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Ethiopia
Raising a Vegetarian Tiger?

Toni Weis

> Transforming Ethiopia into an East African tiger is hardly possible without adequate financial resources. After all, there is no vegetarian tiger.
>
> (Fortune, 2010)

Introduction

The Ethiopian economy, among the fastest-growing in Africa for fifteen years and counting, defies many of the common ideas about the continent's economic resurgence. Although Ethiopian politicians embrace the slogan of a 'rising' Ethiopia, the country's developmental trajectory differs sharply from the modal patterns of the Africa Rising literature (Mahajan, 2011). The latter is driven to a significant extent by images from the financial sector—the success of pan-African banks, for example, or the success of fintech innovations like Kenya's M-Pesa. Ethiopia's financial industry, on the other hand, is among the less impressive aspects of the country's economic transformation: small and shallow, technologically backwards, dominated by public institutions, and closed to foreign competition.

Ethiopia's financial regulators are similarly inward-looking. Despite significant exposure to international banking standards through donors and the IMF, banking supervisors at the National Bank of Ethiopia (NBE) have little use for the Basel framework, at least in its more recent iterations. Neither Basel II nor Basel III are currently being implemented, and there are no plans to introduce them in the near future—in fact, an introduction of Basel II was briefly considered in 2009, but ultimately rejected. The capital adequacy requirements enshrined in Basel I were adopted during the partial liberalization of Ethiopia's banking sector during the mid-1990s, and the Basel Core Principles are occasionally referenced as good regulatory practice. However, even these elementary standards have been adapted to the realities of the Ethiopian financial sector rather than adopted wholesale.

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Ethiopia's reluctant approach to the Basel framework does not just stem from the relative isolation of its banking sector or its regulators, but is the result of a strong preference for political control over the financial industry. The Ethiopian government seeks to emulate the example of East Asian 'tiger' economies for whom financial repression represented a key tool in the pursuit of rapid industrialization. After more than twenty-five years in power, the ruling party's control over the regulatory apparatus, including the central bank, is complete and uncontested. Regulators, in turn, enjoy wide-ranging powers over the financial industry, which remains dominated by state-owned players and off limits to foreign institutions. Ethiopia is therefore a powerful illustration of policy-driven divergence. The domestic orientation of all key actors—politicians, regulators, and banks—has thus far outweighed the preferences of the IMF and foreign investors. As a consequence, Ethiopia is a case of policy-driven divergence from global standards. However, as Ethiopia's domestic banks struggle to sustain transformative growth and the political leadership is relaxing its approach to state-led economic development, pressures for greater financial opening (and, by extension, for increased regulatory convergence) are beginning to mount.

Despite its obvious significance for understanding the economic policies of a 'developmental' state regime, the issue of financial regulation has received little academic attention in the Ethiopian context.[1] The present study, therefore, draws chiefly on primary sources: a systematic review of regulatory texts, central bank publications, and policy documents; newly compiled data on Ethiopian private banks as well as the professional background of financial regulators; and a total of fifteen interviews with central bank regulators, risk and compliance professionals at both private and public banks, and experts from IMF and the World Bank.

Political economy of the Ethiopian banking sector

Ethiopia is a landlocked country in the Horn of Africa which, despite significant economic gains in recent years, remains among the world's poorest. As the only African polity that escaped colonization by European powers, Ethiopia's recent history has been characterized by a relatively inward-looking, nationalist political culture. During the second half of the twentieth century, Ethiopia's political economy underwent a series of transformations as three fundamentally different regimes followed each other in rapid succession. The feudal government of Haile Selassie (1931–74), the socialist military dictatorship of the Derg (1974–91), and the 'revolutionary democrats' of the EPRDF (1991–current) all pursued ambitious visions of national development, but they disagreed radically on the respective roles of government and private sector in bringing about this transformation (Table 14.1).

[1] An exception is Alemu Zwedu (2014).

Table 14.1 Ethiopia: key indicators

Ethiopia	
GDP per capita (current US$)	767
Bank assets (current US$)	6.86 bn (2008)
Bank assets (% of GDP)	25.33 (2008)
Stock market capitalization (% of GDP)	N/A
Credit allocation to private sector (% of GDP)	17.71 (2008)
Credit allocation to government (% of GDP)	5.99 (2008)
Polity IV score	−3

Note: All data is from 2017 unless otherwise indicated.

Source: FSI Database, IMF (2018); GDI database, World Bank (2017); Polity IV (2014)

This is particularly true for the financial sector. Control of Ethiopia's banks was a common concern for all three regimes, yet the level of control (and its effect on the nascent banking sector) differed starkly from one set of leaders to the next. In 1963, Haile Selassie established the Commercial Bank of Ethiopia (CBE), the state-owned behemoth which continues to dominate the sector to this day. Private commercial banks, including banks with (minority) foreign ownership, began to operate shortly after. A military coup in 1974 put an end to this experiment, as private banks were nationalized and integrated into the CBE. However, the CBE retained a significant amount of managerial autonomy and escaped relatively unscathed when the Derg government fell to the Ethiopian People's Revolutionary Democratic Front, a coalition of ethnic insurgent movements, in 1991.

Despite being firmly rooted in Marxism-Leninism itself, the EPRDF signed off on a structural adjustment programme which included a partial liberalization of the banking sector. Two landmark pieces of legislation—the Monetary and Banking Proclamation (83/1994) and the Licensing and Supervision of Banking Business Proclamation (84/1994)—reorganized the country's financial industry, and the first private bank of the post-socialist era was established in 1995. However, the EPRDF fought hard to avoid what it considered to be excessive demands for liberalization. It refused to open the Ethiopian banking industry to foreign competition, restricting ownership of financial institutions to Ethiopian citizens. Just as importantly, the EPRDF rejected the IMF's calls to privatize the remaining state-owned banks or break up the CBE (Stiglitz, 2003, p. 31).

