Public Policy and the Banking System In Ethiopia Post 1991

Aklilu Wubet

A thesis submitted to the School of Graduate Studies of Addis Ababa University in Partial Fulfillment of the Requirements for the Masters of Public Administration in the department of Public Administration and Development Management

July 2007

Addis Ababa, Ethiopia

Addis Ababa University School of Graduate Studies.

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Abstract

The Ethiopian banking system undergone reforms after 1991 and several measures have been taken. Despite these measures, the Ethiopian banking systems appears to have a structural problem. The banking system is highly dominated by public ownership. it is affected by weak credit culture and poor risk assessments. The foreign entry to the banking industry also hinders the introduction of new products and technology. Drawing documentary study and data from the primary sources, various issues of public policy that have impact on the banking system is assessed. Moreover, secondary data are utilized and examined. Public policy has to play decisive role in crafting the rules of the game as appropriate to the temporal economic development commitments as well as macro economic stability in a perquisite for smooth and effective leadership of regulatory and a change management could be sought. To foster the development of the banking institution so as to play a vital role in the economy, the participation of private sectors both domestic and foreign has to be encouraged.

Acknowledgements

This paper has been made possible through the direct and indirect cooperation of various persons for whom I wish to express my appreciation and gratitude.

First and foremost, my special thanks go to my advisor Dr. Mulugeta Abebe for his unreserved efforts to make this senior essay complete.

I am beholden to my parents and other family members for their blessings and encouragement. My wife Sara and children Hermela and Alazar deserve special acknowledgement for willingly making the sacrifices necessary for me to enable me to work for major ambitions of my life.

I am indebted to w/t Emnet Mekoya for typing this material. And the same goes to Addis Ababa University in general and Public Administration and Development Management in particular for offering this chance.

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Chapter One: Introduction

1.1. Background

A bank is an institution, which accepts demand and time deposits from businesses, institutions and individuals and engages in both business and consumer lending. (MC Vash, 1977) Banking helps to mobilize and distribute the idle resources to potentially productive sectors, aiming to raise the level of economic development as a whole. In modern times, commercial banking occupies quite important place in every economy. It must be flexible to enable its face new problems and policy issues so that it can play its useful role in the economy.

Since the coming to power of the Derg in 1974, Ethiopia had been under the central planning economic system for nearly two decades. Most of the macro incentives such as interest rates, exchange rate, prices of major commodities were administratively fixed. Economic sectors were functioning in line with the central plan and they had no management autonomy. The private sector was deprived of resources such as bank credit, land; and above all there was a pre-determined capital ceiling not exceeding a quarter of a million Birr. Coupled with the intensified civil war, these policies resulted in sluggish performance in the economy and macroeconomic imbalances.

With a change of government in May 1991, the new government, with the aim of adjusting the macroeconomic imbalance and fostering sustainable economic growth, declared a market oriented capitalist mode of economic policy. In line with the new market-based and development oriented policies adopted in October 1992, the new government took various policy measures to improve the external sector imbalance, to introduce broad based trade and financial sector reforms, and to streamline fiscal and real sector constraints.

At present, current account transactions are fully liberalized. Accordingly there is no restriction on the repatriation of profits and dividends from investment in Ethiopia. Capital account, however, is not yet liberalized due to Ethiopia's low level of integration into the global financial market. Efforts are also being made to develop financial market, although it still is rudimentary. Currently, there is an active primary market for Treasury bills. Government bonds are also occasionally issued. No secondary market exists to date.

Having briefly highlighted some of the macroeconomic developments which are directly and/or indirectly related to monetary and financial sector activities, it would be more appropriate to deal with specific reforms that have been undertaken in the financial sector during the last decade and the resultant outcomes.

The financial sector development in Ethiopia like in many other developing countries is shallow and rudimentary. The Derg regime nationalized the emerging financial institution on January 1, 1975. First, the Addis Ababa Bank, Banco di Roma and Banco di Napoli, private banks, were merged and formed a government bank known as Addis Bank, which it self was merged with the state owned commercial Bank of Ethiopia. After the private banks were nationalized in 1975, the sector went through mono-banking. Alike other sectors, the banking industry was guided by the central plan. (Fanaye, 1998)

Under the Derg regime, monetary policy was almost wholly subservient to the objectives of the central plan. Interest rates were administratively fixed and rather rigid, the main objectives being the promotion of socialization. The government and state enterprises obtained nearly all the credit they required to implement their respective plan targets. Monetization of the budget deficit was high and thought to be necessary to supplement resources required for plan implementation. Priority was given to achieving planed growth targets and inflation ranked behind growth objectives. The major consequences of the Derg's discernible monetary policy were rising inflation, chronic balance of payments problems, and rather surprisingly, economic growth rates on average were not even parallel to the population growth rate. (Fanye, 1998)

Following the 1992 economic reform, however, a new monetary and banking law was promulgated in 1994. According to the proclamation, private participation in the sector was allowed for Ethiopian nationals. Despite this, however, the number of financial institution are very limited, i.e., two public commercial banks, eight private banks, one specialized (development) bank. All of these banks are licensed and supervised by the National Bank of Ethiopia (NBE).

Government's objectives for financial sector development are essentially twofold. The first is to expand the delivery of financial service to rural areas and the small and medium size agricultural and other enterprises. The second main objective is the development of a sound and efficient formal financial system that can deliver the benefits of financial liberalization to the larger economy, in particular by channeling resources efficiently to the industrial and export sectors, and helping to maintain macroeconomic stability. The government's overarching approach to meeting these objectives is to foster a more market-oriented, liberalized, integrated and sound financial system. (NBE, 2006)

Ethiopian banks are regulated by a comprehensive set of rules and regulations, anchored in relevant laws or NBE circulars. Banks are required by law to maintain a minimum paid up capital of Birr 75 million and minimum capital adequacy ratio of 8 percent of risk weighted total assets. In addition, a set of NBE directives prescribed the following: (a) a single-borrower limit of 25 percent of the net worth of a bank; (b) insider lending (to share holders and officers) not to exceed 15 percent of the banks net worth for an individual, and an aggregate related-party limit of 35 percent; (c) a reserve requirement of 10 percent of net deposits; (d) liquidity requirement of 15 percent of net current deposits; (e) loan classification in to substandard, doubtful, and loss categories and provisioning requirements; and (f) restrictions on non-banking business interests. These regulations should prove valuable in enhancing bank soundness. (Proclamation No.83/94)

Currently, the National Bank of Ethiopia has various monetary policy instruments to influence credit in the economy. However, open-market operations in its standard sense do not exist in Ethiopia at present; but steps are being taken to lay down the foundations for such market operations by building upon the existing treasury bills auction market.(NBE, 2006)

Interest rates were also adjusted periodically to maintain at positive levels in real terms so as to induce mobilization of financial savings. The interest rate structure was reformed in October 1992. In this new interest rate policy the rate differential among different sectors of the economy was maintained while the discrimination between public and private sectors was abolished.

In August 1994, a revision of the above policy was made, as a result of which the lending rates for all sectors were unified. The rates for time and saving deposits, however, were not changed. After January 1995, the NBE started to set only the maximum lending interest rates and the minimum deposit rates. This practice of periodically adjusting minimum and maximum rates continued until December 1997. Effective January 1st, 1998 the lending interest rate was liberalized while a six percent floor rate was set for deposits until it was reduced to three percent as of March 4, 2002. Recently, this three percent rate rose to four percent. In July 2001, another amendment was made on interest rate policies, which allowed paying interest on demand deposits and the rate to be freely determined by each bank. This policy is believed to pave the way for complete liberalization of interest rate policies.

Despite these measures, the financial sector in Ethiopia remained still under developed in the sense that there is a very thin money market represented by a biweekly primary Treasury-bills auction market. Capital and stock exchange markets are not yet established. The inter-bank money market is constrained by the prevailing excess liquidity of commercial banks and interest rates are not fully market determined.

Treasury bills auction market was introduced in January 1995 with the view to develop money market in Ethiopia. Currently, Treasury-bills with three types of maturity date that is 28 days, 91 days and 182 days are auctioned in a fortnight's time. Accordingly, the sale of Treasury-bills largely enabled the government to finance its fiscal deficit through non-inflationary means.

Until 1994, the banking sector was totally closed to the private sector. In 1994, the government issued a proclamation to provide for licensing and supervision of banking business (proclamation no. 84/1994). Since then, eight private banks have been established. These private banks are currently operating along with three state-owned banks now competing among each other.

Both the public and private banks are regulated and controlled by the National Bank of Ethiopia. This licensing and supervision of banking business has been given to National Bank of Ethiopia (Proclamation No. 84/1994). In this period of change within the banking system, the maintenance and strengthening of communication between banks and bank supervisory agency is critical as the core function of central bank is to protect the stability of the banking and financial systems.

1.2. Statement of the Problem

Public policy may be guided by a country's contextual conditions including the state of the economy, the legal and supervisory framework, the structure of the financial system, the quality of accounting, regulatory and auditing standards. The same applies to banking system regulation.

The type and mix of monetary policy instruments employed vary from country to country, largely depending on the degree of sophistication and complexity of the national economy in question. Generally, the major instruments include the rate of interest, the exchange rate, legal reserve, cash and liquidity requirements and open market operations. The major monetary policy tasks also include direct credit ceilings, discounting and rediscounting facilities, open market operations and ceilings on government borrowing and direct monetary and inflation targeting.

Major targets of the current Ethiopia's monetary policy are net foreign assets, net domestic assets and government credit nature of the financial sector; indirect monetary policy instruments are less effective. The National Bank of Ethiopia has monetary policy instruments such as interest rate, credit ceiling, reserve and liquidity requirements and exchange rate policy to influence credit in the economy.

Despite these measures, Ethiopian banking system appears to have a number of structural vulnerabilities and weaknesses in the supervisory, regulatory and legal frameworks. Ethiopian banking system, dominated by public sector banking, is clearly fragile. This can be explained by poor customer service, length delivery time, few products and poor technology back up. The banking system problems need urgent alterations to minimize the cost of restructuring, improve efficiency and to enable the banking sector to perform better in resource allocation function, thereby contributing to growth and long term sustainability.

Both on and off site bank supervision is weak. The central bank does not yet have a well designed open system of early warning indication to monitor bank performance. Much of Ethiopia banking system is affected by a weak credit culture, poor risk assessment and management, supervision and regulation that are not fully in line with international standards and inefficient legal and judicial framework. The slow and inefficient judicial process underpinning debt recovery and the absence of a truly effective bankruptcy law were important factor.

Another important feature of the banking system in Ethiopia is the fact that the establishment of banking business in left only to citizens of Ethiopia. This entry barrier also hinders the introduction of latest banking technology, products and human capabilities. In addition, it is vividly observed in state owned financial sector (Banking) that the government is reluctant to effect privatization where as part of the financial sector (banking) at private hands are shown encouraging results in mobilizing resources and expanding the branch network over the country.

The banking reform needs to be part of a systematic effort to create more diversified financial sectors, with an efficient banking system and well-developed and liquid capital markets. The banking system failed to provide the public with enough currency when it was demanded during unpredictable yet regular phases of the seasonal or business cycle, and made individual banks responsible for their own reserve positions.

1.3. Research Questions

How do the National bank policies that have so far been issued influence the development of banking system?

Do the National bank policies enable or create conducive environment on which the banking system operate effectively?

1.4. Objectives of the Study

The objectives of the study will be:

- To examine the part played by policies in the development of banking system, and their impact on the industry.
- To identify the extent to which the current banking policies are in line with the needs of the market economy.
- To suggest plausible solutions that improve the performance of the banking system in Ethiopia.

1.5. Significance of the Study

The finding of the study will be beneficial to policy makers, bank officials and owners and other stakeholders who are interested in the area of banking and its relation with public policy. In this regard, the study provides these groups with preliminary basis on the experience of Ethiopian banking industry as to how to frame public policy instruments. These policy instruments would create conducive environment for the smooth operations of the banking system. On top of this, the findings of the study will benefit those researchers who are interested in further dissecting the impact of public policy on the Ethiopian banking system.

1.6. Scope and Limitation

The scope of this paper will be limited to the banking system of Ethiopia that are affected by various public policies in general and the National Bank of Ethiopia's directives, in particular.

Bank officials were reluctant to give interviews; this may be considered as a limitation of this paper.

1.7. Data Collection

The study delves in to the primary and the secondary data. The secondary data were collected from sources such as published documents, government circulars, National Bank of Ethiopia directives, quarterly and yearly bulletins of NBE and reports and returns of private and public banks.

The primary data were collected through questionnaire that was distributed first to 20 respondents to asses the questionnaires. After obtaining data from the first open-ended questionnaire, a closed ended questionnaire was distributed to 120 people, comprising public officials, policy analysts, bank managers, investors, academicians and others. A schedule was prepared to administer data gathered from cross sections of people. In addition, interviews were conducted with three bank officials.

1.8 Data Analysis

The data were analyzed using descriptive statistical methods such as percentages, standard deviations, mean and correlation. The presentation of data was made using tables and line graphs. Primary data were first tabulated and percentages were calculated. Then, separate tables, comprising calculations of mean, standard deviation and correlation for related questions were prepared. In addition, line graphs were designed for selected questions that required thorough analysis. Moreover, explanations were supplied for each question along with respondents' justification.

1.9. Structure of the Paper

The paper is organized as follows: Chapter two, the theoretical frameworks presented discussions on public policy process, categories of public policy and models of public policy. Chapter three dealt with relevant experiences and lessons from other countries as well as review of empirical evidences. The subsequent part, chapter four, furnished analysis on public policy and the banking system. The last part is chapter five which provided with summary of findings, conclusion and recommendation.

