

Research Article

Assessing Legal Independence of the National Bank of Ethiopia: An Analytical Framework Using Advanced Metrics

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Abstract

Ethiopia is recognized as the first African country to establish an independently owned central bank. This article evaluates the legal independence of the National Bank of Ethiopia (NBE), tracing its evolution from inception to the present day. Various studies provide robust evidence that an independent central bank is crucial for maintaining price stability without adversely affecting economic growth. The primary objective of this article is to analyze the extent to which the NBE maintains legal autonomy and effectively executes its monetary policy mandate amidst governmental influences. Utilizing contemporary metrics developed by Tobias Adrian, Ashraf Khan, and Lev Menand in 2024, the analysis is anchored in ten indicators of central bank independence, including institutional autonomy, policy-making authority, budgetary independence, and financial independence. A critical examination of the legislative frameworks governing the NBE assesses both existing laws and the proposed Draft National Bank Proclamation. Findings indicate that while the NBE has made significant strides in enhancing its legal independence, such as emphasizing price stability as its primary objective and allowing the board to set remuneration, substantial challenges remain. Persistent governmental control over appointments and financial resource allocation continues to undermine its operational effectiveness. This research underscores the necessity of a robust regulatory framework to enhance the NBE's autonomy and promote economic stability and growth. By integrating historical insights with contemporary assessment metrics, this study advocates for targeted reforms that strengthen the NBE's mandate in an increasingly complex economic landscape.

Keywords

Central Bank Independence, National Bank of Ethiopia, Legal Independence, Measurement Metrics

1. Introduction

Central bank independence (CBI) is widely recognized as a cornerstone of effective monetary policy and economic stability. Autonomy from governmental influence allows central banks to prioritize long-term economic health over short-term political considerations, a necessity in today's dynamic and often volatile economic environment [41]. A robust and independent central bank serves as a safeguard against infla-

tionary pressures and ensures the integrity of the financial system, thereby fostering an environment conducive to economic development [11, 8]. This article seeks to explore the significance of CBI, with a particular emphasis on the legal independence of the National Bank of Ethiopia (NBE) and the evolving practices of central banking within Ethiopia's unique socio-political context.

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In assessing the legal independence of the NBE, this article will provide a thorough analysis of the legislative framework that governs the bank. This assessment will track the evolution of relevant legislation from the bank's inception in 1963 to the current "National Bank of Ethiopia Draft Proclamation," which aims to update and strengthen the legal independence of the institution. The review will highlight both the progress made and the challenges faced throughout this legislative journey, elucidating how legal instruments have shaped the NBE's authority and autonomy. In extending previous research on the independence of the NBE, this study employs a comprehensive set of recently developed indices to evaluate central bank independence, an improvement over earlier methods that did not capture the bank's autonomy holistically [40, 4]. While past research has often relied on outdated metrics, this article incorporates the most recent advancements to provide a clearer understanding of the NBE's legal independence, including the implications of the new draft proclamation approved by the Council of Ministers.

The measurement of central bank independence is a complex endeavor that has garnered considerable attention in academic literature. Recent frameworks, such as those developed by Tobias Adrian, Ashraf Khan, and Lev Menand (2024), provide innovative metrics that capture the multifaceted nature of CBI. These metrics assess various dimensions of independence, including monetary policy autonomy, budgetary autonomy, financial autonomy, and the ability of central banks to act free from political pressure. Applying these metrics to the NBE allows for a comprehensive evaluation of its independence and capability to effectively fulfill its monetary policy objectives amidst Ethiopia's unique socio-economic challenges.

To lay the groundwork for understanding these complexities, Section 2 of this article will provide a historical overview and theoretical foundation of central bank independence. Section 3 will examine the methodologies employed to measure the central bank independence, detailing the metrics utilized in this analysis and their relevance to the assessment of an institution's autonomy. In Section 4, the focus will shift to a specific evaluation of the NBE, applying the aforementioned metrics to assess its legal independence through a detailed analysis of relevant legislation, from its inception to the current draft proclamation, thereby revealing advancements, areas for improvement, and ongoing challenges. Finally, Section 5 will conclude the article by summarizing key findings and offering targeted policy recommendations aimed at enhancing legal autonomy of the NBE.