The EPRDF's shift towards a 'developmental state' framework since the early 2000s has brought about a final transformation of the Ethiopian banking sector. State banks are increasingly taking on a policy lending role: the CBE was fundamentally restructured and turned into a highly profitable institution whose revenue finances key infrastructure projects and the expansion of state-owned enterprises. A second state-owned bank, the Development Bank of Ethiopia (DBE), was tasked with providing long-term financing to priority industries. Regulators

have also been brought in line with the government's new economic vision. Controversial regulation introduced in 2011 is forcing private banks to reduce liquidity by purchasing NBE bills which, in turn, are used to expand the DBE's portfolio. The central bank has also kept interest rates artificially low to encourage investment, yet high levels of government borrowing are pushing the private sector's access to credit well below the regional average (IMF, 2016, p. 106).

At the same time, accelerated growth has resulted in a significant expansion of the financial sector. The combined assets of Ethiopia's commercial banks have almost tripled since 2010, from US$9.3 billion to US$26.5 billion, and are growing at about twice the rate of GDP (see Figure 14.1).[2] Although the number of private banks has risen to 16, the CBE continues to control about two thirds of these assets. Financial intermediation has expanded as a result; in 2016, total bank deposits stood at US$20 billion—up from US$7.6 billion in 2010—while annual loan disbursement doubled during the same time. Nevertheless, the industry remains minuscule by global standards: in 2016, the total assets of the Ethiopian banking system amounted to roughly 1 per cent of the assets managed by HSBC UK.

The Ethiopian banking sector also remains exceptionally shallow. Ethiopia has neither a secondary equity market nor a secondary market for corporate debt, although the creation of these institutions has been discussed occasionally since the early 1990s. A recent NBE directive (SBB/60/2015) clarifies that banks must limit themselves to 'customary' banking activities and that '[n]o bank shall deal in securities'. An interbank money market exists; however, since Ethiopian banks rarely suffer from short-term liquidity problems, it has not seen any transactions

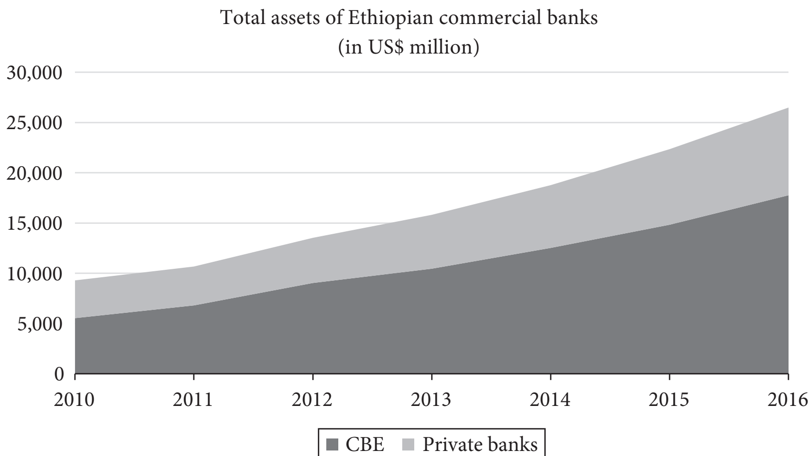

Figure 14.1 Ethiopia: total assets of commercial banks (in US$ million).
Source: Data from Abdulmenan (2017) and IMF (2016)

[2] Unless otherwise indicated, all data in the remainder of this section has been compiled from the NBE's annual reports and from Abdulmenan (2017).

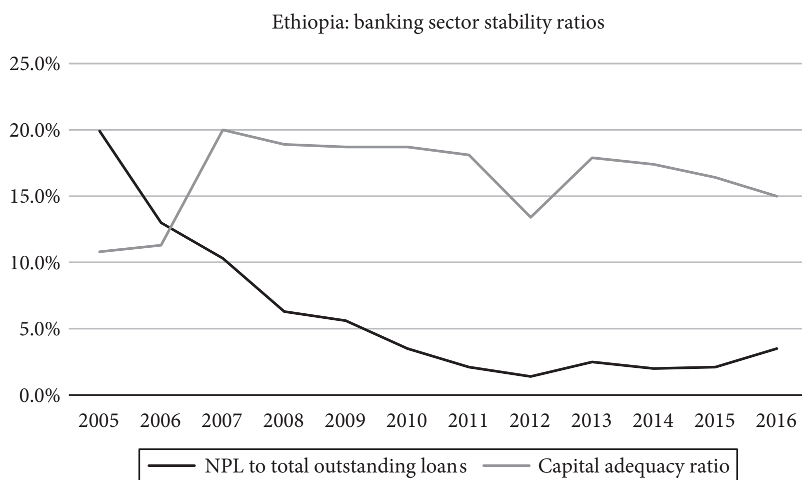

Figure 14.2 Ethiopia: capital adequacy ratios (CAR) and non-performing loans (NPLs).
Source: Data compiled from IMF (2016)