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Chapter Two: Theoretical Framework

2.1 Introduction

This chapter focuses on various policy issues. More specifically, it examines why and what of public policy and policymaking process like agenda setting, policy formulation and policy adoption. In addition, it discusses categories of public policy with more emphasis given to regulatory policies. It also raises models of public policy such as Elite theory, Institutional theory and Political system theory.

2.2 Public Policy

Different authors defined public policies differently. Some stressed that the interest to involve in one action or not may be taken as public policy. For instance, Theodouliu (1995) said that public policy should distinguish between what government intended to do and what, in fact they actually do. According to Dye (2000) governmental inactivity is as important as governmental activity. He further elaborates that the notion of public policy ideally involves all levels of government and is not necessarily restricted to formal actors; informal actors are also extremely important. To strengthen his point he extends that public policy is pervasive and is not solely limited to legislation, executive orders, rules, and regulations. (ibid)

These rules and regulations intended to accomplish some objectives that make public policy as a deliberate activity of the government. Theodoulu (1995) declares that public policy is an intentional course of action with an accomplished end goal as its objective. He further describes public policy as both long term and short term. Policy is on going process; it involves not only the decision to enact a law but also the subsequent actions of implementation, enforcement, and evaluation. (ibid) If public policy is an intentional action of a government, a government as a political entity its decisions should be in line of its political interests. Thus it is part and parcel of politics. That is why Theodoulu believes that one cannot divorce politics from public policy or the environment in which it is made. Public policy generally does or not more of the following: it reconciles conflicting claims on scarce resources; it establishes incentives for cooperation and collective action that would be irrational without government influence; it prohibits morally unacceptable behaviors; it protects the activity of a group or an individual, promoting activities that are essential or important to government. Finally, policy provides direct benefits to citizens. (Theodoulou, 1995)

Public policy is basically a course of government's action (inaction) taken in response to social problems. (Kraft and Furlong, 2004) Lass well (1998) pointed out that Public policy determines "who gets what, when, and how". Contemporary policy analysts might also include "why?" Ripley and Franklin (1986) define policy and the policy process more specifically: policy is what the government says and does about perceived problems. Policymaking is how the government decides what will be done about perceived problems. (Cahn 1995)

At the out set, we have said that the definitions of public policy may vary in their scope and level depending on the perspectives of different writers. The following are examples of such definitions to the subject matter, as a concept or as a practice.

Cochran et.al (1999) define public policy as the term always refers to the action of government and the intentions that determine those actions. Public policy is also the out come of the struggle in government over who gets what.

According to Dye (1992), public policy is whatever governments choose to do or not to do. Governments do many things. They regulate conflict within society; they organize society to carry on conflict with other societies; they distribute a great variety of symbolic rewards and material services to members of the society; and they extract money from society, most often in the form of taxes. These public policies may regulate behaviors, organize bureaucracies, distribute benefits, or extract taxes – or all these things at once. (Dye 1992)

Though some believes that public policy is a purposive action to attain a given goal, but other still stress that the way to formulate policy is not easy rather complex that involves many actors. Public policy is a purposive course of action followed by an actor or set of actors in dealing with a problem or matters of concern. (Andrson, 1980)

In this regard Dror (1967) declares that public policy is a very complex, dynamic process whose various components make different contribution to it. It decides major guidelines for action directed at the future. These guidelines (policies) formally aim at achieving what is in the public interest by the best possible means (ibid)

The study of public policy allows one to view the entirety of the political system, including its output. As Dye (1984) concludes, policy study involves a description of the content of public policy; an assessment of the impact of environmental forces on the content of public policy; an analysis of the effect of various institutional arrangements and political processes on public policy; an inquiry in to the consequences of various public policies for the political system; and an evaluation of the impact of public policies on society, both in terms of expected and unexpected consequences. (Theodoulou, 1995)

We can say that policy will have a different impact and interest according to the level and status of the individuals as it happens in formal and informal organizations. The study of public policy occurs in many institutions and for diverse reasons. Policy analysts both in and outside of governments have a professional concern for public policy. Scholars at universities and research institutions share some of the same interests as policy analysts, but scholars are more often concerned with building general knowledge of the policy process. For citizens with no professional concerns, but strong personal interests in government and public policy, thus political system affords numerous opportunities to become involved. Interest alone is a good reason to study public policy, but it is not the only one. Studying public policy may help citizens sharpen their analytical skills, decides what political positions and polices to support, and evaluate democratic governance. Two additional reasons are presented here: the citizens' ability to participate in policy processes and make choices and their ability to influence decisions. (Kraft and Furlong, 2004)

Most government policies differentiate between the people or organizations subject to office sanctions and the public that is intended to benefit from the policies. This part of what makes policies – as well as the politics that give rise to those policies-so complexes. (Bickers and Williams, 2001)

Public policy making is often viewed as 'Conveyor Belt' in which issues are first recognized as a problem, alternative course of actions are considered, as politics are adopted, implemented by agency personnel, executed, changed, and finally terminated on the basis of their success (actual or perceived). (Lester and Stewart Jr., 2000)

The project of making policy rational rests on three pillars: a model of reasoning, a model of society and a model of policy making.(Stone, 2002) The model of reasoning is rational decision making. In this model decisions are or should be made in a series of well-defined steps (Stone, 2002):

1. Identify objectives;
2. Identify alternative course of action for achieving objectives;
3. Predict the possible consequences of each alternative;
4. Evaluate the possible consequences of each alternative; and
5. Select alternative that maximizes the attainment of objectives.

The model of society underlying contemporary rationality project is the market. Society is viewed as a collective of autonomous, rational decision makers, who have no community life. Their interactions consists entirety of trading with one another to maximize their individual well-being. They each have objectives or preferences, they each compare alternative ways of attaining their objectives, and they each choose the way that yields the most satisfaction. They maximize their self-interest through rational calculation. The market model and the rational decision making model are thus very closely related. (Stone,2002)

The model of policy making in the rationality projects is a production model, where policy is created in a fairly orderly sequence of stages, almost as if on assembly line. Many political scientists, in fact, speak of assembling the elements of policy. An issue is "placed on the agenda" and a problem gets defined. It moves through the legislative and executive branches of government, where alternative solutions are proposed, analyzed, legitimized, selected and refined. A solution is implemented by the executive agencies and constantly challenged and revised by interested actions, perhaps using the judicial branch. And finally, if the policy – making process is managerially sophisticated, it provides a means of evaluating and revising implemented solutions. (Ibid)

2.3. Categories of Public Policy

Earlier in the introduction part, we have tried to explain that policies may differ in their outcomes. Some of the policies may provide provisions for the part of the society, while other policies enforce sanctions. Still some part of the public policy dictates a procedure as to how to perform a given task while a significant number of public policy lies on regulation. Of course, there are policies that endowed opportunity to the society at large.

Regulatory policies involve the imposition of restrictions or limitations on the behaviors of individuals and groups. Self-regulatory policies are similar to regulatory policies in that they involve the restriction or control of some matter or group. Unlike regulatory policies, however, self-regulatory policies are usually sought and supported by the regulated group as a means of protecting or promoting the interests of its members. (Parsons, 2001)

Regulatory polices are also specific and individual in their impact. Although the laws are stated in general terms, the impact of regulatory decisions is clearly one of directly raising costs and/or reducing or expanding the alternatives of private individuals. Regulatory policies are distinguishable from distributive in that in the short run the regulatory decision involves a direct choice as to who will be indulged and who deprived. Since the most stable lines of perceived common impact are the basic sectors of the economy, regulatory decisions are cumulative largely along sectoral lines; regulatory policies are usually disaggregable only down to the sector level (Lowi, 1995)

According to Parsons (2001), policies may be classified as either substantive or procedural. Substantive policies involve what government is going to do. Substantive policies directly distribute advantages and disadvantages, benefits and costs, to people. Procedural policies, in contrast, pertain to how something is going to be done or who is going to take action. Procedural policies may have important substantive effects. That is, how something is done or who takes the action. The action may help determine what is actually done. (Parsons, 2001)

Policies may be classified on the basis of the nature of their impact on society and the relationships among those involved in policy formation. Distributive policies involve the distribution of services or benefits to particular segments of the population. This typically involves the use of public funds to assist particular groups, communities or industries. Redistributive policies involve deliberate efforts by the government to shift the allocations of wealth, income, property or rights among broad classes or groups of the populations. The usual pattern in redistributive policy is the shifting of resources from the haves to the have-nots. (Parsons, 2001)

Public policies may also be described as either material or symbolic, depending upon the kind of benefits they allocate. Material policies actually either provide tangible resources or substantive power to their beneficiaries or impose real disadvantages on those who are adversely affected. Symbolic policies, in contrast, have little real material impact on people. They do not deliver what they appear to deliver; they allocate no tangible advantages and disadvantages. Rather, they appeal to the cherished values of people. (Ibid)

Public policies may also involve the provision either collective goods or private. The nature of collective goods is such that if they are provided for one person, they must be provided for all. Private goods, in contrast, may be broken into units and charged for an individual uses or beneficiary basis and are available in the market- place. Finally, policies are frequently conducted in terms of liberals versus conservatives. Liberals favored the use of government to bring about social change, usually in the direction of greater equality. Conservatives, in turn, were opposed to the use of governments for such purposes. (Ibid)

2.4 Models of Public Policy

To facilitate communication most of the time scholars develop models. These models used by political scientist to explain the nature of policymaking and the policies result. Among the most common are elite theory, group theory, institutional theory, rational choice theory and political system. Each model offers a different perspective on the principal determinants of decision making within government and therefore on what people might regard as the major forces that shape the direction and content of public policies. (Kraft & Furlong, 2003) The following models are relevant to issues that this study intends to address.

2.4.1 Elite Theory

The primary assumption of elite theory is that the values and preferences of the general public are less influential in shaping public policy than those of a smaller, unrepresentative group of people, or elites. (Dye 2001) These policy actors may be economic elites, wealthy people, corporate executives, and professional such as physicians or attorneys. They may be cultural elites, such as actors, filmmakers, and recording artists, or media stars. Elected officials constitute elite as do other influential policy actors, such as scientists and policy analysts. Elite theory, then, focuses on the role of leaders and leadership in the development of public policy. (Kraft & Furlong, 2003)

2.4.2 Institutional Theory

It emphasizes the formal and legal aspects of government structure. Institutional models look at the way governments are arranged, their legal powers, and their rules for procedure. Those rules include basic characteristics such as the degree of access to decision making provided to the public, the availability of information from government agencies, and the sharing of authority between the national and state governments under federalism (Kraft & Furlong, 2003). A major tent of institutional is that the structure and rules make a big difference in the kind of policy process that occurs and which policy actors are likely to be influential in it.

2.4.3 Political System Theory

Systems theory emphasizes the larger social, economic and cultural context in which political decisions and policy choices are made. This theory is a more formal way to think about the interrelationship of institutions and policy actors and the role of the large environment. Systems theory also supplies some useful terms, such as input, demands, support, policy outputs, policy outcomes and feedback. In systems theory, input into the political system comes from demands and support. Demands are the claims individuals and groups seeking to further their interests and values make on the political system. (Kraft & Furlong, 2003)

2.5. Public Policy Making Process

Public policy formulation has followed the same fashion as designing a plan. It follows the step that stretch from definitions of problems up to feedback analysis for further inputs. This step is not distinct by itself rather it relates one after the other. Political scientists who study the policy process attempt to provide a framework that will guide from the emergence of a problem to the final enactment of a policy to address that problem. Such a framework for policy development shows a process to be one of sequential stages of activity. (Theodoulou, 1995)

These phases represent on going activities that occur through time. Each phase is related to the next; and the last phase is linked to the first (agenda setting) as well as to the intermediate phases in a non-liner cycle or round of activities. The application of policy analytic procedures may yield policy relevant knowledge that directly affects assumption segments and action in one phase which in turn indirectly affects performance in subsequent phases. (Dunn, 1994) Let us see the stages one by one:

2.5.1. Agenda Setting

The policy cycle starts when the government pays serious attention to an issue. Policy scientists identify two kinds of agendas: those that government institutions act on known as institutional or governmental, agendas, and those on which they delay action, called systemic or non institutional agendas. System agendas "percolate' in society, waiting to be elevated to the active agenda. A systemic agenda consists of all issues that are commonly perceived by members of political community as meriting public attention and involving matter within the legitimate jurisdiction of existing governmental authorities. In contrast, an institutional agenda consists of those problems on which "legislators or public offices feel obliged to take appropriate measures". (Gupta 2001)

2.5.2. Policy Formulation

According to Theodoulou, (1995) policy formulation is the creation of relevant and supportable courses of action for dealing with problems and does not always result in the assumption of policy. Because a problem or issue arrives on the agenda it does not necessarily mean that the government will act effectively to resolve it. Various actors are involved in policy formulation including legislators, the various departments and agencies of the executive branch and the interest groups.

Formulation is a two-step process. First, a general decision has to be made. About what if any thing is to be done about a problem. Second, if some thing is to be done a policy has to be drafted that if adopted will carry out identified objectives. For policy formulation to be successful, it is essential that policy proposal to be adoptable. In other words policy proposals have to be formulated that will be acceptable not only to the people who make policy decision but also to most other actors (Theodoulou, 1995)

2.5.3. Policy Adoption

It is the cases that decision makers are influenced by what they need to win policy adoption. Certain provisions will be includes and others dropped depending up on that builds support for the proposed policy. The more actors involved in the adoption process the more difficult it is to get an acceptable proposal. The process of building support for adoption can be understood as policy legitimating. Policy adoption is the act of choosing which policy alternatives will be finally chosen as the preferred course of action to meet the problem. (ibid)

Policy adoption comes at the end of the formulation process. Once the policy analysis is complete, they sent to the official decision making bodies, which enact legislation or issue and executive order. In the long cycle of policy formation, the adoption stage is for the most part well defined – if not at the beginning, then certainly at the end of the stage, when the legislative takes a vote or the chief executive issues a formal executive order. Typically the analysts' job ends with policy formulation when decision maker reviews the alternatives and the analysis of their respective impact.