Through this examination, the article aims to significantly advance the understanding of institutional independence within the National Bank of Ethiopia, while also seeking to improve its capacity to maintain autonomy amid the country's evolving political and economic landscape.

2. Central Bank Independence: A Historical Overview and Theoretical Foundation

2.1. The Evolution of Central Banking

The concept of central banking, a cornerstone of modern financial systems, dates back to the 17th century with the establishment of pioneering institutions such as the Swedish Riksbank in 1668 and the Bank of England in 1694 [18]. However, it was during the 20th century that central banks significantly proliferated, enhancing their roles and influence within the global economy [38]. Established mainly to issue currency, these institutions gradually expanded their roles by the early twentieth century, becoming non-profit maximizing, non-competitive entities that operated above commercial interests [16, 34, 7]. Unlike contemporary central banks, which primarily focus on achieving price stability, these early institutions engaged in both commercial and central banking functions. As their roles expanded, they assumed critical responsibilities, including the centralization of reserves for commercial banks and the management of both domestic and foreign currency reserves on behalf of governments [34]. This evolution has solidified their status as essential components of the financial system and as pivotal players in maintaining economic stability.

2.2. Theoretical Foundations of Central Bank Independence

The concept of central bank independence (CBI) is primarily based on the idea that monetary policy should be shielded from political interference, especially the pressures exerted by governments during election periods. The core argument for central bank independence (CBI) arises from the recognition that politicians frequently pursue short-term economic policies aimed at gaining electoral favor, such as reducing unemployment or stimulating economic activity to demonstrate progress as elections approach, which can conflict with long-term economic objectives like controlling inflation and maintaining price stability [7, 14, 30]. This focus on short-term objectives can conflict with the long-term economic goals of controlling inflation and maintaining price stability. Such misalignment between the priorities of the central bank and those of the executive branch frequently leads to inflationary cycles and economic instability, underscoring the importance of ensuring central bank independence [24, 28, 14]. The theoretical support for CBI became more pronounced in the 20th century, particularly after the inflationary crises of the 1970s and 1980s, which underscored the negative impact of politically-driven monetary policies [6, 43].

Scholarly analysis has explored the divergence in objectives between central banks and government executives, highlighting the potential for adverse economic outcomes. For Instance, William Nordhaus's "Political Business Cycles" theory posits

that incumbent governments exploit inflationary policies to reduce unemployment in the lead-up to elections, aiming to boost their chances of reelection [42]. However, this approach is often unsustainable, eventually resulting in higher inflation and economic fluctuations [42]. Nordhaus's work highlighted how political motivations make it difficult for governments to simultaneously achieve low inflation and stable economic growth over the long term. The concept of political business cycles is often associated with the "time inconsistency problem" in macroeconomic policy, a notion first formally introduced by Finn Kydland and Edward Prescott, and later expanded by Robert Barro and David Gordon [32, 33].

In contrast, Douglas Hibbs's "*partisan theory*" adds another dimension to the relationship between macroeconomic policy and the executive by suggesting that political ideologies significantly shape a government's economic preference [30]. Left-wing parties, for instance, may prioritize policies that aim to reduce unemployment, even at the expense of higher inflation, while right-wing parties generally focus on controlling inflation, even if it means tolerating higher unemployment [30]. Hibbs's theory underscores the political motivations behind macroeconomic outcomes and further supports the case for an independent central bank that can focus solely on price stability, irrespective of the political party in power. Hibbs's theory is supported by other prominent scholars, including Alesina and Sachs, who align with his perspective by challenging Nordhaus's political business cycle theory and investigating the politically induced business cycle in the post-World War II United States [31].