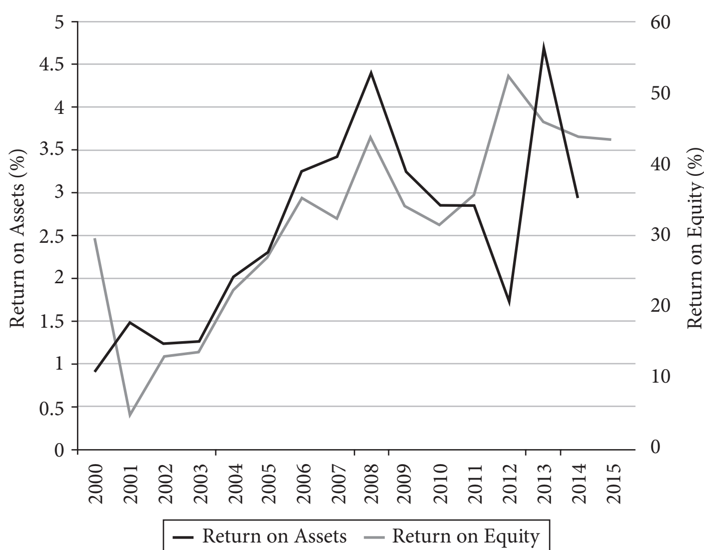

Figure 14.3 Ethiopia: rates of return on assets (RoA) and equity (RoE).
Source: Data from World Bank (2018)

in almost a decade (Alemu Zwedu, 2014, p. 12). The continued isolation of the Ethiopian banking industry also means that the country remains cut off from wider trends and innovations in the banking industry: Ethiopia is one of just two African countries without foreign banks, and one of only four countries where none of the pan-African banks are present (European Investment Bank, 2015, p. 6).

The characteristics outlined above translate into a relatively conservative risk profile, at least among private banks. Market power is relatively dispersed among the latter, interbank lending is negligible, and the law provides strict limits on the extent of cross-ownership and capital concentration. The isolation and lack of depth of Ethiopia's banking sector means that it is sheltered from the vagaries of the global financial markets, and the country has not experienced a major financial crisis. Ethiopia's commercial banks are also highly capitalized and profitable. Their average capital adequacy ratio is hovering between 15 and 20 per cent, well above the 8 per cent stipulated by Basel I, while the ratio of non-performing loans has remained exceptionally low (see Figure 14.2). A substantial interest rate spread, combined with low costs and high non-interest income, also provides domestic banks with a safe business model and a strong return on assets (see Figure 14.3).

The role of the Basel standards

The inward-looking nature of the Ethiopian financial sector is reflected in the regulatory framework that governs the country's banking industry. Unlike some of its African peers, Ethiopia has been highly selective in adopting global standards, and its financial regulators do not consider compliance with international 'best practices' a value in itself. This is particularly evident with regard to the implementation of the Basel framework for banking supervision. Ethiopian regulators are well aware of the Basel standards and have implemented their most basic element—Basel I's minimum capital requirement. At the same time, NBE regulators do not consider the more complex (and costly) supervisory elements of Basel II and III to be a necessary upgrade at this stage, and they have not signalled any intention to adopt all or part of these frameworks (Table 14.2).

The Basel framework represented an important point of reference when Ethiopia began re-licensing private banks in the mid-1990s. The federal proclamation that established the new supervisory framework included the minimum

Table 14.2 Ethiopia: adoption of Basel standards

Basel component	Adoption	Implementation
Basel I	1994 (minimum capital requirement of 8% established in Supervision of Banking Business Proclamation)	1995 (simplified Basel I risk weights introduced in NBE's Computation of Risk-Weighted Asset Directive)
Basel II	n/a	n/a
Basel III	n/a	n/a

capital requirement of 8 per cent stipulated in Basel I (Supervision of Banking Business Proclamation 84/1994). This provision has been reaffirmed by subsequent laws and regulations. However, the rules implemented by the NBE are de facto a simplified version of Basel I, as many of the asset classes included in Basel I do not exist in the Ethiopian financial sector (Computation of Risk-Weighted Asset Directive, SBB/9/95). This includes on-balance sheet assets such as mortgages and municipal bonds, as well as most kinds of off-balance sheet assets. What is more, the NBE's banking supervisors do not distinguish between Tier 1 and Tier 2 capital.[3]

Ethiopia is not currently implementing any elements of Basel II or III, nor are there plans to do so in the near future. An internal study conducted as part of a wider restructuring of the NBE in 2009 considered the introduction of Basel II, but the idea was ultimately rejected.[4] The NBE's Monetary Policy Committee at the time asserted its commitment to 'improve the existing macro-prudential indicators for banks based on [the] Basel Standards' (NBE, 2009, p. 11), but did not further specify any particular element of the framework. A working paper by Getnet, who draws on interviews with NBE staff, asserts that Ethiopian regulators have no interest in adopting Basel II or III 'as a package' but might introduce individual elements that 'fit to the Ethiopian context' (Alemu Zwedu, 2014, p. 33). However, interviews conducted for this study did not indicate that this is happening at present. Instead, an NBE banking supervisor assessed that central bank staff are only following developments around Basel III 'distantly'.[5]

Despite Ethiopia's lack of interest in Basel II and III, the broader work of the Basel Committee has served as an important point of reference for its banking supervisors. When the country's main state-owned bank suffered from an excess of non-performing loans in the early 2000s, the NBE assured IMF staff that it was working on 'bringing prudential regulations in line with Basel standards' (IMF, 2001a) and would base its measures on 'Basel Committee guidelines for the restructuring of troubled debt and credit risk' (IMF, 2001b). Documents published by the Basel Committee also informed the NBE's strategy for gradually moving towards a risk-based supervision system. The NBE's updated risk-management guidelines, issued in 2010, draw heavily on the Basel Core Principles, at times reproducing sections of these documents word for word (Basel Committee, 2004, 2003, 2000a, 2000b; NBE, 2010).