2.5.4 Policy implementation

Theodoulou (1995) discussed that implementation starts after the decision to adopt a particular course of action is made and ends successfully when the goals sought by the policy are achieved and the costs are within reasonable expectations. Thus implementation can be defined as directed change that follows a policy adoption. Often decision by governments do something as seen by general public at the end of the matter. However, in practice the policy decision that emerges from the formulation and adoption stages sets off as long as complex chain in the implantation process. (Gun, 1978)

Once the designers of policies have settled upon a policy design and one or more tools carry out the goals of the policy design, the various actors in the policy process turn their attention to the implementation of public policy. It is important to understand policy implementation because it is a key feature of policy process, and learning from implementation problems can foster learning about better ways to structure policies to ensure that they have the effects those designers the policies seek. (Birkland, 2001)

2.6 Conclusion

So far we have discussed public policy process that ranges from agenda setting to policy adoption and in fact policy implementation too. We have also discussed categories of public policy and models of public policy. As we have mentioned, public policy may be initiated by different parts of the society. But it came in to picture through the different government levels and parts of the government like legislatives, executives or judiciary. So it is hardly to think public policy with out polity. Pubic policy provides a right and or obligation to the people. This encourages different actors to participate in the formulation of policy from initiation of problem to evaluation of the particular policy. So far we have discussed relevant points in relation to public policy. The subsequent chapter deals with review of experiences of other countries and empirical review.

Chapter Three: Relevant Experience Lessons and Review of Empirical Evidence

3.1. Introduction

Till now, we have discussed the theoretical framework of public policy. Now we are going to see the relevant experience and lessons from various countries that include Malaysia, Israel, China, Pakistan and India. The experiences of these countries are taken because these countries are emerging economies and adopted financial liberalizations the same period when Ethiopia did so. In addition, this chapter reviewed empirical evidences about Ethiopian banking and public policies that are collected from primary and secondary data.

3.2 Review of Experiences from Other Countries

A consensus is growing that weak financial institutions emanate from inadequate government regulation. In the United States financial regulation dates back to 1863, in the middle of the American civil war, when it became apparent that a strong banking system was essential to create a new national economy and that such a system required a strong national regulatory structure. Failures in the banking system have strong spillover or externalities, that reach well beyond the individuals and firms directly involved. (Stiglitz, 2001)

But many developing countries are struggling with precisely the opposite problem and over regulated financial system that stifles innovation and the flow of credit to new entrepreneur, stunting the growth of even well established firms. One of the many adverse effects of the East Asian financial crisis is that countries have become wary of reforms that affect the financial sector, aware that they may leave the country worse off. (Stiglitz, 2001) Now lets see experiences and lessons from countries like Malaysia, Pakistan, India and china one after the other.

Malaysia

Bank Negara Malaysia (BNM), as the nation's central bank, is entrusted with the responsibility for the formulation and implementation of monetary policy to action price stability. BNM, therefore, constantly reviews the monetary policy framework to ensure that it remains relevant amid the dynamic changes in the financial and economic environment. The removal of credit ceilings and liberalization of interest rates in the late 1970s had paved the way for greater financial sector reforms. Reinforced by increased globalization of financial markets towards the end of 1980s, deregulation of the financial sector precipitated further changes in the monetary policy framework in Malaysia (BNM, 1999)

In Malaysia, the shift in monetary policy strategy from monetary aggregator to one in which interest rates was the intermediate target was precipitated by four main factors. These are:(ibid)

- The liberalization of interest rates since 1970 to a more market-oriented interest rate determination process;
- Financial deregulation and liberalization measures undertaken during the decade had enhanced the role of interest rate to the monetary transmission mechanism;
- There was a notable shift in the financing pattern of the economy since the mid-1980s following structural changes in the economy from an interest – inelastic market to a more interest- sensitive market; and
- As a matter of policy, BNM has maintains positive real rates of return on deposits. Given these developments an economic environment where investors had become increasingly more interest- sensitive, BNM attached grater importance to interest rate targeting.

As part of the strategy to enhance effectiveness of monetary policy in the medium to long run, monetary implementation procedures have evolved significantly towards a more market-based system. BNM has embarked on a three-pronged strategy to facilitate this transition process. They are namely, enhancing transparency, improving the payment and settlement arrangements; and accelerating regulatory and prudential reforms (BNR, 1999).

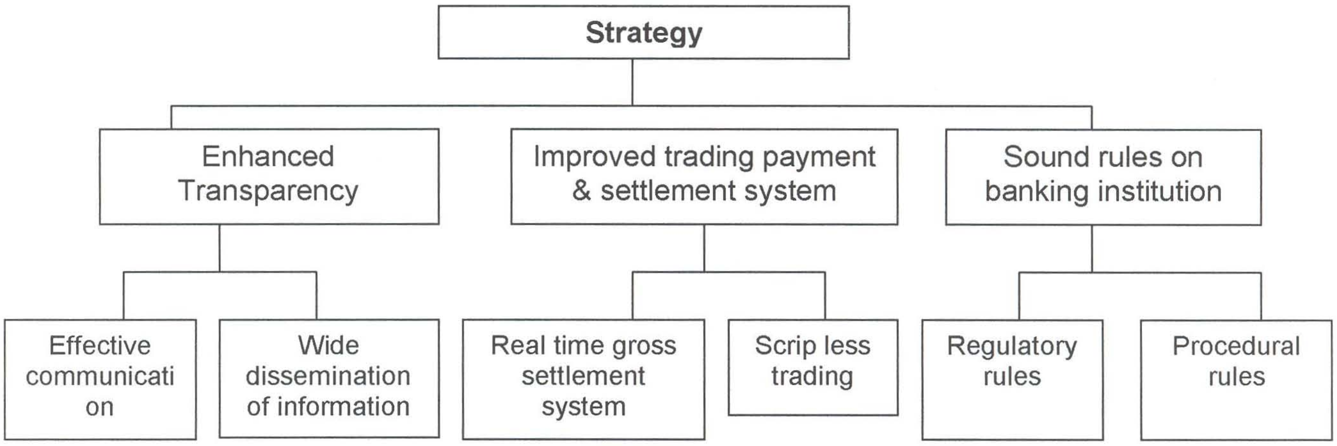


Fig. 3.1 Promotion of a Market Based Implementation Procedure Adopted from Bank Negara Malaysia

A number of measures were implemented to enhance the competitiveness of the banking system. To enable market forces to dictate the interest rate regime, the base-lending rate (BLR) of commercial banks and finance companies was freed from the administrative control of BNM. In 1991 whereby all banking institutions were free to determine their own deposit and lending rates. The deregulation in BLR framework allowed was lending rates to more competitive and more market-oriented (BNM, 1999).

The objectives of the policies following the recovery from the recession in the mid 1980s were as follows (Ibid):

- Create a core of strong domestic banking institutions which are well managed and highly capitalized to meet the challenges of liberalization and to spearhead the development of the financial sector;
- Broaden and deepen the financial markets as well as strengthening the financial infrastructure;

- Improve the overall efficiency and competitiveness of the banking sector; and
- Accelerate the development of the bond market.

So far we have taken into account some relevant features of banking system and regulation in Malaysia. In the upcoming discussions we can the experience of Pakistan.

Pakistan

Banking sector of Pakistan has been transformed within a short period of 5 years (2000 – 2005) from a sluggish and governmental dominated sector to a much more agile, competitive and profitable industry. Speed and sequencing of banking sector transformation and its role in promoting economic growth is now a leading story of a sector success. Within Pakistan it offers a story of what effective leadership of regulator and change management and corporate governance can achieve and offer. Outside Pakistan it is serving to offer rich lessons in what difference governance of regulatory can make and how bank restructuring and privatization can change the landscape of the industry. (Shamshad, 2007)

The banking industry in Pakistan will continue to enjoy these trends and has promising prospectors. However, sustainability of banking sector performance is dependent on continued macroeconomic stability, stronger vigilance on the sector to ensure effective compliance of industry with the prudential regulatory and supervisory framework, and banking sector's maturity to reorient their business models to enhance their penetration ratio and address the asset: Liability Mismatches. (Shamshad, 2006)

In Pakistan, banking sector liberalization and restructuring was well sequenced and well designed in early 2000, financial sector reform receives story impetus from high degree of political commitment as well as macroeconomic stability. Both it is a prerequisite for smooth and effective implementation of financial sector reforms. (Shamshad, 2006)

Financial liberalization process in Pakistan has been remarkable. It not only resulted in privatization of large public sector banks but the process of privatization was effectively conducted, offering new management in most cases relatively cleaner bank were the key issues of non performing loans (NPL) resolution and rationalization of work force were dealt with upfront. Ongoing flexibility is awarded through special schemes to deal with the outstanding issues. Augmenting the private sector involvement, the entry requirements for new private banks were relaxed but made more stringent both in terms of capital requirements and fit and proper criteria for both management and Board of Directors. (Shamshad, 2007)

Accompanying financial liberalization process was a strong effort on the part of central bank to bring prudential regulatory and supervisory framework for banks at international standards. Central bank is now in midst of evaluating and stocktaking of financial sector reforms. While the transformation of financial system is impressive, it is far from complete. Not only is the change more visible in banking and equity markets relative to institutional finance as insurance, but also the change is more fundamental in banking relative to even equity markets. Consequently it is no surprise that the banking system assets remain the larger component of financial asset and cater for bulk of financing requirements of the country. (Shamshad, 2006)

The discussion above clearly depicted the impact of policy on the performance of banking system in Pakistan. For more enrichment of experience, lets deal with the banking sector and the policy framework in India

India

Since 1991, India has been engaged in banking sector reforms aimed at increasing the profitability and efficiency of the then 27 public sector banks that controlled about 90 percent of all deposits, assets and credit. The reforms were initiated in the middle of a "current account" crisis that occurred in early 1991. The crisis was caused by poor macroeconomic performance, characterized by a public deficit of 10 percent of GDP, a current account deficit of 3 percent of GDP, an inflation rate of 10 percent, and growing domestic and foreign debt, and was triggered by a temporary oil price boom following the Iraq, invasion of Kuwait in 1990. (Narayana, 2000)

Prior to the reforms, India's financial sector had long seen characterized as highly regulated and financially repressed. The prevalence of reserve requirements, interest rate controls and allocation of financial resources to priority sectors increased the degree of financial repression and adversely affected the country's financial resource mobilization and allocation. (ibid)

The major factors that contributed to deteriorating bank performance included: too stringent regulatory requirements that required banks to hold a certain amount of government and eligible securities; low interest rate charged on government bonds; directed and concessional lending; administered interest rates; and lack of competition. (Narayana, 2000)

These factors not only reduced incentives to operate properly, but also undermined regulators' incentives to prevent banks from taking risks via incentive, compatible prudential regulations and protect depositors with a well-designed deposit insurance system. While government involvement in the financial sector can be justified at the initial stage of economic development, the prolonged presence of excessively large public sector banks often results in inefficient resource allocation and concentration of power in a few banks. Further once entry deregulation takes place, it will put newly established private banks as well as foreign banks in an extremely disadvantageous position. (Narayana, 2000)

Against this background, the first wave of financial liberalization took place in the second half of the 1980's, mainly taking the form of interest rate deregulation. To preserve some profitability, interest rate margins were kept sufficiently large by keeping deposit rates low and non-concessional lending rates high. Based on the 1985 report of the Chakravarty Committee, coupon rates on governments were gradually increased to reflect demand and supply conditions. (Ibid)

Following the 1991 report of the Narashiman Committee, more comprehensive reforms took place that same year. The reforms consisted of a shift of banking sector supervision from intrusive micro level intervention over credit decisions toward prudential regulations and supervision, reduction of cash reserve requirement, interest rate and entry deregulation and adoption of prudential norms. (ibid)

Further, in 1992, the Reserve Bank of India issued guidelines for income recognition, asset classification and provisioning; and also adopted the Basel Accord capital adequacy standards. The government also established the board of financial supervision in the Reserve Bank of India and recapitalized public sector banks in order to give banks sufficient financial strength and this helps to enable them gain access to capital markets. In 1993, the Reserve Bank of India permitted private entry in the banking sector, provided that new banks were well capitalized and technologically advanced and at the same time prohibited cross-holding practices with industrial groups. The Reserve Bank of India also imposed some restrictions on new banks with respect to opening branches, with a view to maintaining the franchise value of existing banks. (Narayana, 2000) As a result of the reforms, the number of banks increased rapidly. In 1991, there were 27 public sector banks and 26 domestic private banks with 60,000 branches, 24 foreign banks with 140 branches, and 20 foreign banks with a representative office.