Another major theoretical justification for CBI is the "*credibility argument*", notably advanced by Kenneth Rogoff in 1985 [41]. Rogoff proposed that delegating monetary policy to a central banker who is highly committed to maintaining low inflation often referred to as a "conservative central banker" enhances the credibility of the central bank's inflation targets [41]. This enhanced credibility helps anchor inflation expectations, thereby contributing to long-term price stability and economic growth. By reducing uncertainty and fostering a stable macroeconomic environment, an independent central bank can improve investor confidence and lower inflation over time [41].

Together, these theoretical arguments form a compelling case for central bank independence, suggesting that when central banks are insulated from political pressures, they are better positioned to achieve long-term monetary stability and control inflation, while maintaining economic growth and development [11, 26, 13, 9, 29, 22, 8, 15, 25].

3. Measuring Central Bank Independence: Methodologies and Metrics

Central bank independence is a complex and multifaceted concept, and its definition varies depending on the perspective

and criteria used by different scholars. Broadly, central bank independence refers to the capacity of a nation's central bank to formulate and implement monetary policy based on its own objectives and preferred instruments, while managing the financial system without undue political interference, particularly from the government [26]. The term encompasses a range of meanings, including the methods used to select and insulate the governing board from political influence, the determination of the central bank's objectives, and whether it can be used to finance government budget deficits [8, 1]. Scholars, including Mark Swinburne, further refine this definition by distinguishing between two forms of independence [7]. The first form insulates central banks from political pressures through established rules, such as the gold standard, which restrict the bank's operational flexibility. The second form, more relevant to modern central banking, grants central banks greater discretion in shaping and implementing monetary policy while remaining free from political influence. Thus, central bank independence can vary in its scope, from rule-based constraints to broader discretionary powers, reflecting different levels of autonomy across institutions.

Measuring central bank independence presents challenges due to the influence of various factors and the absence of a universal criterion for ranking the level of independence among central banks. This complexity arises because scholars assess central bank independence through various dimensions, including political, legal, operational, and financial independence. These differing aspects can lead to varying interpretations and indices, with the specific variables within each dimension also subject to change.

Among the scholars who have proposed diverse methodologies to assess the independence of central banks are Cukierman, Webb, and Neyapti, along with Bade and Parkin, and Grilli, Masciandaro, and Tabellini [26, 17, 29]. Bade and Parkin (BP) developed the first central bank independence (CBI) index, using a sample of 12 countries to assess financial and policy characteristics of central bank charters based on government influence [17]. They ranked central banks on a scale from 1 to 4, with a lower government influence corresponding to a higher rank. Financial characteristics include the extent of government control over the central bank's budget, board members' salaries, and profit allocation. Policy characteristics range from government control over policy and board appointments to full central bank authority with some independent appointments. Another central bank index was developed by Vittorio Grilli, Donato Masciandaro, and Guido Tabellini (GMT), who expanded on Bade and Parkin's work by including 18 countries and a total of fifteen elements, comprising eight political metrics and seven economic metrics [29]. Their eight political metrics evaluated factors such as the appointment process for governors, government involvement in decision-making, and the statutory relationship between the central bank and the government, while their seven economic metrics assessed monetary financing and instruments. Each of the fifteen metrics was scored on a bi-

nary basis, with specific criteria earning additional points, resulting in varying scores that indicated different levels of independence among central banks [29]. Alex Cuikerman, Steven B. Webb, and Bilin Neyapti developed widely recognized measures of central bank independence, which include four indices of legal independence based on 16 variables coded on a scale from 0 to 1 [26]. These variables cover the appointment, dismissal, and term of office of the chief executive officer (usually the governor) of the bank; policy formulation, focusing on the resolution of conflicts between the executive branch and the central bank regarding monetary policy and the central bank's involvement in the budget process; the objectives of the central bank; and limitations on the central bank's ability to lend to the public sector, which include restrictions on the volume, maturity, interest rates, and conditions for direct advances and securitized lending. They also developed two indices of informal actual independence, acknowledging that legal independence is merely one factor influencing true autonomy, with these measures evaluating elements such as the turnover rate of central bank governors and utilizing data from a questionnaire distributed across 23 countries. Their research encompasses a broad sample of 72 countries, including 21 industrialized nations and 51 developing countries, covering the period from 1950 to 1989 [26].

