical implication is the basic manifestation of the functional independence of a CB. In this regard, when we refer to the Central Bank of Kenya's case, the CBK Act stipulates the objectives of the bank in a hierarchical manner that is, the formulation and implementation of monetary policy directed to achieving and maintaining stability in the general level of prices is given the precedence. Besides this, the CBK also has the objective to foster the liquidity, solvency, and proper functioning of a stable market-based financial system and support the economic policy of the government [9]. Such provision of a clear monetary policy objective and prioritizing price stability could signify a better autonomy of the CBK. This fact is different when we refer to the case of NBE where the establishing Proclamation provided for multiple objectives in which price and exchange rate stability, financial system stability, and economic growth are stipulated on equal footing; with no hierarchy [6].

Price stability is provided to be the major focus of the Central Bank of Brazil. Be this as it may, the law further stipulates for the bank to work towards financial system stability, controlling the fluctuation of the economy and working towards increasing the employment rate [1]. Consequently, though the CBB has multiple objectives to take care of, the law has made it clear that the bank should give fundamental emphasis to price stability. This is considered to be a good move towards ensuring the functional independence of the CBB. Nonetheless, this is in contrast to the case of Ethiopia where the establishing law does not provide for a hierarchy to the objectives; though the fact that both CBs have multiple objectives could be a point of similarity.

When we see the Bank of Japan in terms of functional independence, the law states that its major purpose is the issuance of legal tender and monetary policy control to attain price stability; hence working towards the economic development of the country. Moreover, ensuring the financial system stability through the facilitation of the settlement system is another purpose of the BoJ [30]. Nonetheless, monetary policy control to attain price stability seems to get major attention as compared to the financial systems' stability and contribution to economic development; which is a good indication of the functional independence of the bank.

Another manifestation of functional independence is the clear prohibition or limitation on the government from asking for automatic loans as of right [14]. Thus, unless these limitations are provided under the law, CB's power to work on its mandate will be impaired. It would just be a money factory designated to finance the budget deficit, and as a result, the functional independence of the CB will be affected [35].

Concerning this, the CBK is expected to provide loan to the government; however, each advances extended to the gov-

ernment shall be secured with negotiable securities issued by the government. These advances are allowed with the intention to provide temporary accommodation for the government and shall mature not later than twelve months at the market interest rate. And the total of advances shall not exceed 5% of the gross recurrent revenue of the government [9]. Generally, the fact that the law stipulated such restrictions assisted the bank to control the inflationary credit provided to the government; which will ultimately contribute to its functional independence [32]. Nonetheless, NBE has the responsibility to provide loans or advances to the government which shall be defined in consultation with the bank and are expected to be consistent with the maintenance of price and exchange rate stability. Besides this, there is no specific limitation on the amount of advances to be provided to the government in terms of purpose, quantity, maturity date, or interest rate as in the case of CBK. The effect of such lack of limitation could be seen in the budget deficit that the country is facing in recent years; for which the major share is expected to be covered by NBE's financing [35].

Art. 3 of the National Financial System Law No.4595 of Brazil states that the National Monetary Council has the power to authorize the CBB to release funds up to 10% of the country's previous year's money supply for operational costs and money circulation in the country. For an amount beyond that upon the request of the president, the Council needs to get the approval of the Senate if the reason is convincing. With the same token, Complementary Law No. 101/2000 clarified that the CBB shall not issue government bonds for monetary policy reasons; this is considered as a major step taken by the State to give the bank a separate authority from the government's fiscal policy concern [24].

The Bank of Japan is mandated to release a temporary loan to the government without collateral within the limit decided by the House of Representatives and the House of Councillors. Besides this, the BoJ is expected to buy government securities within the limit provided by the two houses [17]. Consequently, in contrast to the NBE's legal regime, the BoJ Act authorized the two parliaments of the country to set limitations on advances to be granted to the government. Though this type of limitation is rather unique, it could also be seen as a positive move since it is believed that the members of the parliaments are direct representatives of the public and could be considered to have the best interest of the public in their hearts.