Between January 1993 and March 1998, 24 new private banks (nine domestic and 15 foreign) entered the market; the total number of scheduled commercial banks excluding specialized banks such as the Regional Rural Banks rose from 75 in 1991/92 to 99 in 1997/98. (Narayana, 2000)

Entry deregulation was accompanied by progressive deregulation of interest rates on deposits and advances. From October 1994, interest rates were deregulated in a phased manner and by October 1997, banks were allowed to set interest rates on all term deposits of maturity of more than 30 days and on all advances exceeding RS 200,000. While the cash reserve requirement and legal reserve, interest rate policy and prudential norms have always been applied uniformly to all commercial banks. The Reserve Bank of India treated foreign banks differently with respect to the regulation that requires a portion of credit to be allocated to priority sectors. In 1993, foreign banks, which used to be exempt from this requirement while all other commercial banks were required to earmark 40 percent of credit, were required to allocate 32 percent of credit to priority sectors. (Roland, 2006) So far we have seen the banking sector of India and its development along with its problem and prospects; for better experience enriching it is also advisable to see development of the banking sector in China.(Ibid)

China

Like in other countries the development of the banking sector in China has been strongly influenced by predominant political philosophies. Since the foundation of the People's Republic of Chine (PRC) the Chinese banking sector has undergone several distinct policy changes. The people's Bank of China (PBC) stood at the center of a virtual mono-banking system since it had the main responsibility for cash credit and settlements. Even though at the beginning of the 1950s other banks and rural cooperatives existed, they de-facto functioned as extensions of the PBC, and were eventually merged in to the PBC system in 1955. (Roland, 2006)

In 1979 china established a two-tier banking system with the foundation of three state-owned banks. These were the Agricultural bank of China (ABC) the bank of China (BOC) and the people's construction Bank of China (PCBC). Several important measures were taken to further commercialize the banking system between 1985 and 1994. Among them was the replacement of direct grants with interest-bearing loans to harden the budget constraints of state-owned enterprises, the granting of formal responsibility for the PBC in 1986 over monetary policy and the supervision of the financial system and the formulation of a credit plan that instituted an aggregate credit ceilings, the branches gained increasing autonomy to make credit decisions. (Roland,2000)

In 1993 the state council initiated further reform steps that included the transformation of the PBC in to a modern central bank with responsibility for monetary policy and financial system supervision, and the decision to separate policy and commercial lending which was the basis for the transformation of the state banks in to commercial banks. In addition to the foundation of the policy banks, major reforms in the areas of reserve requirement, interest rate deregulation, reduction of directed lending entry deregulation, improvement of prudential regulation are NPL management have been started since 1994. These reforms are interest rate liberalization, statutory pre-emption, priority sector lending, stabilization and institution building. (Ibid)

Monetary policy strategies[1] in selected countries[3]			
Exchange rate targeting	Monetary targeting	Inflation targeting	Other
Argentina, Brunei Darussalam, Hong Kong, Denmark, Singapore	Germany, China	Australia, Canada, New Zealand, Sweden, United, Kingdom, Korea, Chile	Euro area[1], Malaysia, USA[2], Japan

[1] Comprise Australia, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain.
[2] Monetary policy is based on a broad range of indicators.
[3] BNM (1999)

From what has been discussed about various countries experiences we can understand that public policy has paramount importance in shaping the effectiveness of banking system. The above table depicts that different countries according to their contextual environmental situation have used different policy instruments.

The government-through its ability to tax, to spend, and to control the money supply-attempts to promote full employment, price stability, and an adequate rate of growth in the economy. Pursuing these objectives through taxing and spending is called fiscal policy; pursuing them through regulating the money supply called monetary policy. Macroeconomics examines both policies. The tools of fiscal policy sort into two categories: automatic stabilizers and discretionary fiscal policy. These are, automobile stabilizers structural features of government spending and taxation that dampen fluctuations in disposable income, and thus consumption, over the business cycle and discretionary fiscal policy the deliberate manipulation of government purchases, taxation, and transfer payments to promote macroeconomic goals, such as full employment, price stability, and economic growth. (William A. 2003)

Economists everywhere are increasingly becoming to acknowledge the fundamental importance of a country's banking system for its economic and social development. The banking system does much to set the pace of income formation. It plays a part in income distribution in the process of saving and in the allocation of investment as between different geographical areas, economic sectors and forms; it can use interest rates as dynamic factors of development contribute to monetary stability and influence short-term economic conditions. Governments in their turn are increasingly abandoning there past agnostic attitude to the structure and working of the banking system. Beyond law enforcement and the imposition of a tangentially systematic and organic order public control is now actively concerned with maximizing the efficiency with which the banking system discharges its function in relation to the aims of economic policy. (Dell'Amore, 1971)

3.3 Review of Empirical Evidence

The financial sector left behind the socialist oriented government, constituted only three banks each enjoying monopoly in its respective market. Following the change in the economic policy, financial sector reform also took place. Monetary and Banking Proclamation of 1994 established the National Bank of Ethiopia as a judicial entity, separated from the government and outlined its main functions. (Proclamation No. 83/1994)

The Licensing and supervision of Banking Business Proclamation No. 84/1994 of the Transitional Government of Ethiopia provided the general framework. From then on, a series of directives setting out the specific rules and regulations, the quantified requirements and compliance impositions are released and enacted by the NBE. From the outset, the proclamation, in its articles (Articles3-11), outlines the requirements and procedures in applying for undertaking banking business in Ethiopia. In these are included the requirements for a company to be called a bank, NBE's power as the sole supervisory organ, the exclusion of foreign nationals from undertaking /owning any banking business, requirements or documents to be attached in applying for license, introduction of investigation, procedural and annual license renewal fees, deadlines for NBE to respond in grants or refusals for banks to commence operations, contravention measures for operating banking business without license and finally the conditions under which the revocation of license can occur. Along these lines, Directives No SBB1/94, 2/94, and 3/94 have the licensing and Supervision of Banking Business of the NBE outline the specifications. Directive No SBB/3/94 especially instructs as to the procedures and the standards of capital formation to open a banking business. (Seife, 1999)

Shortly after the proclamation, the private banks start to emerge. As a result of this the Ethiopian banking system comprises eight private banks along with three publicly owned banks. These 11 banks are Commercial Bank of Ethiopia (CBE), Construction and Business Bank (CBB), Development Bank of Ethiopia (DBE), Awash International Bank (AIB), Dashen Bank (DB), Bank of Abyssinia (BOA), Wegagen Bank (WB), Nib International Bank (NIB), United Bank (UB), Oromia Cooperative Bank (OCB) and Lion International Bank (LIB).

3.3.1 Monetary policies

Currently, the National Bank of Ethiopia has various monetary policy instruments to influence credit in the economy. A few among others are: interest rate, credit ceiling, reserves and liquidity requirements and exchange rate policy.

3.3.1.1 Interest rate policy

Both the minimum deposit and maximum lending rates were set by NBE until the decision to do so was later left to the decision of commercial banks. Effective January 1, 1998, the minimum deposit rate has been set at six percent and the lending rate has been liberalized. The minimum deposit rate further was set at three percent. This minimum deposit rate now is changed to four percent. Notwithstanding the interest rate floor set by the NBE, banks may determine interest rates on inter-bank deposits and lending. Government deposits and borrowing and large institutional savings are being taken care of by negotiation with the concerned parties.

Table 3.1 Interest rate structures of commercial Banks

Items	June 01/02	June 02/03	June 03/04	June 04/05	June 05/06
1.Saving Deposit Rates					
• Minimum	3.00	3.00	3.00	3.00	3.00
• Maximum	3.15	3.15	3.15	3.15	3.15
Average Saving Rate	3.08	3.08	3.08	3.08	3.08
2. Time Deposit (weighted)					
• Up to 1 year	3.30	3.35	3.40	3.47	3.60
• 1-2 years	3.51	3.62	3.64	3.71	4.01
• Over 2 years	3.57	3.82	3.84	3.94	4.30
Average Time Rate	3.46	3.60	3.62	3.71	3.97
3. Lending Rate					
• Minimum	7.50	7.00	7.00	7.00	7.00
. • Maximum	14.00	14.00	14.00	14.00	14.00
Average Lending Rate	10.75	10.5	10.50	10.50	10.50

Source: NBE fourth quarterly Bulletin 2005/06

3.3.1.2 Reserve Requirement

Prior to the recent amendment to lift the requirement to 10%, lending banks had to deposit in cash five percent of their net deposits with the National Bank of Ethiopia. The reserve instrument attempts to influence the money creation powers of commercial banks by increasing or decreasing their cash reserve bases on which their money creation powers are based. Concentrating on the directives associated with prudential supervision, one concerns capital adequacy to ensure asset quality and solvency. Directive No. SBB/9/95 provides the weights that should be attached to the assets of a bank and the standards for the computation of capital adequacy to fulfill for the minimum required capital of 8 percent of risk-weighted assets, as outlined by proclamation 84/1994 (Article 13(1)). Similarly, the proclamation, in its Articles 12 and 13(4), augmented by Directive No.SBB/4/95 directs every bank to transfer annually 25% of its net profits after tax to its legal reserve account until such accounts equals its capital. Once the equivalent is reached and maintained, the legal reserve transfer only is 10% of annual net profits.

Table 3.2 Monetary Aggregates and Ratios **(In Million of Birr)**

Particulars	2002/3	2003/4	2004/5	2005/6
1. Reserve Requirement (CB's)	1,320.3	1,549.4	1,827.6	2,120.9
2. Actual Reserve (CB's)	3,816.9	4,911.3	12,739.7	8,452.1
3. Excess Reserve (CB's)	2,496.6	3,362.0	10,912.1	6,331.2
4. Reserve Money	11,117.9	13,404.1	23,913.1	21,181.9
. Currency in Circulation	7,203.7	8,569.5	10,961.7	12,560.2
. Banks deposits at NBE	3,914.2	4,834.5	12,951.4	8,621.7
5. Money Multiplier (Ratio)				
. Narrow Money to Reserve Money	1.4	1.3	0.9	1.1
. Broad Money to Reserve Money	2.6	2.5	1.7	2.2
6. Other Monetary Ratios (%):				
. Currency to Narrow Money	46.7	47.5	51.5	52.7
. Currency to Broad Money	24.8	25.5	27.3	27.1
. Narrow Money to Broad Money	53.1	53.6	52.9	51.3
. Quasi Money to Broad Money	46.9	46.4	47.1	48.7

Source: NBE fourth quarterly Bulletin 2005/06

3.3.1.3 Liquidity Requirement

As to liquidity requirements, Article 16 of proclamation No. 84/1994 imposes liquidity requirement on banks to maintain liquid assets amounting to not less than a prescribed percentage of the total, as is directed by the NBE. Per Directive No. SBB/15/95 the NBE expects any licensed bank to maintain liquid assets of not less than15% of its total current liabilities. This requirement is imposed to avoid critical asset/liability mismatches. For prudential purposes again, Article16 (5) of the Licensing and Supervision of Banking Business Proclamation mandates the NBE as the setter of the percentage of a reserve balance that banks are required to maintain out of their total deposit liabilities from time to time. A prescribed percentage of currently 15 percent of short term liabilities must be maintained by banks in liquid assets, namely cash on hand, legal and excess reserves with the NBE and deposits with other banks, both domestic and foreign. By sterilizing additional cash reserves of banks which could be for creating money, the liquidity requirement helps control the growth of credit and money, thereby the growth of inflation.

Table 3.3 Stock of Deposits Mobilized by the Banking System as at end of June 2006

(In Millions of Birr)

Types of Deposits	2004/05		2005/6	
	Quarter IV	% Share	Quarter IV	% Share
Demand Deposit	17,778.10	47.6	21,264.00	47.8
Savings Deposit	17,324.40	46.3	20,488.20	46.1
Time Deposit	2,284.63	6.1	2,706.80	6.1
Total	**37,387.13**	**100.0**	**44,459.00**	**100.0**

Source: NBE fourth quarterly Bulletin 2005/06

3.3.1.4 Credit Ceilings

Although enforcement has not been as effective as expected, the NBE has from time to time imposed such direct credit ceilings on lending banks as a means of promoting price stability. A similar control mechanism is the ceiling imposed on government borrowing from the NBE. As the NBE's option to influence the movement of credit and monetary aggregates via open market operation is limited. Because of the near absence of money and capital markets in the country at present, the NBE shall continue to avail itself of the mechanism of direct credit and borrowing ceilings on lending banks and the government in pursuit of monetary and exchange rate stability.

Coming to the credit regulation, we first find those provisions to be made for depreciation of assets, operating and accumulated losses, preliminary expenses and the value of any assets lodged or pledged to secure liabilities by every bank in its calculation of the capital and reserve requirements (Article 15(1) and (2) of proclamation 84/1994). Directives No SBB/7/95 and its amending Directive No SBB/18/96 of the NBE outline the specifications in this regard. As to provisions for non- performing loans, five tiers setting for minimum provisions are instructed (Pass, special mention, substandard, doubtful and loss loans). The other side of the credit sector regulations broadly comprises those morally hazardous issues of single borrower loan limits and insider lending. Directives No. SBB/16/96, No.SBB/10/95 and SBB/17/96 have especially restrictive percentages that are meant to avoid any intentional or seemingly unintentional favoritism steps in credit extension of banks. Associated with these are also limitations on investment of banks whereby NBE prescribes as to where banks are allowed to invest and operate or not (Directive No.SBB/12/1996).

Table 3.4 Breakdown of Loans & Advances of the Banking System by Clients, for the Fourth Quarter of 2005/06 ended June 30, 2006 (In Millions of Birr)

Particulars	Disbursement	Collection	Outstanding
Public Banks	**1,381.4**	**1,550.4**	**28,396.3**
Central Government	-	-	12,682.6
State Enterprise	48.0	368.8	2,997.1
Cooperatives	95.9	312.5	1,694.5
Private Enterprise	1,237.5	865.9	10,747.1
Inter-Bank Lending	-	3.1	274.9
Private Banks	**1,827.2**	**1,574.4**	**11,235.0**
Central Government*	-	-	197.5
State Enterprise	-	0.1	20.2
Cooperatives	41.7	208.9	154.3
Private Enterprise	1,785.6	1,365.4	10,862.9
Inter-Bank Lending	-	-	0.0
Grand Total	**3,208.6**	**3,124.8**	**39,631.2**

Source: NBE fourth quarterly Bulletin 2005/06

3.3.1.5 Exchange Rate Policy

The rate of exchange is classified as one of the monetary policy instruments available to the monetary authorities of a country. The supply of foreign exchange in the Ethiopian economy is a function of the following determinants; exports of goods and services, official foreign grants, private inward remittances and foreign loans. On the other hand, the major demand for foreign exchange emanates from imports of goods and services and private outward remittances. Previously, wholesale foreign exchange auction system for commercial banks and investors' (previously it was retail auction) operated by the NBE. And, exchange rates set by negotiation between commercial banks or bureaus and clients or independently set by the former on the basis of market trends are operating side by side.