Numerous scholars have updated and utilized these indices, including Alesina and Summers, Arnone et al., Arnone and Romelli, and Binder, who applied the GMT index to assess central bank independence [11, 23]. Additionally, Cukierman et al.'s index has been cited by a variety of scholars, including Campillo and Miron, Oatley, Crowe and Meade, Unsal et al., and the distinguished work of Davide Romelli [12, 45, 3, 46, 10].

Tobias Adrian, Ashraf Khan, and Lev Menand, who provided the most recent indices utilized by the author of this article to assess the independence of the National Bank of Ethiopia, critique existing central bank independence (CBI) indices, specifically focusing on the Cuikerman, Webb, and Neyapti (CWN) and Romelli versions. They identify several shortcomings in the CWN framework, noting that it neglects to consider the legal status of board members, an important factor addressed by Grilli et al., and it fails to assess the central bank's budgeting process, which is a feature highlighted by Bade and Parkin [1]. This lack of comprehensiveness diminishes the effectiveness of the index. The authors also emphasize that the CWN index places excessive weight on lending rules while underrepresenting critical factors, such as restrictions on government securities [1]. Additionally, they critique Romelli's methodology of applying equal weight to all categories, including less significant aspects like reporting requirements, which further compounds these issues [1]. It is important to recognize that not all variables affect a central bank's independence equally; some have a significantly greater impact than others. They also express concern over the practice of granting partial credit for disaggregated variables, as this can result in misleading assessments; for instance,

central banks might receive points for long-term leadership despite facing other challenges to their independence [1]. This indicates that variables that should be evaluated collectively ought not to be separated, as doing so makes it difficult to accurately determine the true level of independence. Recognizing the deficiencies in previous measurements of central bank independence, the authors developed their own metrics designed to address these shortcomings. Their approach aims to provide a more accurate and nuanced assessment of central bank autonomy, eliminating the biases and oversights present in earlier indices.

3.1. New Metrics for Assessing Central Bank Independence

The index developed by the authors introduces ten key metrics to evaluate central bank independence (CBI), each with specific criteria [1]:

- 1) *Independence of the Chief Executive*: This metric requires that the chief executive, designated as the governor or chief executive officer (CEO), be appointed for a term longer than the electoral cycle. It mandates the involvement of non-executive officials in the appointment process, protection from dismissal for policy reasons, appropriate compensation, and a prohibition on holding other high-ranking executive positions simultaneously.
- 2) *Independence of the Highest Governing Body*: Similar to the independence of the chief executive, this metric mandates that the governing body—designated as the board, council, court, or committee—be appointed for a term longer than the electoral cycle. It requires non-executive officials to be involved in the appointment process, that members are protected from political dismissal, and that they receive compensation while being prohibited from holding other high-ranking positions.
- 3) *Budgetary Independence*: This metric indicates that the central bank's budget should not be subject to legislative approval or oversight, thereby allowing it to operate independently in financial matters.
- 4) *Independence in Formulating Monetary Policy*: For a central bank to be considered independent under this metric, it must set monetary policy without government approval and without government officials on the policymaking body. If the central bank only provides recommendations to other bodies, which can choose to adopt or reject those recommendations, it does not meet the independence criteria.
- 5) *Primary Objective*: This metric ensures that the central bank's sole goal is price stability, with any other objectives clearly subordinated to it. If the statute outlines additional goals, such as financial stability, maximum employment, or political responsibilities that are not explicitly subordinated to price stability, the central

bank does not meet this criterion.