Concerning Personal Independence, commonly CB laws provide that the leaders of the CB need to be experts in the area, personally qualified, and are not involved in other engagements which cause a conflict of interest. As to the appointment procedure, the double veto system is much appreciated. The other crucial issue to secure the personal independence of a CB is related to the tenure of the Governor, Deputies, and BOD members. On a similar note, the dismissal criteria and procedure should be another way to protect the Governor, Deputies, and BODs from the government's in-

fluence. Moreover, if government representatives are present in the BOD, their number should be limited and/or should not have voting right [11].

Having said this, CBK's Act elucidates that the bank is supposed to have a BOD composed of a chairperson, the Governor, the permanent secretary to the Treasury, and eight other non-executive directors. The chairperson and the eight non-executive directors shall be appointed by the President through a competitive process with the approval of parliament; they shall hold office for four years and are eligible for one more term. For a member of the board to be eligible he or she shall be an expert in monetary policy-related areas as stipulated under the law. In this BoD, the government is represented by the Permanent Secretary to the Treasury or his representative who is a non-voting member [9].

The Governor and Deputies are expected to be professionally qualified persons with ten years of experience in the field of economics, banking, finance, law, or other related fields. Based on these criteria they are elected competitively for four years by the President of the Country with the consent of the Parliament and they are also qualified for one more term. Besides eligibility criteria the Act also provides for disqualifying or removal conditions like being a member of the National Assembly or shareholder of a FI; though the law provides for some exceptions [9]. However, when it comes to the time for the removal of a Governor the President shall first ask for the case to be reviewed by a tribunal of high court judges; which is considered as one indication of the personal independence of the CBK. The Governor and the deputies are expected to serve the bank fully without engaging in any paid employment, business, or professional activity outside their responsibilities resulting from their appointment in the bank [9].

As could be witnessed from the CBK Act, the management is elected through the double veto system in which not only the executive but also the legislative branches of the government are involved in the process as recommended by international practices [32]. Moreover, not only election procedures, the law has stipulated terms of office, appointment, removal, and disqualification conditions which are crucial to deter arbitrary acts of the government and indicators of strong personal independence.

When we see CBK's law against the NBEs case, Art. 3 & 4 of Regulation No. 172/2009 only provides for the power of the government to appoint the Governor, Vice Governors, and members of the BoD. There is no stipulation for any additional procedure of election, no qualification, dismissal, or removal criterion, and a term of office. Besides this, though the CBK law limits the representation of government to one with no vote, in NBE's case almost all members of the BoD are appointees of the government. Concerning this, there is no provision to prohibit the Governor, Vice Governors, or the BoD members from serving in other branches of government and FIs as in the case of the CBK.

In relation to this, Mr. Habtamu stated that the fact that the

Governor and Vice Governors are appointed by the PM is not an issue by itself as long as the functional independence of the NBE is ensured. Whereas, concerning BoD composition he listed that the current BoD contains the MoF, State (Deputy) MoF, Advisor to the PM who chairs the Board, the Governor, and a Vice Governor of NBE and the rest is vacant; and there are no private or professional representatives. Given this fact, he stressed that it is undeniable that the dominance of the interest of the government will be unavoidable; which will be a clear influence on the journey towards achieving the mandates of the NBE [35].

In Brazil, the board contains nine members of which the Governor is an ex-officio member. The Governor and the other BOD members are appointed by the President of the Country after the nominees are approved by the Senate. The Constitution of the Country makes it clear that the election of the Governor, Vice Governor, and other BoD members should be done with the participation of the public by providing a public hearing session which will be concluded by a secret vote approval of the Senate [5]. The appointees shall be citizens of the country and equipped with manners and qualifications in the field of economics and finance. The Governor and the other BOD members of the CBB are allowed to be in office for four years and one additional term. However, the term of office of the directors is started to be calculated from different years to ensure the continuity of the functions of CBB [16].