The inter-bank money and foreign exchange markets are introduced recently as part of liberalization measures. The primary foreign currency in which the

Ethiopian Birr quoted will continue to be the US dollar, however, the possibility of pegging the Birr to specially tailored baskets of currencies. Monetary and banking proclamation No. 83/1994 and the Licensing and Supervision of Banking Business No. 84/1994 laid down the legal basis for investment in the banking sector. (NBE)

Table 3.5 Capital and Branch Network of the Banking System at the Close of June 30, 2006

(Branch in Number and Capital in Million Birr)

Banks	Branch Network							Capital			
	2004/05			2005/06				2004/05		2005/06	
	Regions	Total	% Share	Regions	Addis Ababa	Total	% Share	Total Capital	% Share	Total Capital	% Share
1. Public Banks											
Commercial Bank of Ethiopia	138	174	44.7	141	36	177	42.0	1,427.0	29.9	1,505.3	27.8
Construction & Business Bank	15	26	6.7	15	12	27	6.4	115.0	2.4	179.0	3.3
Development Bank of Ethiopia	31	32	8.2	31	1	32	7.6	1,806.0	37.8	1,822.0	33.6
Total Public Banks	**184**	**232**	**59.6**	**187**	**49**	**236**	**56.1**	**3,348.00**	**70.1**	**3,506.3**	**64.8**
2. Private Banks											
Awash International Bank	14	33	8.5	16	20	36	8.6	226.8	4.75	304.3	5.6
Dashen Bank	15	33	8.5	15	22	37	8.8	242.3	5.07	311.1	5.7
Abyssinia Bank	10	22	5.7	12	14	26	6.2	268.4	5.62	406.8	7.5
Wegagen Bank	19	29	7.5	21	12	33	7.8	189.3	3.96	256.8	4.7
United Bank	4	17	4.4	7	15	22	5.2	125.0	2.62	193.2	3.6
Nib International Bank	3	17	4.4	4	16	20	4.8	265.0	5.55	313.4	5.8
Cooperative bank of Oromiya	6	6	1.5	11	0	11	2.6	112.1	2.35	122.7	2.3
Total Private Banks	**71**	**157**	**40**	**86**	**99**	**185**	**43.9**	**1,428.9**	**29.9**	**1,908.3**	**35.2**
3.Grand Total Banks	**255**	**389**	**100**	**273**	**148**	**421**	**100.0**	**4,776.9**	**100.0**	**5,414.6**	**100.0**

Source: Supervision Directorate (Bank Supervision Department)

3.4 Summary of Questionnaire

Out of 120 distributed questionnaires 85 (70.80%) of them are responded.

Section One-General

Organization Type

Governmental	40	47.1
Private	45	52.9
Others		0
Total	85	100

Position Held

CEO	4	4.7
Dep't. Head	20	23.5
Div. Head	12	14.1
Branch Manager	5	5.9
Sect. Head	5	5.9
Supervisor	1	1.2
Expert	17	20
Others	21	24.7
Total	85	100

Years of Experience

0-2] Yrs	4	4.7
(2-5] Yrs	13	15.3
(5-10] Yrs	38	44.7
Above 10 Yrs	30	35.3
Total	85	100

Section two-Public Policy

Monetary Policy awareness

Rate of interest (1)	10	11.8
Exchange rate (2)	9	10.6
Legal reserve (1)	6	7.1
Cash & liquidity req. (4)	6	7.1
Credit Ceiling (5)	6	7.1
1,2,5	20	23.5
1&2	16	18.8
1,4,5	12	14.1
Total	85	100

The monetary policy instruments so far employed in Eth are in line with the state of the economy

Strongly disagree	4	4.7
Disagree	35	41.2
Neutral	28	32.9
Agree	18	21.2
Strongly agree	0	0
Total	85	100

The major targets of the current Ethiopia's monetary policies are achieved.

Strongly disagree	4	4.7
Disagree	36	42.4
Neutral	26	30.6
Agree	19	22.4
Strongly agree	0	0
Total	85	100

Do you believe that the monetary policy of the country post Derg has been consistent

Yes	45	52.9
No	29	34.1
N.A	11	12.9
Total	85	100

Policy of NBE influences credit in the economy.

Strongly disagree	7	8.2
Disagree	7	8.2
Neutral	5	5.9
Agree	56	65.9
Strongly agree	10	11.8
Total	85	100

Which of the policy of NBE influence the credit in the economy?

Rate of interest (1)	15	17.6
Exchange rate (2)	14	16.5
Legal reserve (3)	10	11.8
Cash & liquidity req. (4)	8	9.4
Credit Ceiling (5)	8	9.4
1&5	14	16.5
1,4,5	16	18.8
Total	85	100

Do you perceive any gap (missed or to be added) in the policy of NBE?

Yes	45	53.00
No	29	34.1
N.A	11	12.9
Total	85	100

Reason for the above question

1. Stock market	16	31.4
2. Modern payment system	13	25.5
3. Foreign currency account for resident & non resident (limit)	8	15.7
4. Credit customer rating	7	13.7
5. Standardize the credit analysis	7	13.7
Total	51	100

Have you encountered or felt any problem in relation to the NBE policy?

Yes	45	52.9
No	28	32.9
Others	12	14.1
Total	85	100

Section three- Regulatory body

Do you agree with the functions of National Bank of Ethiopia?

Yes	68	80
No	7	8.2
N.A	10	11.8
Total	85	100

Do you agree with the objectives of NBE?

Yes	72	84.7
No	2	2.4
N.A	11	12.9
Total	85	100

The performance of NBE

Extremely ineffective	4	4.7
Worse than average	7	8.2
Average	52	61.2
Better than average	13	15.3
Extremely effective	9	10.6
Total	85	100

Specify the strongest performance of NBE

A. Exchange rate policy	29	34.1
B. Controlling of inflation	21	24.7
C. Follow up NPLs	16	18.8
D. Endorsement of CEO/President	5	5.9
E. Examination of accounts/transaction	14	16.5
Total	85	100

Specify the weakest performance of NBE

1. Absence of stock market	28	32.9
2. Excessive supervisor	14	16.5
3. Back ward payment system	23	27.1
4. Inflation rise	11	12.9
5. Ridged policy	9	10.6
Total	85	100

The supervision of NBE towards Commercial banks

strongly disagree	4	4.7
Disagree	9	10.6
Neutral	15	17.6
Agree	38	44.7
Strongly agree	19	22.4
Total	85	100

The supervision of the NBE follows the international standards

strongly disagree	3	3.5
Disagree	9	10.6
Neutral	40	47.1
Agree	32	37.6
Strongly agree	1	1.2
Total	**85**	**100**

Section Four-The banking system in Ethiopia

How do you see the Ethiopian banking system?

Extremely ineffective	2	2.4
Worse than average	20	23.5
Average	44	51.8
Better than average	14	16.5
Extremely effective	5	5.9
Total	**85**	**100**

What is the contribution of the private banks to the banking system?

1. New product	1	2.6
2. Easy loan facility	5	12.8
3. High customer satisfaction	6	15.4
4. Competition sprit	13	33.3
5. Technology	14	35.9
Total	39	100

What are the major impediments of the private banks in the banking system?

1. Vulnerable to share holder interest	22	40
2. Introduce unfair competition	6	10.9
3. Lack of stable internal policy	9	16.4

4. Fraudulent & corruption	6	17.6
5. Aggravation of NPLs	12	21.8
Total	55	100

The banking system does not provide the public enough currency when it is demanded

Strongly disagree	5	5.9
Disagree	18	21.2
Neutral	18	21.2
Agree	20	23.5
Strongly agree	24	28.2
Total	85	100

The credit system in Ethiopia

Extremely ineffective	6	7.1
Worse than average	24	28.2
Average	47	55.3
Better than average	6	7.1
Extremely effective	2	2.4
Total	85	100

What kind of credit system do you propose?

1. Minimum collateral requirement	15	17.6
2. Project ideas	7	8.2
3. Managerial capability	7	8.2
4. Repayment capacity (plan)	4	4.7
5. Borrowers credit needs	6	7.1
6. Borrowers credit worthiness	4	4.7
Total	85	100

Which of the following have major impact in the banking system?

Judicial (1)	14	18.2
Infrastructural (2)	10	13
Technology (3)	18	13
Inland Revenue (4)	10	13
Customers (5)	7	9.1
Shipping lines (6)	6	7.8
Other	20	26
Total	85	100

3.5 Data Discussions

As already tabulated in the summary of questionnaire, we have distributed about 120 questionnaires for different individuals like bank officials, policy makers, academicians and experts; we have only received response from 85 respondents that is 70.80 percent.

What has been already collected seemingly covered enough of what the research intended to achieve. In addition, face-to-face interviews were conducted with top officials of the banking system in Ethiopia. For better understanding and clear flow of the analysis, the data were collected in such a manner that considered both public and private banks of Ethiopia. As we are trying to make the discussion understandable, we further divided the results of the questionnaire into four sections to be discussed along with the already obtained secondary data.

1. General

To begin with, let us forward the general information gathered from the first part of the questioner. Out of 85 respondents 40 (45%) of them are from public banks. These are Commercial Bank of Ethiopia (CBE), National Bank of Ethiopia (NBE) Construction and Business Bank (CBB) and Development Bank of Ethiopia (DBE), and the rest 45 (55%) of them are from private banks like Bank of Abyssinia, Awash International Bank, Dashen Bank, Wegagen Bank, Lion International Bank, Oromia Cooperative Bank, Nib Bank and United Bank.

This kind of distribution of samples has a paramount importance since the Ethiopian banking system is comprised of both public and private banks. Both banks are simultaneously regulated by the policies and directives of the government through the regulator body of the National Bank of Ethiopia (NBE).

It is not only the distribution of sample organizations was important here, but also the respondents' mix that may be explained by along with respondents' respective position. These respondents played major role directly in the execution as well as directly and indirectly in formulation of directives and policies of NBE.

Therefore of 85 respondents five percent is CEOs/Presidents, 57% is Department Heads, Division Heads and Experts, 12% is Branch Managers and Section Heads and the remaining 20% is supervisors and other important stakeholders in the banking systems.

To understand policies of the banking system formulated by the regulatory body, it is worth staying in the banking system for long period so as to identify the positive and negative influence of the policy on the banking system, we have deliberately assessed the experiences of years of services of respondents in the system. To our satisfaction 45% of respondents is staying in the system between five to ten years and 35% of the respondents renders service for more than ten years in the banking industry and only the remaining 20% have experience below 5 years.

2. Public policy

Coming to the questions of knowledge about public policy and its source, 60% of the respondents had moderate or less understanding of the public policy. The remaining 40% of the respondents possessed very high or a great deal of knowledge about public policy.

Regarding this issue, an interview conducted with the Vice President of Awash International Bank depicts that knowledge about public policy, especially on regulatory policies and directives need to be understood clearly, challenged and criticized. This helps identify whether the policies are in line with desired objectives or not. It is also important, according to the president that a feedback has to be forwarded to policy makers without any hesitations for a win-win situation to the regulator and regulated bodies. To this end, pre-policy participations, discussions and need assessments have to be carried out and post policy influence has to be identified.

On the other hand, 30.6% of the respondents indicated that their sources of knowledge about public policy are both government offices and media while for 21.2% of respondents the source is media; the same percentage (21.2%) of respondents' source of knowledge is the government. The remaining 15.3%, 7% and 2.4% go for media and individual, individuals' alone and civic society respectively. Media and government offices have played a great deal of role in disseminating knowledge about public policy on banking regulation.

3. Regulations and Supervision

While discussing the relationship between banking system and public policy, it was highlighted relationship in terms of between banking regulation and directives wherein NBE is vested with a regulatory power. Therefore, it is worth to note the function, objectives and performances of the regulatory body to explain policy impacts on the banking system. Consequently, more than 70% of the respondents agree on the existing functions and objectives of the NBE as provided by the government.

The first question under the monetary policy section sought for respondents' awareness about the monetary policy. It happened to be 23.5% is well aware of only rate of interest, exchange rate and credit ceiling. Awareness on both exchange and interest rates accounts 18.8 %, while knowledge of rate of interest, cash, liquidity and credit ceiling is 14.1 %. Only 11.8 % and 10.6% know rate of interest and exchange rate respectively, while 7.1% goes to legal reserve, cash and liquidity requirement and credit ceiling each.

For the second selected question on monetary policy of the country consistency has been there in post Derg period. 53% of the respondents believe that the policy is consistent, 34% of them argue that it is not consistent while the remaining 12% does not say anything on he issue.

Regarding monetary policy instruments so far employed in Ethiopia, it is depicted from columns that the instruments are in line with the state of the economy as shown in table 3.6 below. And the same table show whether major target of the current monetary polices is achieved or not.

Table 3.6 policies in line with economy and objective achievement

	Policy in line with Economy		Policy objective achievement	
	Frequency	%	Frequency	%
Strongly disagree	4	4.71	4	4.71
Disagree	35	41.18	36	42.35
Neutral	28	32.93	26	30.59
Agree	18	21.18	19	22.35
Strongly agree	0	-	0	-
	85	100.00	85	100.00

When asked about their perception of policy gap (missed) or policy to be included (added), 53% of the respondent perceived the presence of gap while 29% indicated that there is no gap. The remaining 11% took a neutral position.

While reasoning for what they perceived above, 31.4% of the respondents reportedly indicated that the policy needs to include a secondary market option or stock market, 25.5% of them believed that current payment system requires change to modern payment system. Other respondent, 15.7% insisted on having changes regarding maintenance of foreign currency account for resident and non–resident customers. The remaining respondents underscored the importance of changes on credit system rating and standardization of the credit analysis.