- 6) **Long-Term Direct Lending to the Government:** A central bank is considered independent if it is prohibited from lending long-term to the government or from purchasing long-term securities in the primary market. Long-term lending is defined as any lending, including loans, advances, and guarantees, extended for periods exceeding 90 days.
- 7) **Short-Term Direct Lending to the Government:** This metric indicates that a central bank is deemed independent if it is prohibited from lending to the government for 90 days or less, including through loans, advances, primary market purchases of securities, or guarantees. However, if the central bank can lend in emergencies, such as during wars or natural disasters, it would not fully meet this independence criterion.
- 8) **Financial Independence:** This metric stipulates that if the central bank is separately capitalized meaning it has its own capital distinct from the government or other public entities it is considered financially independent. This includes having paid-up capital, controlling distributions to the government, maintaining a reserve fund, and excluding unrealized gains from its net profit.
- 9) **Lending Outside the Financial System:** A central bank maintains its independence if it is prohibited from providing loans, advances, or guarantees to entities not regulated and supervised by the financial authorities. Further restrictions on quasi-fiscal activities that allocate credit to non-financial institutions reinforce this independence.
- 10) **Monetary Policy Audit:** This metric indicates that if the law stipulates that a state audit body can only assess the operational efficiency of the central bank, without examining policy-related decisions, the central bank is considered independent in its monetary policy formulation.

3.2. Methodology for Evaluating Central Bank Independence

In their approach, Adrian, Khan, and Menand assign each variable a score of either zero or one, with a country earning a score of one only if all specific criteria are met [1]. To earn one point for each metric, a central bank must fulfill all specified criteria; for instance, under the independence in formulating monetary policy metric, the central bank must set policy without government approval and without the involvement of government officials in the decision-making body, while in the primary objective metric, it must ensure that price stability is the sole goal with other objectives clearly subordinated to it, as failing to meet any of these conditions results in a score less than one for that metric. They avoid giving credit to central bank laws that appear to offer independence but contain loopholes that undermine its effectiveness.

The authors developed a weighted index of central bank in-

dependence (CBI) using survey responses from senior central bank officials across 193 monetary authorities [1]. Their respondents rated the importance of ten key metrics on a scale from 0 (not considered) to 5 (critical), focusing on global relevance rather than the specifics of their own institutions. They received 87 responses from central banks worldwide, with a higher response rate from high-income and European countries. While all metrics were deemed at least “very important,” there was variation in perceived significance; financial independence was rated as “critical” by the majority, whereas short-term lending restrictions and lending outside the financial system were viewed as less important by some respondents [1]. The authors primarily relied on data from the Central Bank Legislation Database (CBLD) for 2020/2021 provided by the international monetary fund (IMF) as their main source of information on central bank legislation.

4. Measuring the Independence of National Bank of Ethiopia

4.1. History of National Bank of Ethiopia

Ethiopia is recognized as one of the oldest nations to establish a bank, exemplified by the founding of the Bank of Abyssinia in 1905, which was, however, owned and managed by the British-controlled National Bank of Egypt [44, 5]. Ethiopian control of its banking system was realized in 1931 when the Ethiopian government, during the reign of Emperor Haile Selassie I, purchased the Bank of Abyssinia and renamed it the Bank of Ethiopia [36, 5]. This transition occurred during a period when much of Africa remained under colonial rule, underscoring Ethiopia’s unique position within the continent’s financial landscape. This pivotal moment marked the establishment of the first entirely indigenous bank in Africa, granted exclusive authority to issue currency and serve as a lender to the government [36, 5]. Its function as the sole issuer of currency and lender to the government mirrored that of early banks such as the Swedish Riksbank and the Bank of England, which were initially mandated with issuing currency and serving as lenders to their governments while also providing commercial banking services and engaging in profitable activities.