It could be understood from the stipulation of the law, to make sure of the personal autonomy of the CBB the election process of the Governor, Vices, and BoD members is made not only with the participation of the executive and legislature but also by the participation of the public at large at different levels based on qualification criteria. This could be considered good practice to reduce the political influence of the government in the appointment process. This scenario is the reverse in the case of NBE since Art. 3 & 4 of Regulation No. 172/2009 state that the Governor, Vices, and the BoD members are all appointed by the government with its own screening process; since the law did not identify the qualification criterion as in the case of CBB. Moreover, the law of CBB also provides for a specified period of term in office with the possibility of reelection; which is hardly the case in NBE's situation since it is dependent on the will of the leading executive.

In contrast to NBE's Law which did not outline conditions for dismissal, the CBB law provides that the Governor and the other BOD members are dismissed from office by the President of the Country because of reasons stated under the law. However, if the dismissal is because of failure to perform well the process of dismissal needs to pass through the approval of the Senate after which the NMC submits it to the President of the Country [1].

Referring to the personal independence of the Bank of Japan, the Governor, two deputies, and other members of the policy board are appointed for five years by the Cabinet after

the House of Representatives and the House of Councillors gave their endorsement. These members are expected to be experts in the area of economy or finance [17]. It could be seen from this stipulation that, the law provided for conditions of appointment, and the procedure of appointment is not only limited to the hands of the executive but rather involves the legislatures as well; which is in line with the double veto principle as recommended by international practices [32]. These provisions illustrate the involvement of more than one branch of the government in the election process. Besides, the criterion for election and the provision of tenure is also in contrast to the case of NBE; since the government itself dictates the election process, conditions, and tenure as it thinks fit.

Furthermore, the BoJ Act states that the Governor, Deputies, and the members of the board are prohibited among others from being a member of any of the legislators or a local council [17]. Such stipulation is crucial to reduce the chance of a conflict of interest with different branches of the government and private entities including FIs. This is considered a key point in ensuring personal independence. Nonetheless, when we see Proclamation 591/2008, we will not be able to witness such a provision prohibiting the Governor, Vices, and BoD members from being part of other branches of the government or private entities.

Besides the appointment conditions, the law provides for the dismissal criteria for the Governor, Deputies, and the members of the Board; for instance, if s/he is declared bankrupt or sentenced to imprisonment. If one of these conditions is fulfilled the Cabinet or the MoF is given the mandate to dismiss the person from his or her post [17].

During the meeting of the Policy Board of the BoJ, the government may be represented by the MoF or Minister of State for Economic and Fiscal Policy to be part of the discussion and reflect on issues related to monetary policy. This government representative could submit proposals concerning monetary policy issues or even ask for the adjournment of deliberation of the board on a certain issue; though the law gives the mandate to the board to either accept such request or not [17].

## 4. Conclusion and Recommendations

### 4.1. Conclusion

Central Banks are entities that are entrusted with the responsibility to formulate and implement monetary policies that will affect the country's money supply. They are either known to be held wholly by the government or shared ownership with private holders; mainly having the goal to maintain price stability, employment, financial stability, and supporting stable and sustainable economic growth. Nonetheless, for the CB to fulfill its fundamental objectives, it must be free from needless intrusions that might originate from the government. Therefore, as emphasized in this study a CB should

be institutionally, functionally, and personally independent.

Having said this, when we review the legal framework of the NBE in terms of the manifestations of independence and the selected countries laws, it could be fairly said that the NBE is far behind. In terms of institutional independence, though the law stipulates that the NBE is autonomous, there is a lack of clear provisions protecting the Bank from the meddling of the government and other private entities in its operations.

Whereas, the NBE establishment Proclamation states that the bank is mandated to take care of multiple objectives without providing for hierarchy which would be a hindrance to its operation in time of need. On another note, the law does not clarify who is exactly mandated to work on monetary policy formulation; and there is an overlap of responsibilities between the BoD and the executive of the bank. Moreover, the absence of a mandate which will empower the NBE to limit the advances provided to the government is identified as an indication of the impairment of the functional independence of the Bank.