According to responses from an interview conducted on the same issue with the director of Ethiopia Financial Institution public policy, amongst others, has to incorporate foreign banking entrance to the Ethiopia Banking system, inclusion of technology, human resource as licensing requirement along with the minimum paid up capital of Birr 75 million. The president of United Bank argued that the policy needs to consider the issue of leadership as it is hardly possible to find banking leaders. The reason being there is a tendency to favor the interests of owners, government for public banks and shareholders for the private ones, while the banking system needs professional and proactive judgments in decision-making. Therefore, policy makers need to consider ways as to how to upgrade leadership qualities in the banking sector since the human aspect is crucial to the service industry.

The president of Awash Bank on his part said that policy issues essential to attain stipulated objectives, but not yet pursued, are inflation targets, monetary aggregate targets, financial system stability, price targeting, expansion of the monetary base or targets of the use of money, transitioning the economy to auditable value exchange and transformation system, payment system development, enhancing monetary depth, exchange reserve control, and unemployment monitoring.

In the category of policy instruments, he goes on listing stipulated but not actively persuade policy issues like interest rate, capital requirement, loan loss provisioning and other risk related policies, money market regulation, bank corporate governance, affiliated parties and the regulation on ownership of financial institution, liquidity crises management guideline, the domain of permitted bank business, transparent accounting and reporting standard and failing and insolvent banks management regulation.

Regarding policies formulated by NBE, 52.9% of the respondents feels the presence of problems while 33% does not. The remaining 14.1% are neutral.

Table 3.7 Supervisions of National Bank of Ethiopia

	Supervisory role		Supervisory role vis-à-vis international standards	
	Frequency	%	Frequency	%
Strongly disagree	4	4.71	3	3.53
Disagree	9	10.59	9	10.59
Neutral	15	17.64	40	47.05
Agree	38	44.71	32	37.65
Strongly agree	19	22.35	1	1.18
Total	85	100.00	85	100.00

As it is clearly depicted in the above table the lion share of the respondent agree (44.7%) and strongly agree (22.4%) that the supervision of NBE on commercial bank is necessary while 17.6% remains neutral, and the rest 4.7% strongly disagrees while 10.6% disagree to this role of NBE.

Regarding the supervisory role of NBE in following international standard, only 38.8% of respondents agree to the issue, and 62.2% of respondents demonstrated neutrality.

4. The banking system

So far we have seen knowledge about public policy and awareness, the policy impact on the banking system, supervisory and regulatory role. Now let us see the banking system in Ethiopia. In relation to the question of whether the Ethiopian banking system is dominated by the public sector, 62% confirmed the prevalence of this domination while 19% declined domination. The reason for domination can be brought from the Asset size of the banking system, the branch number and its liability in terms of the deposit concentrated in public banks, especial CBE as indicates in table 3.5 earlier.

Table 3.8 Contribution and Impediments of Private Banks

Contribution	Frequency	%	Impediment	Frequency	%
New product	7	8.24	Vulnerable to shareholder interest	22	25.88
Easy loan facility	7	8.24	Introduce unfair competition	6	7.06
High customer satisfaction	8	9.41	Lack of stable internal policy	9	10.59
Competition sprite	15	7.64	Fraudulent &corruption	6	7.05
Technology	17	20.00	Aggravation of NPLs	12	14.12
1 & 5	19	22.35	2, 4 &5	12	14.12
1, 2 & 3	12	14.12	1 & 5	18	21.18
Total	85	100.00		85	100.00

The above table shows that private banks have both contributions and impediments. Regarding contribution, 22.35% of respondents believe that introduction of new products and technology are the major contributions to the system while 20 % believe technology alone is the contribution of the private banks followed by competition sprite that constitute only 17.64 % of the respondents.

On the impediments of the private banks, the lion share of the percentages of the respondents indicate vulnerability to share holders' interest (22%), while introductions of unfair competition, fraud and corruption and escalation of NPLs are mentioned by 18% of the respondents.

To asses the performance of the banking system looking into issues of whether the banking system provides enough currency when it is demanded is relevant. Accordingly, more than half of the respondents (51.7%) declare that the banking system does not provide enough money and 21.2 % of the respondents are neutral to the questions; but 27.1% of the respondents agreed that the banking system provides enough currency when it is required.

Table 3.9 Banking and Credit System

	Banking System		Credit System	
	Frequency	%	Frequency	%
Extremely ineffective	2	2.35	6	7.06
Worth than average	20	23.53	24	28.24
Average	44	51.77	47	55.29
Better than average	14	16.47	6	7.06
Extremely effective	5	5.88	2	2.35
Total	85	100.00	85	100.00

According to respondents, the credit system in Ethiopia on is average (55.3%); and 2.4% of the respondent believes that the credit system in Ethiopia is effective. The respondents (38%) propose that the credit system should be based on minimum collateral requirement, project ideas and managerial capability. 17.6% stress that the credit system has to follow the principle of minimum collateral requirement, and 11.5% of the respondent go for project ideas and minimum collateral requirement, the remaining respondents proposed for repayment capacity plan, borrower credit needs and credit worthiness of the clients.

3.6 Conclusion

In the empirical reviews we have seen the impact of banking regulation and supervision on the banking system and its tremendous impact on policy formulation with its time and other factors. Moreover, we have drawn lessons from other countries' experience with reference to their respective economic system and banking system changes. Now, let us look into the Ethiopian banking system and public policy in the subsequent chapter.

Chapter four: Assessment of Public Policy and the Banking System

4.1 introductions

So far, we have seen the experience of other countries and data discussions on empirical evidences. Now we try to asses the public policy and the banking system through lessons learned and empirical facts.

4.2 Analyses

As there should be an accountable to institution that can guide and control financial sector activities, the functions and objectives assigned to NBE by Proclamation number 83/1994 are very important. As depicted in table 3.5, the asset of the banking sector is owned by the public. This means that the responsibility of banks so as to safeguard the public's money at large is very vital. This public money is injected to the economy by way of loans and advances. Hence, NBE plays pivotal roles to protect the public and the economy of the nations as a regulatory body. Due to the risky nature of certain activities, banks are highly supervised entities worldwide.

Central banks have two main interrelated functions, the first is the macro function of maintaining nominal price stability; and the second is the micro function of ensuring healthy development of the payments. The banking and financial systems exhibit high and volatile inflations while the price mechanism in turn is likely to be disturbed by booms and busts.

One of the public policy that has impact on the banking system is the monetary policy. In this regard, there are monetary policies such as, inflation targeting, monetary aggregates targeting, financial system stability, price targeting and expansion of the monetary base.

We can deduce that knowledge and awareness is revolving around instruments of deposit, credit, import and export as well as around rate of interest, credit ceiling and exchange rate. Response shows that public policy awareness is still a problem in the banking sector.

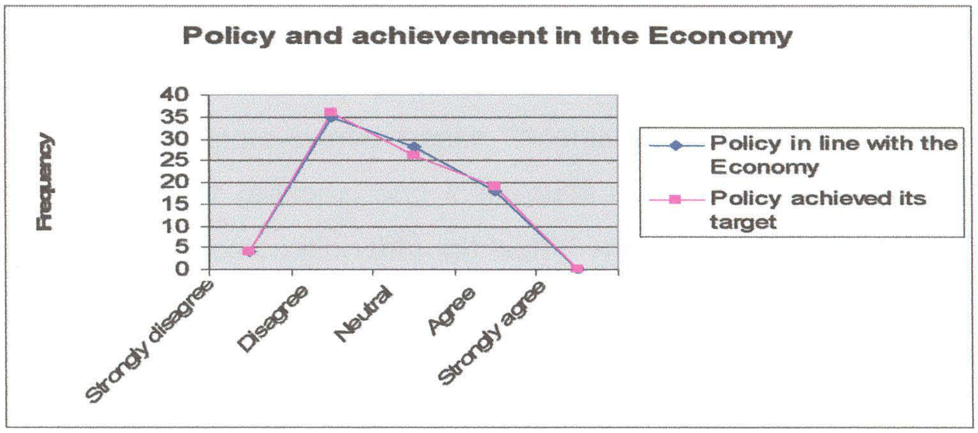
As a result, it is believed that seminars, workshops and other types of instruments to what and why of a particular public policy have to be conducted. This is mainly because financial institutions, especially banks are taken as steering wheels to the economy. In relation to this, we can learn from the economies of India and Malaysia the importance of banking reforms in changing the banking system. If central banks of developing countries dictate the terms and conditions under which financial institutions operate, they may loose their role as pace makers in the economy.

Directives issued in connection to monetary policy are centrally managed by NBE (not led by market forces), and as banks like CBE, the biggest player of the market is owned and directed by the government. No dynamic interaction of finance is observed.

A consistent policy is a policy that is predictable. The central bank is seemingly managing its intended jobs well. This partly indicates the presence of consistent policy. Nonetheless, others argued that there is little or no evidence that resonantly indicates whether policies pursued currently are in consonance with best practices or pervasive standards in the field and what the market and the economy requires. Nor is there evidence that indicates if policies are engineered to obtain desirable goals stated on a priori set model of economic growth, development priorities and economic change objective. The same can be said about the attainment of promulgated objective.

The prime monetary policy goals, in proclamation 83/1994 article 6 are defined to be fostering monetary stability, protecting the value currency of the country, maintaining sound financial system and creating conducive credit and foreign exchange environment.

Suffice to say, some important policies yet vital to the attainment of stipulated monetary policy of the country, are not purposefully used. Habit of monetary use, transitioning the economy to auditable value exchange and transaction system, payment system development, enhancing monetary depth, exchange reserve control, unemployment monitoring, licensing and supervision of banks, capital requirement, liquidity crises management guideline, failing and insolvent bank management regulation, loan provisioning and export guarantee scheme, determination of external debt and others are missed in the Ethiopian banking policy.



In our view, the policy that has to be emanated from the central bank of Ethiopia has to be finely tuned to the state of the economy the country follows. In broad sense the country follows a free market economy that gives a significant portion of the economy to be in the hands of the private sector. However, the privatization agency is still reluctant to privatize public banks so that these banks could play more roles in the economy than ever before. Failure to comply to the needs of market economy per see results in substantial part of government organizations, donors and private savers to stick to old orders and remain as customers of the public banks especially the CBE. This has its own influence on the liquidity position of private banks, quality of assets, as well as relief of savers from the stigma of depositing and doing business with private banks. In addition, it will have a paramount influence on the efficiency and effectiveness of service delivery.

The financial sector is still untouched in terms of privatization except the agency inviting prospective domestic investors to submit bids for the acquisition of the Construction and Business Bank of Ethiopia on July 2002. This could be a good example to substantiate the absence a policy that is in line with the economy.

World Bank (2002) report on finance and growth asserts that the lower the income of a country, the higher the proportion of its bank assets that are state-owned. The theory was that state–owned banks would distribute capital to more productive investments, provide greatest access to credit for deserving sections of society, and be less prone to crises. In practice it has proven difficult to design incentives to guide either public or private banks toward efficient resource allocation. With state-owned banks, incentives are often especially weak, for political and other reasons, and the results are usually worse. State ownership tends to reduce competition through higher spreads on interest rates, lend to less stock exchange activity and non-bank credit, and results in greatest concentration of credit, usually to the largest firms, often to inefficient state enterprises.

Boehmer (2004) said that because state-owned banks often provide government with important policy tools, privatization of the banking sector is often regarded as a sensitive issue. With rare exceptions, public banks have performed poorly by conventional financial measures, such as returns on equity or assets, the extent of NPLs and expense levels according to Caprio (2004).
On top of this the policy failed to attain some of the stipulated targets. Even though it is claimed that the current inflation rise is related to growth, it is partly

associated with failures of the monetary policy. In addition, although various incentives are provided to exporters by NBE, the results achieved are otherwise. One can mention that flower export is booming. It is only growing at the expense of other sectors. The result achieved in this sector is not tantamount to the huge investment it consumed.

In our view, the Ethiopia Banking system and its policies are traditionally managed; it lacks dynamism. This is to say, stock markets to mobilize capital as to the needs of the market, are highly overlooked; the assets of many banks are affected by non-performing loans; due to lack of standard credit analysis, the banks' corporate governance either the board of directors or the top management hardly have international exposures to lead banks proactively.

Generally, most of the regulations are prescriptive and sometimes downright restrictive. The directive on approval of directors and CEO, SBB 39/2006 is for instance, prescriptive lacking the substance promoted in principles of corporate governance; Directives No FXD/25/2004, meant for opening foreign currency denominated accounts by Non-Residents Ethiopians, is another prescriptive regulation because this directive outlines details of the opening maintenance, closure accounts and interest rates applicable for these type of account. It creates some dysfunctions in the operation of banks.

The prescriptive stance regarding export proceeds payment modalities failed to include many export payment methods, having the power to expand Ethiopian producers into new markets and new buyers or initiating bargains of direct non-cash finance investment in the country. It is suffice for NBE to leave domestic banks and producer to raise additional foreign exchange or equivalent that would otherwise leave customs boarding of Ethiopia. There are some more prescriptive regulations like branch licensing rule and the directive about credit card operation.

The restrictive posture of NBE pertains to stipulations relating to ownership, financial institution structure, definition of banking business, organization of banks, reserve and liquidity requirement. Ownership, for example, excludes foreigners and Ethiopians of Foreign nationality. This is quite aggressive by any standard; and the objective it is meant to achieve is not clear. If an institution is to use the name "bank" it can be instituted in the structure and legal personality defined for it in the licensing supervision of banking business proclamation No. 84/9991. This is of immense consequence as it excludes institution of banks in the form of a holding company, along with other financial or non-financial companies.