Ethiopia's commercial banks have responded by introducing new risk-management policies of their own. Compliance staff at Wegagen Bank, a large private bank with ties to the EPRDF government, showed familiarity with Basel, but did not draw on Basel Committee documents in the development of their comprehensive 'enterprise risk assessment' system.[6] Staff at the private NIB bank,

[3] Interview, NBE banking supervisor, Addis Ababa, 15 February 2017. [4] Ibid. [5] Ibid.
[6] Interview, compliance manager at Wegagen Bank, Addis Ababa, 17 January 2017.

on the other hand, specifically looked to Basel when designing their internal risk-management processes, citing their will to be one step ahead of the regulatory requirements of the NBE. For example, NIB's management monitors the bank's net stable funding ratio, an indicator of liquidity borrowed from Basel III.[7]

While Ethiopian officials are showing little inclination to move beyond Basel I in banking supervision, they have advanced the adoption of international financial standards in other areas. Ethiopia recently adopted a law mandating businesses to comply with the International Financial Reporting Standards (IFRS; Financial Reporting Proclamation 847/2014); however, implementation remains patchy. In a similar vein, Ethiopia began working with the Financial Action Task Force (FATF) in 2009 but has struggled to satisfy the group's expectations. Ethiopia introduced anti-money laundering legislation in 2009 and began with the establishment of a Financial Intelligence Centre. Nevertheless, the country was 'greylisted' as a 'jurisdiction with strategic deficiencies' from 2010 until 2014, at which point the FATF considered Ethiopia's commitment to a mutually agreed reform agenda to be satisfactory. Citing 'a lack of effective implementation', the FATF put Ethiopia back on alert in early 2017 (FATF, 2017).

The politics of banking regulation in Ethiopia

As the previous sections have shown, the relatively low level of financial-sector development in Ethiopia limits the relevance and applicability of global financial standards. However, a simple reference to the regulatory fit of Basel II and III is not a satisfactory explanation for why Ethiopia's banking supervisors have shown little enthusiasm for the framework—especially compared to their counterparts in other cases discussed in this volume. Understanding the interests of Ethiopian regulators, and those of other key actors, requires a look at the politics behind the regulation of Ethiopia's banking industry. The remainder of this chapter therefore traces the ways in which the EPRDF's mission to create an Ethiopian 'developmental state' provides these different groups with an inward-looking set of incentives, while Ethiopia's dependence on foreign funding is raising pressures for financial opening.

The primacy of political control

Ethiopia has been following the statist developmental model exemplified by the East Asian 'tiger' economies since the early 2000s, when the leadership of state and ruling party was consolidated under prime minister Meles Zenawi (Abbink

[7] Interview, risk manager at NIB Bank, Addis Ababa, 17 January 2017.

and Hagmann, 2016; Vaughan, 2011; Weis, 2016). The EPRDF's avowed ambition is to turn the country into a mid-income manufacturing powerhouse by 2025, following a strategy of 'agricultural development-led industrialization'. Massive investments in public infrastructure—industrial parks, electricity, roads, and railways—have been undertaken to attract companies producing for the export market, while new state-owned enterprises seek to reduce the dependence on the importation of basic commodities such as fertilizer or sugar. The five-year Growth and Transformation Plan (GTP), now in its second phase (2015–20), coordinates the efforts of different ministries, while key operational decisions are taken within the prime minister's office.

Government control of the financial sector plays a crucial role in the developmental state: as Woo-Cumings (1999, p. 10) puts it, '[f]inance is the tie that binds the state to the industrialists'.[8] This is particularly true with regard to the banking sector, as state-led economies have traditionally preferred credit-based—rather than market-based—financial systems (Zysman, 1984). By influencing the process of financial intermediation, governments gain the ability to allocate capital across firms and industries. They are also able to maintain interest rates beneath the market rate, thus lowering the cost for capital investment and government borrowing alike. Whether such a policy of financial repression can ultimately be beneficial to low-income countries has been subject to much debate; however, the fact that the East Asian 'tiger' economies have in fact been built 'over the dead bodies of [...] savers' seems hard to dispute (Woo-Cumings, 1999, p. 17).

In their policy and internal training documents, the EPRDF and its government have been remarkably explicit on how their interventionist approach to financial-sector development fits with the movement's larger political agenda. As the latter changed over time—from orthodox Marxism-Leninism during the guerrilla years to the uneasy liberalism of the 1990s, and on to the current paradigm of the 'developmental state'—the EPRDF's attitude towards the banking sector evolved as well. The EPRDF's first manifesto from 1989 demanded that 'economic institutions must be brought under the control of a genuine people's government'. After coming to power, the EPRDF embraced the idea of (partial) financial liberalization while establishing a foothold in the fledgling private financial sector. An internal position paper from 1993 thus advised the party to 'monopolize rural credit services' while establishing private banks in the urban centres; within three years, the EPRDF had founded Wegagen Bank, as well as microcredit institutions serving its rural heartlands.

The first formulation of the current approach, which looks at financial regulation primarily through the lens of industrial policy, can be found in an internal party document published in 2000 as part of the EPRDF's 'renewal' campaign.

[8] For a more recent theorization of the role of finance in the context of 'developmental state' policies, see Heep (2014, p. 26).