On April 15, 1943, the State Bank of Ethiopia was founded as the central bank of the nation, taking on the dual responsibilities of central and commercial banking that had characterized its predecessor [44]. In 1963, a significant restructuring occurred with the establishment of the National Bank of Ethiopia, which formally separated its central banking functions from commercial banking activities [5]. This transition resulted in the creation of the National Bank of Ethiopia, which was assigned exclusive responsibilities for central banking, while the Commercial Bank of Ethiopia was established to handle commercial banking services. Established by Order No.30 of 1963, the National Bank of Ethiopia com-

menced operations in January 1964, representing a significant advancement in the country's financial system and the establishment of a dedicated and independent central banking institution [19]. Since then, the legislation governing the National Bank of Ethiopia has evolved to reflect the prevailing political ideologies over time. The Monetary and Banking Proclamation No. 99/1976 centralized the banking system in accordance with socialist principles, while Proclamation No. 83/1994 marked a transition to market-oriented policies aimed at enhancing monetary stability and promoting economic growth. Currently, the operative framework is established by Proclamation No. 591/2008, which delineates the powers and responsibilities of the National Bank.

In a further significant development in the evolution of the National Bank of Ethiopia, the Council of Ministers approved a draft proclamation on June 14, 2024, aimed at amending Proclamation No. 591/2008, which has been in effect for 16 years [35]. This amendment is anticipated to bring about significant changes in the governance and operational framework of the National Bank of Ethiopia (NBE). The draft will be submitted to the House of Peoples Representatives for review and ratification. It aims to enhance the NBE's capacity to prioritize its monetary policy objectives and select appropriate instruments to achieve these goals. The author will discuss the changes introduced in the "Draft National Bank of Ethiopia Proclamation" while assessing the independence of the National Bank of Ethiopia across all legislations that have established it. Based on this analysis, recommendations will be presented to strengthen the draft proclamation, thereby enhancing the independence of the National Bank of Ethiopia.

4.2. Employing the New Metrics for Measurement of National Bank of Ethiopia Across all Legislations

In this subsection, the author will assess the legal independence of the National Bank of Ethiopia by examining the legislations that establish its powers and duties, utilizing the ten metrics developed by Tobias Adrian, Ashraf Khan, and Lev Menand, as discussed in the previous section. To streamline the evaluation, the author has combined the metrics related to the independence of the chief executive and the governing body, as well as those concerning short-term and long-term direct lending to the government.

4.2.1. The Independence of the Chief Executive and the Highest Governing Body (Governor and Board) from Executive Branch Officials

The National Bank of Ethiopia is considered independent based on these two metrics when both the Governor, as the chief executive, and the Board of Directors, as the highest governing body, are appointed for a term that exceeds the electoral cycle. Furthermore, this independence is ensured by the involvement of non-executive officials in the appointment

process, the protection of the Governor and the Board from dismissal for policy reasons, the provision of appropriate compensation, and the prohibition against holding other high-ranking executive positions simultaneously.

The first constitutive legislation of the National Bank of Ethiopia, Order No. 30 of 1963, addressed the organization and administration of the bank. Chapter 4 established a Board of Directors composed of five members, which included the bank's Governor, the Minister of Finance, and three appointees selected by the Emperor [19]. Both the governor and vice governors were appointed by the emperor, with the governor serving a term of up to five years, subject to reappointment, and the vice governor's tenure at the emperor's discretion [19]. The Monetary and Banking Proclamation No.99/1976 expanded the board to nine members, with the Governor, the Minister of Finance, and the Commissioner of the Central Planning Commission serving ex-officio roles [2]. The remaining members were appointed by the government upon the recommendation of these ex-officio members. During the transitional government period, Monetary and Banking Proclamation No. 83/1994 reduced the board to seven members. Ex-officio members included the Governor, the Minister of Finance, the Minister of Planning and Economic Development, and the Minister of Trade, with the chairman and two other members appointed by the government [27].