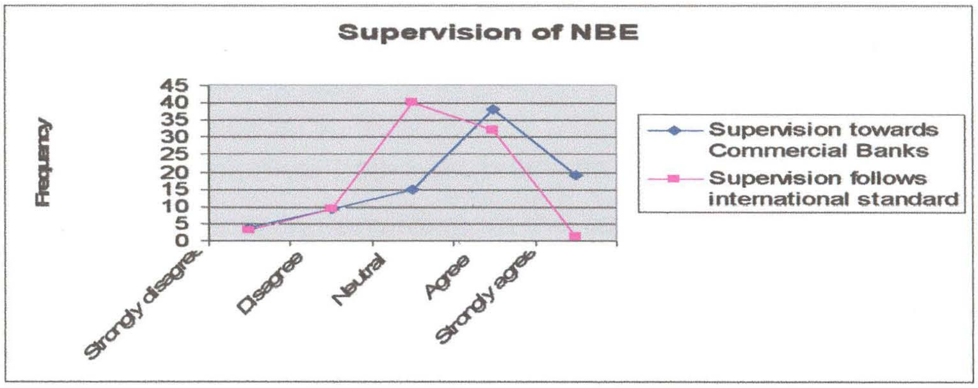
Although the NBE discusses regulations and directives with financial institutions before the issuance one, it hardly incorporates valid suggestion from players in the sector.

In principle, bank regulation and supervision should be non-intrusive and cooperative. The structuring of the regulations, guidelines and directives should always reflect the interest of stakeholders. When issuing regulations, guidelines and the directives, the regulator needs to respect the domain of interest of each stakeholder. Above all, the regulator should shy away from promoting, tacitly or otherwise, the interest of one stakeholder, whether it be for direct economic or 'higher social objectives'.

The NBE, when issuing or in contemplating to issue regulations, directives, and guidelines it needs to build a sense of mutual trust that players in the sector will execute its regulations in good faith. This includes optimism that financial institutions operate based on sound and fundamental banking principles and are cooperative in controlling the violation of rule of law. Literatures reveal policy has to participative to achieve the end by aggregating the interest and views of many.

As depicted in table 3.7 the supervisory role vis-à-vis international standards and NBE's oversight role over commercial banks are positively correlated (0.52). The weighted average (3.69) also indicates the supervision by NBE on the activities of commercial banks is convenient for commercial banks. The weighted average (3.22) for NBE in following international standards indicates good track record though slightly less than that of its oversight role.

Central bank is ensuring the healthy development of the payment banking and financial systems. In doing so, NBE has followed the international standards of supervising like ordinary audited accounts, special audits, on-site examinations and regular returns. But the researchers argue that NBE lacks dynamism and is less proactive. For instance, the introductions of loans provisioning came to picture very lately. The private banks' board members mix and periods of staying in the power has also lately introduced after it has being put the mark in the banking system.



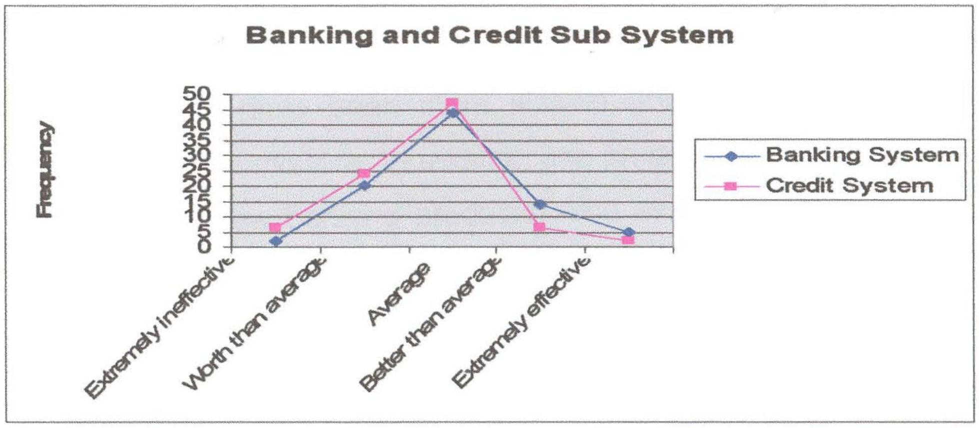
What makes the supervision of NBE towards commercial banks very important is due to the leverage of shareholders contribution and resources mobilized. It draws immediately the attention of the policy makers that the very significant portions of the liability of the banks are the public money. For instance the total capital of private banks for the year 2005 was around birr 1.5 billion, while the resource mobilized for the same period stood 3.5 billion.

The respondents strongly believe that the supervision of NBE towards commercial banks is necessary, but it's hardly to believe that NBE follows international standards. A regulatory body which has no clue how to wield its carrot and stick instruments, to goad financial sector player to a beneficial level of developments, economic growth assisting roles or high ground and a government which is unable to hold the regulator accountable for its ineffectiveness and failure are not good mix for the kind of financial sector development the country needs. Financial sector development is not and cannot be a peripheral issue in fact. It is one key component that needs thorough reviews whenever growth and development of the country is under plan.

As the role of NBE is of importance, its supervising capacity should be compatible to its duties as responsibilities. However, NBE at its presently seems to have only 25 staff (4.2%) that are assigned for supervisions to 389 branches of the eleven banks, as adequate professionals that can be able to shoulder the responsibility entrusted to it. Apart from this, its customer's service and payment network is by and large behind the required standard. It looks the proper automation to facilitate check clearing and inter bank electronic payment as reporting systems.

The gap is wide vis-à-vis both best practices and international standards and the kind of financial enabling environment the country needs. We will mention a few here:

- Corporate governance and code of conduct of financial institution ;
- Depositor protection ;
- Liquidity crisis management ;
- Bank failure management ;
- Risk based regulation and supervision; and
- Stipulation relating to ownership, structure, organization, bank business definition.



The banking sector is dominated by public sector due to the fact that bulk of the financial resource and services are concentrated in government banks. The domination of public banks in the banking system it is not the result of performance. It is rather the government that is using the banks to promote a development agenda which it strongly, believes it benefits the country. There is for example an effective and tacit accord between public banks and other public economic agents that are enforced by the government to bolster the position of public banks in terms of size.

This is in the interest of government, which is pushing an agenda of cheep source of fund and investment in as much as the public banks are made dominant in size and return. It can push this agenda through them as well as in other similar agenda by making them price setters of financial assets in the country.

For example, the annual report of National Bank of Ethiopia for the year 2005/6 read as the Ethiopian banking is highly liquid but if we see between the lines it is only declared as liquid because the public banks are highly liquid due to government and its affiliated institution depositors. But the truth is otherwise for private banks since these banks suffer from the liquidity problems. For instance, about 70% of the commercial banks activities are performed by CBE. Above 80% of deposit resource of the country are found in government banks.

The contribution of private banks is fairly meaningful, these days. This is true in terms of asset size, branch outreach, deposit mobilization and international banking. It would have been more sizable, if the banks were wise and the regulations were permissive. In addition, the private banks provide relatively good service delivery, new banking products such as credit cards cashing, trade bill discounts and Tele-banking. They also inspire competition sprit in the banking industry that may lead the system to excellence as well as factor mobility, especially labor.

On the other hand, the impediments of these private banks may be explained as shortage of loanable fund, conflicting interest of shareholders, desire to operate in cities and towns, limited skilled and qualified personnel with the increasing numbers of banks, branch expansions. Another shortcoming emanates from policies that favor public banks. The recent incidents in relation to Ethiopian export to China enforce exporters to use only Commercial Bank of Ethiopia. In addition, the major impediments to the newly emerging private banks are difficulty to win public trust and absence of capital market to raise more capital.

All the products and services that banks in Ethiopia deliver are bland and undifferentiated. Little thought goes in to structuring products in the country and most products, as indicated earlier are not market responsive. They are sold because the market has no choice. The same can be said about risk. Very little effort is made to profile products and services on the basis of pricing. This is harmful to customers who are forced to take prices based on the most expensive cost profile and also to the banks themselves. Undifferentiated risk, especially credit risk, has the effect of impacting on overall interest income and net interest margin.

Although the Ethiopian banking is liquid from time to time it is only left aside to the portfolio of the public bank especially the CBE. The private banks are unable to supply currency when their customers demand them. The reason behind could be either they attract less depositor or what has been collected earlier is dispersed as a loan to various customers.

The private banks currently demand a time deposit both from the public organization and private companies to cover their liquidity shortage by competing among themselves to the extent of a yearly interest that ranges from 6% - 7%. This can show that the deposits are flooded to private banks to enjoy the handsomely paid interest rate.

According to NBE's annual report of 2004 – 2005 in the table 3.1, we can see that the average interest rate for time deposit had been 6.35% in 1998/99; but it sharply declined to an average interest rate of 3.71%. This is only because the minimum average deposit interest was 6% per annum. But currently, the minimum deposit interest is 3%. However, banks (private) are willing to pay above 6%. This implies that the government has to introduce another interest policy that suits the prevailing business environments. Though recently the minimum deposit interest rate goes up to four percent, it is not enough as per the requirement to attract new depositors into the industry.

Credit is the lubricant of economic system in Ethiopia. It is hardly possible to do without it as the absence of it essentially stifles the productive capacity, the purchasing or the cash surplus and cash cycle of surplus agents in the economy. There is really as good as barter trade. The banking system should devise multitude of credit facilities that leave with the cash cycle.

In fact, the existing system is dominated by the collateral based credit system. It happened to be poor in performance based credit delivery. However, in order to do so adequate credit analysis and dependable financial system are required. If professional credit rating companies come to the picture, the credit system would be more efficient, due to the fact that banks would be able to save their time and money by avoiding the rudimentary procedure that they are currently following to identify their customers.

The banking system should abolish the cash cycle of the production agents in the real and service sector and devise other mechanisms by organizing several sector players such as hotel and tourism, transport and individual operators and others who cater service and products to the requirements of the economy.

It would not take genies to figure out how much our economy is starved for credit. This starvation for credit exists side by side with the claim of market liquidity in the country. Is there an institution that can provide credit for start up doctor, engineer, architect, teacher, plumber, small dwelling unit builder, iron smith etc? Is it easy to structure credit for small dwelling unit builder, mortgage and real estate developer? Is it easy to get pre-export credit? Is it easy to find project financing? The answer to these and other similar questions is obvious, non-existence of facilities. The credit system that should be put in place is the one that could satisfy the real demands.

Ethiopian banking credit products are by and large, traditional ones. The more the system is traditional, the more it would be isolated from the order of the global financial network. This, in turn, would result in the inefficient delivery of services to the economy and may have a risk of losing the business to the envisaged foreign banks that is likely after the country's accession to World Trade Organization (WTO).

It is not only the credit system of the Ethiopian banking system that does not follow the international standard and lacks dynamism, but also the credit culture follows the same fashion.

The credit culture is more or less in agreement with the socio-cultural characteristics of the country. A large size of the society is not cognizant of the value of credit in helping expand production for carrying inventory in good and bad times and bridging the cash cycle from production to actual sales. There is little understanding that in the absence of credit, production would be limited to the immediate disposable income of the surplus sector of the economy. Big and small companies alike choose cash cycle from production to actual sales. There is little understanding that in the absence of credit, production would be limited to the immediate disposable income of the surplus sector of the economy. Big and small companies alike choose cash sales over credit of whatever nature; wholesalers do likewise. Banks have no facility to support inventory or account receivable credit. This says a lot about the mistrust, which the society has for credit. This has made the little credit available in the economy hugely expansive and productively unsustainable.

The commercial code of the land, especially the execution side, is not creditor friendly. This exacerbates the acceptance of credit in the economy. Even where the credit culture is said to be relatively in good name, most credit consumer do not know the importance of information to credit decision and hardly keep books of accounts to help that.

The government's lack luster position in enforcing credit contracts, enforcing the use of accounting standards, showing commitment to the establishment of credit bureau, organized pledge, mortgage and chattel mortgage and business mortgage registration bureaus, all erode the acceptance of credit in the economy, besides making credit expensive when it is available.

The recent adopted minimum reserve that changes from five to ten percents of the net deposits of the banks will have a paramount effect on the supply of money to the market in terms of credit, especially to the private banks. The objectives of the NBE particularly in this regard may works, but it may decrease the profit of banks by increasing amount of cost of funds and diminishing credit through lack of loanable funds.

4.3 Conclusions

To sum up, public policy makers have a lot to do to help expand the depth and breadth of the financial sector. The policy makers are required to play a decisive role in crafting the rules of the game as appropriate to the temporal economic development agenda of the country. They have to ensure the protection of the rights of various stakeholders involved in the financial sectors as this is being the pure domain of public policy. They have to draw the precise contours of the incentive and penalties in the financial sector. Public policy has to define acceptable behaviors for the sector's players, and the penalties ensuing infringements. Public policy has also another relation with the banking system since it determines the methods and rules of the sector's regulation. It fixes the responsibility matrix of agents in the sector and the precise relationship channels of agents.

Chapter five: Summary, Conclusion and Recommendation

This part of the paper presents brief summary and major conclusions of the study. Important among the issues are public policy in the banking system in Ethiopia and some recommendations.

5.1 Summaries of the findings

From this study, the following particular findings are observed:

- The policies that are emanated from the National Bank of Ethiopia have failed to accomplish its targets as well as to meet demands of the economy;
- Reserve requirement is more useful in as one of sterilizations of excess liquidity. It acts as buffer to reduce volatility in the short –term interest rates caused by external shocks; but it is ineffective if liquidity is unevenly distributed among banks;
- A high requirement imposes cost on bank intermediation and could lead to a wide spreads across lending and deposit rates. Not convenient for short term liquidity management, as frequently it disrupts portfolio management;
- It is found that the entire banking system is not liquid. The private banks are still suffering from shortage of funds while the public banks are highly liquid;
- The price stability objectives of the regulatory body failed to achieve its goals in terms of controlling inflation;
- Though the supervision of national bank of Ethiopia towards the commercial banks follows the international standards, it is not backed by technology and manpower.
- The banking system in Ethiopia is highly dominated by public ownerships in terms of branch networks, capital, deposits, loan assets and others;

- The absence of secondary markets that is capital markets hinder banks from raising more capital;
- The credit system of the Ethiopian banks is highly based on collateral and the credit products are by and large traditional ones; and
- The products of the Ethiopian banking system are very few to influence the performance of the system.