Last but not least the personal independence of the NBE is considered to be in question; as the law fails to stipulate Governor's, Vice Governors', and BoD members' tenure, appointment, and removal criterion and procedure. Additionally, it is indicated that the BoD of the Bank is dominated by government representatives and thus, there is no place for the representation of private professionals<sup>2</sup>. This is also related to the absence of conflict of interest provisions restricting the management of the NBE from being members of the executive or the legislative.

### 4.2. Recommendations

This study has tried to assess the NBE's legal framework in terms of its nature, functions, and independence. While doing so analysis against the parameters of institutional, functional, and personal independence and comparison to CB laws of selected countries was conducted. And thus, the study identified some of the impediments which are considered to impair the autonomy of the NBE. Therefore, in order to address these issues the researcher recommends the following.

- 1) Policymakers shall assess the identified impediments under the law and consider making the revisions stated here-in-under.
  - a. Guarantee the institutional independence of the NBE under the law by providing that the NBE shall not be subject to any direction from the government, individuals, or institution in the performance of its purposes.
  - b. Ensuring the functional autonomy of the NBE by clarifying the hierarchy of its mandates and emphasizing that price stability gets precedence.
  - c. Clarifying that the NBE could only support economic growth through monetary policy.

<sup>2</sup> Besides impairing the personal independence the composition of board also affects the functional independence of the Bank.

- d. Separating the BoD's policy formulation and oversight roles; and clarifying the body bestowed to formulate policies within the NBE.
  - e. Providing for a restriction on the advances to be provided to the government by introducing limitations on the amount, purpose, maturity date, and interest rate. Moreover, bestowing a power on NBE to be able to restrict further advances to the government before it pays previous debts; unless in case of clearly stipulated force majeure situations.
  - f. Stipulating a limitation on the number of government representatives in the BoD to reduce the influence of the fiscal policy and allowing independent professionals from different areas of expertise to be represented in the BoD.
  - g. Introducing the term of office; criteria and procedure of appointment and dismissal; conflict of interest provisions for Governor, V/Governors, and BoD members and allow a competitive and transparent way of selection of the Governor, Vice Governors and members of the Board.
- 2) As it could be understood from this study, the area is under-researched; therefore, it is recommended for researchers to further study the autonomy of the NBE. In this regard, it is suggested for future studies to dig more into financial autonomy which is the fourth parameter of independence, and explore the practice, to get the full picture.

## Abbreviations

BOD	Board of Directors
BoE	Bank of Ethiopia
BoJ	Bank of Japan
CB	Central Bank
CBB	Central Bank of Brazil
CBE	Commercial Bank of Ethiopia
CBK	Central Bank of Kenya
CEO	Chief Executive Officer
CoM	Council of Ministers
EU	European Union
FDRE	Federal Democratic Republic of Ethiopia
FIs	Financial Institutions
GRF	General Reserve Fund
IMF	International Monetary Fund
MoF	Ministry of Finance
MPC	Monetary Policy Committee
NBE	National Bank of Ethiopia
NMC	National Monetary Council
PM	Prime Minister

## Acknowledgments

I would like to send my greatest respect and appreciation to

my advisor, Mr. Fekadu Petros, whose valuable assistance and constructive remarks have put the paper on the right track to its realization. I also want to pass along my note of gratitude to all the teaching and administrative staff of the School of Law who shared their valuable assistance.

I would like to acknowledge the support of the National Bank of Ethiopia, and special thanks go to Mr. Mesfin Getachew, Mr. Efreem Baraki, Mr. Habtamu Werkeneh, and my fellow workmates at the LSD for sharing their priceless professional support. Besides this, I want to mention Mr. Mellessee Minale, a former senior macroeconomic advisor to the Governor of the NBE and currently Senior Economist at the IMF, for squeezing my request for expert advice into his busy schedule.

## Author Contributions

Elsabet Dessalegn Regassa is the sole author. The author read and approved the final manuscript.

## Conflicts of Interest

The author declare no conflicts of interest.

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## Biography



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## Research Field

**Elsabet Dessalegn Regassa:** Central Banks, Rehabilitation and Reintegration of Prisoners, Due Process Rights of Tax Payers