The current legislation governing the National Bank of Ethiopia, Proclamation No. 591/2008, outlines comprehensive provisions regarding the organization, management, and functions of the bank. This includes detailed guidelines on the accountability, organizational structure, objectives, powers, and responsibilities of key governing bodies, such as the Board of Directors, the Governor, and the Vice Governor. The proclamation establishes that the National Bank of Ethiopia is unequivocally accountable to the Prime Minister of the Federal Democratic Republic of Ethiopia, with both the Governor and the Vice Governor appointed by the Prime Minister serving as ex-officio members of the Board of Directors, which consists of seven members, including five appointed by the government, thereby reinforcing the government's influence over the bank's governance [39]. While Article 3.6 lacks precision regarding the term "government," a thorough examination suggests its association with the executive branch, given NBE's direct accountability to the Prime Minister. Additionally, Proclamation No. 1263/2021, defining the powers and duties of the executive organ, designates the National Bank of Ethiopia as an executive organ accountable to the prime minister [21].

In examining the legislative evolution of the National Bank of Ethiopia, it becomes evident that while structural changes occurred over time, government influence remained a consistent theme in its governance structure. From the centralized appointments under Order No.30 of 1963 to the continued government involvement seen in Proclamation No. 591/2008, the trend suggests a strong relationship between the National Bank and the government. Although changes in the composi-

tion of board of directors occurred, the overarching framework indicates a significant level of government control, particularly in the appointment of key leadership positions and the bank's accountability structures. Therefore, while the National Bank has undergone legislative refinements and adaptations, its independence appears to be tempered by the influence of government authorities. Compensation is provided for members of the National Bank's Board, including the Governor [19, 39, 27]. However, the fixed nature of this compensation, determined by the government, raises concerns about the bank's independence. Unlike the autonomy granted under Order No. 30/1963, which allowed the board greater discretion in determining the remuneration of its members, subsequent legislation has placed control of compensation in the hands of the government, potentially undermining the bank's operational autonomy and ability to function independently [39, 27]. Additionally, there is a lack of clarity regarding the potential for the Governor and the Board of Directors to hold concurrent executive positions, as none of the legislation explicitly prohibits them from holding other high-ranking executive roles simultaneously. In fact, under the Monetary and Banking Proclamation No. 99/1976 and Monetary and Banking Proclamation No. 83/1994, members of the Board, including the Minister of Finance, the Minister of Planning and Economic Development, and the Minister of Trade, served as board members, highlighting their simultaneous positions. Regarding the dismissal of governors and members of the board of directors, there is no prohibition against dismissal for policy reasons, as this is not addressed in the proclamation. However, there is also no evidence that governors and board members have been dismissed for policy reasons in the past. As for their tenure, only Order No. 30 of 1963 established a five-year term limit for the governor. However, this provision cannot be effectively assessed, as the country was under imperial rule at the time, which precluded any elections.

The Draft National Bank of Ethiopia Proclamation, currently awaiting review and approval by the House of Peoples Representatives, introduces some changes regarding the independence of the governor and the board of directors from the executive branch officials. Firstly, the term for both the governor and the board members is fixed at six years, with eligibility for reappointment for one additional term, thereby extending their tenure beyond Ethiopia's electoral cycle of five years [37]. This change represents a positive development, as staggered terms for the governor and board of directors can effectively prevent their replacement or removal by the executive branch immediately following elections for policy reasons. This stability is crucial for maintaining the independence of the bank in pursuing its primary objective of price stability. However, one might question the effectiveness of this provision, considering that in Ethiopia, the ruling party is seldom replaced in the short term, often remaining in power for extended periods. This raises concerns that the ruling party could remove or replace these officials after their terms expire