5.2 Conclusion

This study explored the relationship between public policy and the banking system in Ethiopia. In doing so, emphasis was given to the various regulation, directives and procedures that have been issued by regulatory body of the Ethiopia banking system, the National Bank of Ethiopia.

The researchers have got five chapters. The first chapter dealt with the formulation of problem statement, presentation of the objectives of the study and the research questions. It also presented the methodological aspect in relation to sampling, data gathering and analysis of the research. In addition, it discussed the significance and background of the study. The second chapter was about the theoretical and conceptual framework, which revealed the importance of policy formulation, model specifications, actors of policy making and of course the why and how of public policy.

Review of relevant lessens and empirical data are discussed in chapter three. The study dealt with the experience of various countries by taking into consideration countries in similar contexts as Ethiopian. Hence, the study discussed the experiences of Malaysia, India, China and Pakistan. In doing so, it raised the impacts of public policy in the banking system of the above mentioned countries.

In the preceding chapter the research assessed issues of public policy and the banking system in Ethiopia with particularly emphasis given to the knowledge about public policy, monetary policy awareness', policy in line with economy, the target of the policy achieved, policy consistency, performance of the regulatory body in terms of supervision and control, the relationship between public policy and the banking system. In presenting survey results, this same chapter explored the major impediments and contribution of the private banks, the credit system and its variables that affects the economy as perceived by the respondents, concurrently, the impact of public policy

The knowledge and awareness' level on public policy depicted the importance of giving emphasis to stakeholders' participation in the banking system. Directives of the NBE have to be understood comprehensively to identify if the policies are in line with the desired objectives. For these to be effective, pre-policy participations, discussions and need assessments have to be taken for granted.

As we discussed the banking system and its relation with the public policy, the central bank is the regulatory body of the banking system. Therefore, the objectives and functions of the National Bank of Ethiopia are very important. This means that the responsibilities of banks to safeguard the public money at large are very vital. Hence, to protect the public and the economy of the nation central bank as a regulatory body plays pivotal roles.

To accomplish this, the central bank has two interrelated functions: price stability and healthy developments of the payment system through the banking system. In doing so, one of the public policy that has impact on the banking system is monetary policy In this study, the researcher came to understand that the participants in the banking system fail to identify the impact of each policy on the economy.

The policies that are emanated from the National Bank of Ethiopia have failed to meet its targets and the demands of the economy. As was stated clearly, the banking system is dominated by public ownership, and the entries of foreign banks are closed until to date.

In addition, what has been falsely taken for granted is that the Ethiopian banking system is highly liquid. This is mainly because the public banks especially CBE is found to be liquid and its domination in the system makes observers to fall to the wrong net that compels them to say the banking system is liquid; but, on actual sense, it is not the entire banking system that is liquid but the public banks. The private banks are still suffering from shortage of funds. Moreover, the price stability objectives of the regulatory body failed to achieve its goals in terms of controlling inflations. A good example is private banks are interested to pay a yearly interest of six percents for time deposits.

The banking system in Ethiopia is highly dominated by public ownerships in terms of branch networks, capital, deposits, loans, assets and others. As a result, the public and privates are competing to enjoy the cake of the economy with out having equal footings. Consequently, the liquidity preference and risk taking capacities of private banks are highly affected.

Nevertheless, the private banks have tremendous contributions in terms of new products, technology, customers' satisfactions and other similar issues. They also inspire competition sprits in the banking industry that leads the system to excellence as well as to factor mobility especially the labor.

One of the tasks that are endowed to NBE by proclamation is the task of supervising commercial banks. This supervision has a tremendous impact on controlling the implementation of the policies that guide the banking system. In doing so, the NBE tries to follow international standards of supervisions like ordinary audited accounts, special audits, on site examinations, regular returns and endorsements of Chief Executives Officer /Presidents/ of each individual's banks. It also supervises the board mix by taking in to accounts educational background and managerial capability as parameters. These and others put its mark in the banking systems of Ethiopia.

In general, the Ethiopian banking system own bland and undifferentiated products and services. Little thought goes in to structuring products in the country. These products and services are sold because the market has no alternative. The same can be said about risk. Undifferentiated risk, especial when it is credit risk, has the effect of impacting on overall interest income and net interest margin.

The existing credit system is dominated by collateral systems. It is poor in terms of performance bases credit delivery. It is not only the credit system of the banking system that lacks dynamisms, but also the credit culture. The credit culture is more or less in agreement with the socio –cultural characteristics of the country. There is little understanding that in the absences of the credit, product would be limited to the immediate disposable income of the surplus sectors of the economy.

In addition, the banking system suffers from shortage of experienced and well-trained staffs that are acquainted with modern banking business.

It has been observed that some of the directives that are drawn from the development of the banking systems are hindering fair competition and equal treatments among the participants of the banking industry. There are also times that policy are formulated for specific purposes entailing a negative reference towards the banking systems, such as land policy, investment policy, national bank directives such as single borrower-limit, selection criteria of Chief Executives officers to banks, and inter bank forex deal.

5.3 Recommendation

Having the empirical results obtained and the outline of Ethiopian banking system, the following policy recommendations are forwarded:

I) To foster the development of the banking institution to play a vital role in the economy, the participation of private sectors both domestic and foreign has to be encouraged;

II) To utilize the idle deposits that are found in the public banks, the inter bank market has to develop. To this effect, the National bank has to play a major role by introducing the required procedure and regulation;

III) As high degree of political commitment as well as macro economic stability is a perquisite for smooth and effective implementation of financial sector liberalizations, an effective leadership of regulators and change management could be sought;

IV) Stable financial regulations initiate and sustain competitive environment that are suitable for the banking system is required. Therefore, the domination of public banks has to be removed;

V) A proactive control mechanism fosters the development of banking system and a participative one accounts for minimizing risks. Consequently, the participation of various actor in the policy making process has to be taken seriously along awareness creation on given policy before or during implementation;

VI) To upgrade the credit culture of the society, a monetized economy has to be introduced at various levels in the value transformation system;

VII) To upgrade the quality of the bank assets, a sector risk analysis for allocations of credit, and a separate body as a wealth management is required for the non–performing loans;

VIII) For wealth creation purpose and to provide alternate to the money holders the establishment of capital market is advantageous; and

IX) To participate in the global economy, the product of the banking system has to follow the international standards. This, therefore involves the introduction of latest technology.

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ANNEX

Addis Ababa University

Business and Economics Faculty

Dear respondent:

As part of completion graduate study **(MPA),** I am currently conducting a research on **"Public Policy and the Banking System in Ethiopia"** that is aimed to study various issues associated with the relationship between the banking system and the public policy for enhancing the effectiveness of policy to the economy in general and to the banking system in particular.

Information is being sought purely for academic purposes and shall be kept strictly confidential.

SECTION ONE: **GENERAL INFORMATION**

1. Name of Organization/Institution:

____

2. Position held
   - ☐ President/CEO /General Manager
   - ☐ Department Head
   - ☐ Division Head
   - ☐ Branch Manager
   - ☐ Section Head
   - ☐ Supervisor
   - ☐ Expert
   - ☐ Others – Please specify ___________________________________

3. Years of Experience __________________

SECTION TWO: Questions related to **PUBLIC POLICY**

* Public Policy is a purposive course of action followed by an actor or set of actors in dealing with a problem or matter of concern. Policy may categorize as substantive, procedural, distributive, regulatory and others. E.g. National Bank Regulation, Directives etc

Sub Section 2 – 1: General

4. What are the main sources of your knowledge about public policy?

☐ Media

☐ Individuals

☐ Government Offices

☐ Civic society

☐ Other – Please specify ______________________________

Sub Section 2 – 2: Questions related to monetary policy

5. Which monetary policy are you well aware? You may select more than one.

☐ Rate of interest

☐ The exchange rate regime

☐ The legal reserve

☐ Cash & liquidity requirement

☐ Credit ceiling

☐ Other – Please specify ______________________________

6. The monetary policy instruments so far employed in Ethiopia are in line with the state of the economy (free market)

☐ Strongly Disagree

☐ Disagree

☐ Neutral

☐ Agree

☐ Strongly Agree

7. The major target of the current Ethiopia's monetary policies are achieved.

☐ Strongly Disagree

☐ Disagree

☐ Neutral

☐ Agree

☐ Strongly Agree

8. Do you believe that the monetary policy of the country post Derg has been consistent (not changing now and then)?

☐ Yes

☐ No

9. If your response for question number 224 is "Yes/No", please comment.

Sub Section 2 – 3: Questions related to NBE Policy & Credit

10. The policy of National Bank of Ethiopia influence credit in the economy.

☐ Strongly Disagree

☐ Disagree

☐ Neutral

☐ Agree

☐ Strongly Agree

11. Which of the policy of National Bank of Ethiopia influence the credit in the economy?

(Please rank)

☐ Interest rate

☐ Credit ceiling

☐ The exchange rate policy

☐ Reserve & liquidity requirement

☐ The legal reserve

☐ Other – Please specify ________________________________

12. Does the central bank guarantee any category of domestic loans? If so please specify.

13. What direct controls are imposed on bank loans to the private sector at present?

Sub Section 2 – 4: Questions related to the problem of Policy

14. Do you perceive any gap (missed or to be added) in the policy of National bank of Ethiopia?

☐ Yes

☐ No

15. If your response for question number 241 is "Yes", please specify the gap.

16. Have you encountered or felt any problem in relation to the National Bank Policy?

☐ Yes

☐ No

17. If your response for question number 203 is "Yes", what have you encountered or felt?

18. There are different balance sheet ratios imposed on banks like minimum capital requirement, reserve & liquidity etc. Which of them you think stringent enough for the operation and why?

19. Do such control involve selective policy between sectors? If so please specify.

Sub Section 2 – 5: Others

20. Other important issue you want to add.

SECTION THREE: Questions related to **Regulatory Body (NATIONAL BANK OF ETHIOPIA)**

Sub Section 3 – 1: Questions related to function & Objectives of NBE

21. Do you agree with the functions of National Bank of Ethiopia?

☐ Yes

☐ No

22. If your answer for question number 311 is "Yes/No", please give your rationale.

23. Do you agree with the objectives of National Bank of Ethiopia?

☐ Yes

☐ No

24. If your answer for question number 313 is Yes/No, please specify your rationale.

Sub Section 3 – 2: Questions related to the performance of NBE

25. The performance of National Bank of Ethiopia

☐ Extremely ineffective

☐ Worse than average

☐ Average

☐ Better than average

☐ Extremely Effective

26. Please specify the strongest performance of National Bank of Ethiopia if any

27. Please specify the weakest performance of National Bank of Ethiopia if any

Sub Section 3 – 3: Questions related to Supervision of Regulatory Body (NBE)

28. The supervision of National Bank of Ethiopia towards Commercial Banks.

☐ Strongly Disagree

☐ Disagree

☐ Neutral

☐ Agree

☐ Strongly Agree

29. The supervision of the National Bank of Ethiopia follows the international standards.

☐ Strongly Disagree

☐ Disagree

☐ Neutral

☐ Agree

☐ Strongly Agree

30. Do you perceive any gap in the banking regulation that is to be amended or added?

Sub Section 3 – 4: Others

31. Other important issue you want to add. / Please, it is very important/

SECTION FOUR: Questions related to **THE BANKING SYSTEM IN ETHIOPIA**

Sub Section 4 – 1: General

32. How do you see the Ethiopian Banking System? (Like structure, products, human resource, technologies etc)

☐ Extremely ineffective
☐ Worse than average
☐ Average
☐ Better than average
☐ Extremely effective

Sub Section 4 – 2: Questions related to the Private Sector & the Banking System

33. What policy incentives are there for the private sectors' participation in the banking system?

34. What is the contribution of the private banks to the banking system?

35. What are the major impediments of the private banks in the banking system?

Sub Section 4 – 3: Questions related to the Performance of Banking System

36. What is the strongest part of the banking system in Ethiopia?

37. What is the weakest part of the banking system in Ethiopia?

38. The banking system do not provide the public enough currency when it is demanded

- ☐ Strongly Disagree
- ☐ Disagree
- ☐ Neutral
- ☐ Agree
- ☐ Strongly Agree

Sub Section 4 – 4: Questions related to Credit in the Banking System

39. The credit system in Ethiopia

- ☐ Extremely ineffective
- ☐ Worse than average
- ☐ Average
- ☐ Better than average
- ☐ Extremely effective

40. What kind of credit system do you propose? Please state

41. What is the credit culture in Ethiopia? And what do you recommend?

Sub Section 4 – 5: Questions related to Policy & the Banking System

42. What will be the relation between the public policy and the banking system?

43. Which of the following have major impact in the banking system? (Please rank)

- ☐ Judicial (Legal)
- ☐ Infrastructure (e.g. Telecommunication)
- ☐ Technology
- ☐ Inland Revenue
- ☐ Customs
- ☐ Shipping Lines
- ☐ Other – Please specify ______________________________

44. Please comment for your response of question 452.

Sub Section 4 – 6: Others

45. Generally, what do you think about the Ethiopian banking products and its risks?

46. Other important issue you want to add (very important)

Thank you

N.B: You may use extra pages for additional comments & suggestions that may be forwarded.

Declaration by the Candidate

The thesis on , ' Public Policy and the Banking System In Ethiopia' is my original work. It has not been presented for a degree in any other University and that all sources of material used for the Thesis have been duly acknowledged.

Addis Ababa
13 July 2007

Aklilu Wubet

Dr. Mulugeta Abebe
Advisor