The paper argues that the Ethiopian underdeveloped financial market is characterized by pervasive market failures, which inevitably result in a misallocation of capital. Consequently, 'it is mandatory for the state to establish its own banks' and direct credit to those firms that offer the greatest economic promise (EPRDF, 2000, p. 15). Because foreign banks threaten to undermine this policy, the state should 'bar them temporarily until the financial and banking system of the country becomes stable' (ibid., p. 16). In an incomplete draft of his 2006 master's thesis, Meles Zenawi develops these ideas further. He suggests learning from Taiwan and South Korea, whose governments 'largely replaced the financial market and allocated investible resources in accordance with their development plan' (ibid., p. 18), adding that 'financial repression can be a powerful instrument to promote growth and investment' (ibid., p. 27).

If the approaches and arguments have evolved over time, one theme has remained constant: the primacy of the political sphere over the financial market and its interests. From the beginning, the EPRDF government has been acutely aware of the enormous gap in capacity between international banks and local regulators, and it has sought to preserve the autonomy of the latter. This position was most clearly expressed by Meles Zenawi (2012) at a World Economic Forum event in Addis Ababa, shortly before his death, and is worth quoting in full:

> These giants [major international banks] can wreck giant economies such as that of the United Kingdom. Ours is a flimsy one…They come in, they use instruments we cannot control, that in most instances we can't even understand. The best of us can't even understand. How are you going to regulate them? How are you going to regulate these people? It's not possible. We don't have the capacity now.
>
> So what did we do? We allowed the private sector in Ethiopia, which is not infinitely more complex than the public sector, and which therefore could easily be regulated by the public sector, we allowed the private banks to operate here. Is it going to be a permanent feature? No. As we grow, as we develop, and as we become more sophisticated in our regulatory capacity, of course we'll liberalize. But not now. And we have lost nothing because of this policy.

Domestic regulators: professionalism, not autonomy

The centrality of the banking sector to the political vision of the EPRDF government ascribes particular importance to those in charge of regulating it. Staff at the National Bank of Ethiopia consequently resort to 'developmental' vocabulary when talking about their employer: one senior expert in the NBE's banking supervision directorate describes the central bank as the 'engine of economic

transformation',[9] while a former colleague characterizes it as 'a key policy agent in the developmental state system'.[10] Interestingly, this 'developmental' ambition has also found its way into the legal framework of the central bank: the federal law which formally re-established the NBE in 2008 tasks the bank with creating conditions 'conducive to the *rapid* economic development of Ethiopia' (Proclamation 591/2008, emphasis added), while the original 1994 banking law instead spoke of 'balanced growth' (Proclamation 83/1994).

Given the high degree of political intervention in the Ethiopian financial system, it comes as no surprise that the Ethiopian central bank is a thoroughly political rather than a politically independent institution. The political nature of the NBE reflects the EPRDF's attitude towards the civil service more broadly, which emphasizes professionalism over autonomy: the government has invested significant resources in building the technical capacity of public servants, but it expects them to implement policy, not to shape or question it (Vaughan and Tronvoll, 2003; Weis, 2016, p. 160). Regulators must maintain their independence from those they regulate, not from those they serve; in Meles Zenawi's terms, 'autonomy must be defined in class terms, not institutional terms' (cited in de Waal [2013, p. 473]). Measures that increase the regulatory independence of private banks, such as the promotion of internal risk models or a general deference to 'market discipline' (introduced under pillars 2 and 3 of Basel II, respectively), thus run counter to the EPRDF's philosophy.

The political role of the Ethiopian central bank is enshrined in its governing documents. Article 4 of the 2008 NBE law stipulates that the bank 'shall be accountable to the Prime Minister', while the seven members of the NBE's board of directors are also appointed by the federal government. The board is dominated by senior members of the administration and ruling party, such as the minister of finance, the head of the national planning commission, and the chief economic adviser to the prime minister (who currently serves as chairman of the board). Teklewold Atnafu, who served as governor of the NBE for almost two decades until June 2018, was a key member of the macro-economic team in the prime minister's office—the command centre of the EPRDF state—as well as a member of the central committee of the SEPDM, one of the four ethno-regional parties that form the EPRDF coalition (Sebsibe, 2015). His successor, Yinager Dessie, is a career politician who most recently served as head of Ethiopia's National Planning Commission and is a senior member in the EPRDF's Amhara party (Addis Standard, 2018; Fortune, 2018).

The EPRDF government is also exerting efforts to ensure that lower-level central bank staff are aware of, and subscribe to, the NBE's political mission. A government directive issued in 2008 which lays out the rights and obligations of NBE

[9] Interview, NBE banking supervisor, Addis Ababa, 15 February 2017.
[10] Interview, former NBE banking supervisor, Addis Ababa, 1 March 2017.

staff thus specifies that '[a]ny employee shall…respect and implement government policies' (Council of Ministers Regulation 157/2008). The NBE has certainly succeeded in ensuring that its employees remain on message: one World Bank official describes the bank as 'monolithic', with a highly disciplined staff that 'sings from the same hymn book' when communicating with outside experts.[11] Nevertheless, NBE regulators strongly reject the allegation of private bank employees that the central bank is a political institution—referring to it as 'highly independent' with 'no government influence'—and argue that there is no difference between its relationships with private and state banks.[12]

At the same time, the Ethiopian government has invested heavily in building the technical and supervisory capacity of the central bank. Between 2005 and 2012, the NBE benefited from a World Bank-led capacity-building programme which focused on introducing risk-based supervision methods, establishing new liquidity forecasting and macro modelling tools, and updating the bank's IT infrastructure (World Bank, 2012a). The NBE also continues to increase its technical staff: in 2011, there were twenty-seven experts in the NBE's banking supervision department, of whom only one had a higher academic degree (World Bank, 2012b); by 2017, the number of staff had grown to forty, a dozen of whom held graduate degrees. Despite the progress made in recent years, however, NBE staff still consider the 'brain drain' towards the private banks and the resulting shortage of skilled supervisors to be essential challenges.[13]

IFIs and the importance of 'policy independence'

If Ethiopian financial regulators are conscious of the domestic political context in which they are embedded, they are even more determined to retain their independence from the international financial institutions. Ethiopia's state-led economic model, as well as the highly interventionist financial policies that underpin it, goes against the grain of the reform measures promoted by the World Bank and the IMF, and Ethiopian policymakers regularly find themselves at odds with the representatives of these organizations. Arkebe Oqbay, the head of the Ethiopian Investment Commission and one of the main thinkers behind the country's economic agenda, summarizes the stance of the EPRDF government thus:

> Ethiopia is able to achieve this because it chose its own development path. We have not always been good students of the IMF and other financial institutions. We have always been choosing our way because policy independence is important to us. (cited in Tamrat, 2015)

[11] Interview, World Bank financial sector expert, Washington, DC., 21 February 2016.
[12] Interview, NBE banking supervisor, Addis Ababa, 15 February 2017.
[13] Interview, former NBE banking supervisor, Addis Ababa, 1 March 2017.

This emphasis on 'policy independence' expresses itself in two ways. On the one hand, it means that the professional culture of Ethiopia's financial regulators is inward-looking, concerned primarily with domestic concerns rather than developments in the global financial centres. In contrast to other African economies, Ethiopia's banking regulators are trained and recruited locally; exposure to the global financial industry is both less prevalent and less relevant than in other countries. Money is certainly an important factor in this context: salaries at the central bank range from US$150/month for entry-level positions to US$900 at the director level,[14] while jobs in the modern private sector, international organizations, or the non-profit sphere are considerably higher and receive greater attention from Ethiopians who received an international education.

A review of the LinkedIn profiles of 126 current and former technical experts at the National Bank—while certainly not a fool-proof methodology—highlights some interesting patterns in this regard: of the 126 NBE staff, only five received an education outside Ethiopia, while the remaining 121 were trained inside the country. Just as importantly, the majority of the latter—seventy-three in total—studied at one of Ethiopia's new regional universities, whose academic credentials have often been disparaged; a large minority of forty-eight employees graduated from Addis Ababa University, the most prestigious—and, until the mid-1990s, the only—university in the country. Central bank staff also tend to join the NBE quite young and inexperienced; out of the total 126 employees, eighty started working for the bank within one year of obtaining their undergraduate degree. Lastly, staff tend to migrate from the NBE to the private banks, rather than vice versa: at least twenty-two out of sixty former NBE employees reported a new position at a private bank, while only one of sixty-six current NBE employees previously worked for a private bank.

On the other hand, Ethiopia's insistence on 'policy independence' has made for a rocky relationship with the Bretton Woods institutions, and particularly the IMF (Gill, 2010, pp. 79–96). Ethiopia's difficulties with the Fund reach back to the 1990s, when government officials and IMF staff clashed over the EPRDF's reform agenda and loan disbursement was suspended twice. Relations improved later on without ever becoming cordial. In 2014, the IMF closed its office in Addis Ababa because of the government's lack of interest in engaging with the Fund beyond the bare minimum of activities: Ethiopia is one of very few countries of its size that has never requested a Financial Sector Assessment Programme (FSAP), and publishing reports or even press releases on the annual Article IV consultations—otherwise a mere formality—has often been a contentious issue in Ethiopia.[15]

This is not to say that there are not areas of mutual collaboration. Today, World Bank and Fund officials largely acknowledge the government's reluctance towards

[14] Interview, NBE banking supervisor, Addis Ababa, 15 February 2017.
[15] Interview, IMF official, Washington, DC, 27 April 2017.

greater financial liberalization and try to 'work in the margins'.[16] They also do not push for the adoption of the Basel II or III packages, acknowledging that these do not represent a good fit with Ethiopia's regulatory capacity or requirements.[17] Ethiopian officials regularly request IMF or World Bank assistance on specific technical issues, and foreign consultants from these institutions have been involved in a range of projects at the central bank recently, from the development of a liquidity forecasting model to assisting in the drafting of directives in new issue areas.[18] NBE regulators also attend trainings and experience-sharing meetings at the IMF's Regional Technical Assistance Center (AFRITAC) in Tanzania (Gottschalk, 2015, p. 9); however, these are primarily concerned with macroeconomic rather than regulatory issues, and NBE staff are perceived to be less integrated into regional expert networks 'because they do not have to be'.[19]

The acquiescence of private banks

In debates (if indeed the term is warranted) about financial regulation in Ethiopia, the voice of the commercial banks themselves—and of the private banks in particular—is noticeable mostly by its absence. Somewhat surprisingly, all private bank employees interviewed for this study characterized their communication with the central bank as constructive: they reported that central bank staff regularly consult with private banks—both at the board level and with technical experts—during the development of new laws or regulations. However, they also did not feel that their feedback was ultimately taken into account by the NBE.[20]

As a consequence, controversial or openly punitive measures may provoke initial protest from private bank staff, but are enforced and obeyed nevertheless, and with little attempt to push back. The most striking example is the introduction of a regulation in 2011 that requires all private banks (but not the CBE) to purchase five-year NBE bills equivalent to 27 per cent of new loan disbursements. The 3 per cent interest paid on these bills is well below the rate of inflation, and their maturity far exceeds that of the average bank loan. In the absence of a secondary debt market, this means that a growing part of private bank assets are invested in government debt, which has in turn been used to finance long-term industrial projects. Ethiopia's private banks initially protested vigorously against the new rule (Mesfin, 2011). However, the Ethiopian government remained

[16] Interview, World Bank financial sector expert, Washington, DC, 21 February 2016.
[17] Interview, IMF official, Washington, DC, 27 April 2017.
[18] Interview, NBE banking supervisor, Addis Ababa, 15 February 2017.
[19] Interview, IMF official, Washington, DC, 27 April 2017.
[20] Interview, compliance manager at Wegagen Bank, Addis Ababa, 17 January 2017; and interview, risk manager at NIB Bank, Addis Ababa, 17 January 2017.

unimpressed by the objections (including those of the IMF later on), and the rule remains in place today.

The relative lack of power of Ethiopia's private banks vis-à-vis their federal supervisors is partly a reflection of market structure. With two thirds of the country's total banking assets under the control of the CBE, systemic risk is largely concentrated within one state-owned institution. Meanwhile, the structural risks emanating from the private banking sector are modest. The largest of the sixteen private banks, Awash International Bank, has a market share of just over 5 per cent. Risk exposure between different private banks is minimal, as interbank lending and cross-ownership are non-existent. What is more, Ethiopian banking law prevents the concentration of ownership structures: the 2008 Revised Banking Business Proclamation stipulates that an individual or family can own no more than 5 per cent of a bank's total shares,[21] while an 'influential shareholder' owning 2 per cent of a bank's shares or more cannot purchase stock in any of the other institutions.

Remarkably, and in contrast to other 'developmental' states, there are also few indications of outright clientelism between banks and political elites which could raise the former's influence with policymakers. The CBE's annual reports, for example, list all of its major non-performing loans, and none of the firms and individuals listed are known to be major political operators (CBE, 2014). A small number of private banks do have ties to the EPRDF—most importantly Wegagen Bank, an institution which was established with funds accumulated by the EPRDF during the war against the Derg, but is now formally part of a charitable endowment. However, they do not seem to benefit from preferential treatment, and there have been few allegations levelled against them recently. At the same time, the central bank has not been involved in any of the high-profile corruption cases which the Ethiopian courts have (very publicly) prosecuted in the past years.

There is, of course, another reason for the relative acquiescence of Ethiopia's private banks: the fact that they are, overall, among the main beneficiaries of the NBE's inward-looking and protectionist policies. According to data compiled by Abdulmenan (2017), Ethiopia's private banks are profitable without exception, and have been so since at least 2010. Operating in a rapidly growing yet significantly under-banked economy, private banks have their pick of relatively safe short-term and highly collateralized loans. Non-interest income from banking fees, forex services, and trade financing represents an additional revenue stream, amounting to a third of total revenues on average. Opening the financial sector to foreign banks would expose domestic institutions to a much more difficult competitive environment; as long as their profits are safe, there is thus little reason for private banks to rock the boat.

[21] This number was revised downward from the 20 per cent figure included in the original banking law of 1994.

Pressures for financial liberalization and convergence

Even foreign observers who are generally sympathetic to the EPRDF's vision of state-led economic transformation, however, question the financial arrangement that underpins it (Bienen et al., 2015). The 'developmental' financial policies of the East Asian tigers were premised on high savings rates, a sizeable private banking sector, undervalued currencies, and a large current-account surplus. In Ethiopia, the situation is the exact opposite: the savings rate is low and the banking industry in its infancy; the Ethiopian birr is propped up by strict capital controls, and the rapid increase in imports far outpaces the sluggish export growth (World Bank, 2016a, pp. 20–1).

The result has been a growing financing gap, which has in turn increased the demand for foreign capital. From 2010 to 2015, total investment—disproportionally driven by public spending—increased from 22 to 40 per cent of GDP (NPC, 2015, p. 13), while savings remained at 22 per cent. Since the Ethiopian financial sector is struggling to sustain economic growth by mobilizing the necessary amount of savings at home, the country has to bring in foreign savings. The growing interaction with global financial markets that results from this dependency has increased the linkages between an otherwise isolated Ethiopian financial sector and global capital markets. This, in turn, is slowly introducing new pressures for financial opening and regulatory convergence.

While there is no indication that the Ethiopian banking sector will be opened to foreign competition in the immediate future, it is slowly starting to acquire an international outlook. On the one hand, the state-owned Commercial Bank has become the first Ethiopian bank to venture out of the country.[22] In April 2017, the CBE opened a new branch in Djibouti, the main economic gateway for landlocked Ethiopia (Yewondwossen, 2017). According to a CBE representative, this move is part of a larger expansion plan which will see the bank opening offices primarily serving the growing Ethiopian community in diaspora hubs like Washington, DC, Dubai, and Johannesburg. At the same time, foreign banks have also begun opening representative offices in Ethiopia. These offices act as overseas correspondent banks for their Ethiopian counterparts and underwrite letters of credit for local businesses who trade internationally. In 2007, the German Commerzbank was the first to open such an office in Addis Ababa (Kifle, 2007). Since 2014, several other banks—notably (pan-)African banks such as Ecobank and Standard Bank—have followed (Strydom, 2015).

Outside the banking industry, the gradual internationalization of Ethiopia's financial sector has manifested itself even more strongly. One key event was the

[22] The CBE maintained an office in Djibouti which was closed by Djiboutian regulators in 2004, and it also opened several offices in South Sudan after 2009, most of which have since been closed again.

issuing of Ethiopia's first Eurobond in 2014—the country's first foray into the global debt market, and oversubscribed by 260 per cent. In Ethiopia's first credit ratings, obtained just before the issue, the agencies specifically commented on the particularities of the Ethiopian financial sector and their impact on the country's sovereign credit risk. Moody's, for example, noted 'the high concentration in the banking sector and the dominance of state-owned banks' which, in addition to government policies undermining the process of credit allocation, had 'a negative effect on the development of the financial sector' (Moody's, 2014). While these declarations do not create any immediate pressure for reform in the financial sector, they certainly introduce a new set of incentives.

The EPRDF government has made it clear that it does not consider the current level of financial restriction as a goal in itself, but rather as a means to an end, to be phased out over time. As Meles Zenawi (2012) said at the World Economic Forum, '[a]s we grow, as we develop, and as we become more sophisticated in our regulatory capacity, of course we'll liberalize'. The trends outlined above all create pressures in this direction. The long-term objective of Ethiopian regulators is convergence with global regulatory standards, but at their own pace, and without sacrificing control over the process. In the words of one World Bank official, where the Ethiopian government does show an interest in global financial norms, it is primarily interested in 'future compliance': there is no urgent need to be compliant quite yet, but once Ethiopia's financial regulators introduce a new set of reforms, they do not want to be taken by surprise.[23]

In the meantime, the Ethiopian central bank is undertaking a number of measures to strengthen the competitiveness of local commercial banks. In 2017, the NBE announced a likely increase in minimum capital requirements, which had already risen rapidly in recent years: not accounting for inflation, the NBE's minimum capital requirement for the establishment of a new commercial bank rose by a factor of 200 (from 10 million birr to 2 billion birr) between 1995 and 2015. The NBE also raised the prospect of promoting the consolidation of the commercial banking sector through mergers between private banks, something that has not happened since the EPRDF government first started licensing private banks in 1994 (Taye, 2017). Similarly, the second phase of the Growth and Transformation Plan, in a section on capacity building in the financial sector, announces plans to develop 'regulations that meet international standards', although the latter are not further specified (NPC, 2015, p. 110). And the establishment of a working group on financial-sector reform—with the participation of experts from both IMF and World Bank—by the new NBE Governor Yinager similarly indicates a willingness to revise existing institutions and policies (Fick and Maasho, 2018).

However, it would be short-sighted to see these instances of gradual change towards greater compliance with global financial norms as signs of a more radical

[23] Interview, World Bank financial sector expert, Washington, DC, 21 February 2016.

shift in the immediate future. To date, every reference by Ethiopian politicians and regulators to the eventual liberalization of the financial sector has been accompanied by a caveat that the time for this measure has not yet come. To complete Meles Zenawi's quote from above: '... of course we'll liberalize. But not now'.

Conclusion

This chapter has argued that Ethiopia's divergence from international standards in banking supervision is not simply a reflection of the bad regulatory 'fit' of Basel II and III, but more fundamentally a consequence of the policy orientation and strong domestic orientation of key actors. The EPRDF government sees itself as a 'developmental' regime in the tradition of the East Asian tigers and therefore considers control of financial markets to be a key component of industrial policy. Central bank regulators, on the other hand, take pride in increasing their technical competence, but their loyalty lies with domestic political leaders rather than with foreign institutions or networks. As key beneficiaries of the ERPDF's protectionist policies, finally, domestic commercial banks have little incentive to go abroad. However, the growing need to attract foreign capital is likely to usher in a gradual internationalization of the Ethiopian financial sector, and with it a greater interest in global financial standards.

As a highly aid-dependent country with significant exposure to the donor community, Ethiopia should be expected to converge on international standards. The analytical framework presented in this volume helps explain why this is not the case. It does so by drawing attention to the preferences of key actors: while Ethiopia's politicians, regulators, and banks are well aware of global norms and the community that promotes them, this awareness alone is not sufficient to sway them from their strong domestic agendas. Ethiopia provides an excellent example of the dynamics behind policy-driven divergence. This straightforward causal story is complicated only by the need to account for likely moves towards greater regulatory convergence in the future. Vietnam, for example, is regularly cited as an example of the kind of economy Ethiopia's state-led industrialization strategy might eventually engender (e.g. World Bank, 2016b). However, whether Ethiopia will mirror Vietnam's approach of gradual financial liberalization—and, consequently, demonstrate a similar willingness to embrace global standards like the Basel framework—remains speculation at this point.

The contrast between Rwanda and Ethiopia, countries that are held up as African 'developmental states', is striking. Like Ethiopia's EPRDF, the government of Paul Kagame has its roots in an armed insurgency movement and has rejected calls for political liberalization in favour of a state-led approach to economic transformation (Matfess, 2015). However, the two countries follow fundamentally different economic strategies. In contrast to Ethiopia's focus on labour-intensive

industries with strong backward linkages to agriculture, the Rwandan government pursues the development of a skills-based service economy. As Behuria argues in this volume, the promotion of a competitive financial industry is a key aspect of this endeavour. In comparison to their Ethiopian counterparts, Rwandan politicians and regulators therefore have a more internationalist agenda for the financial sector, and they are more likely to embrace compliance with international standards as a means of boosting the competitiveness of the Rwandan banking sector.

Comparison with the Angolan case highlights the importance of distinguishing conceptually between politically driven and policy-driven lending. As the discussion of the Angolan banking industry in this volume illustrates, both kleptocratic and 'developmental' regimes are driven by domestic concerns which motivate them to control the banking sector—elite enrichment and economic transformation, respectively. Although both regime types can be expected to reject supervisory frameworks that reduce their control over the process, the implications for financial regulators are very different. This highlights the importance of closely examining actor preferences.

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