for policy-related reasons and, crucially, select a governor and board members who are aligned with its agenda, thereby allowing them to remain in office for extended periods potentially up to a total of 12 years. Nevertheless, this draft proclamation is a commendable advancement that deserves recognition. It also holds the potential for further development, as it is still subject to approval by the House of Peoples' Representatives, which serves as the legislative body in Ethiopia. Secondly, the remuneration for the governor and vice governor is now determined by the board of directors, marking a significant development [37]. However, the determination of the remuneration for the board of directors remains under the control of the government, specifically the Prime Minister. Consequently, the draft does not enhance the provisions of Proclamation No. 591/2008 and falls short of Order No. 30/1963, which empowered the board to set its own members' compensation. This limitation undermines the board's operational autonomy and independence in managing remuneration matters. Lastly, the draft proclamation outlines grounds for dismissal that explicitly exclude policy decisions, indicating that governors and board members will not be dismissed for reasons related to policy choices [37]. This represents a significant improvement over previous legislation, which did not address dismissal grounds, thereby reinforcing their independence in decision-making. However, the absence of non-executive officials in the appointment process persists, as the Prime Minister continues to appoint members. Additionally, the draft proclamation lacks a provision prohibiting the simultaneous holding of high-ranking executive positions. Such a provision is essential to prevent conflicts of interest and undue influence from executive branch officials, allowing governors and board members to focus solely on their primary objective of monetary stability. As these factors are essential components of the metrics assessing the autonomy of the chief executive and the governing body, their non-fulfillment reduces the overall independence of the National Bank.

4.2.2. Budgetary Independence

The National Bank of Ethiopia is considered to have budgetary independence from the legislature if legislative bodies do not engage in the annual budgeting process, including proposing, approving, or suspending the budget.

Evaluating the budgetary independence of the National Bank of Ethiopia (NBE) under Proclamation No. 591/2008 is crucial for assessing its legal autonomy. Previous legislative efforts have struggled to address this vital aspect, making the current proclamation a significant regulatory advancement. Unlike many other governmental entities, the NBE enjoys a considerable degree of budgetary autonomy, as the governor is responsible for preparing the annual budget, which is then subject to approval by the board of directors [39]. This level of budgetary autonomy stands out, particularly when compared to other governmental bodies. For instance, the judiciary, often regarded as the most independent organ, is required to

prepare its budget for approval by the parliament, which can introduce potential avenues for political influence [20]. This level of independence is further maintained in the draft National Bank of Ethiopia Proclamation [37]. This budgetary autonomy enhances the NBE's ability to execute its monetary policy effectively and to maintain stability in the financial system, contributing to the overall economic health of Ethiopia. Consequently, the NBE receives full marks regarding budgetary independence, as the legislative body does not participate in its budgeting process, thereby enhancing its overall legal autonomy and contributing to the economic health of Ethiopia.

4.2.3. Independence in Formulating Monetary Policy

The National Bank maintains the ability to set monetary policy independently from executive branch officials when it can do so without requiring approval from other government officials, and when there are no government officials, regardless of voting rights, on the body responsible for monetary policy decisions, such as the board or monetary policy committee (MPC).

Across various legislative frameworks, including Order No. 30/1963, Monetary and Banking Proclamation No. 99/1976, Monetary and Banking Proclamation No. 83/1994, and Proclamation No. 591/2008, the National Bank of Ethiopia (NBE) has consistently been acknowledged for its crucial role in formulating policies to advance its objectives, particularly in shaping monetary policies [39, 2, 27]. This recognition underscores the enduring authority of the NBE in shaping monetary policy despite changes in legislation over time. In the current arrangement, Article 55(10) of the Constitution of the Federal Democratic Republic of Ethiopia delineates the roles of the House of Peoples' Representatives. The Article stipulates that the House of Peoples' Representatives shall approve general policies and strategies encompassing economic, social, and developmental aspects, as well as fiscal and monetary policy of the country [20]. This delineation signifies that while the legislature is entrusted with approving general policy goals and objectives, the National Bank's authority is confined to formulating those policies for parliamentary approval and devising measures for the enforcement of the general policy objectives and goals thereafter. The authority of the National Bank of Ethiopia to formulate policies and devise measures for their enforcement, subsequent to approval by the parliament, is clearly evidenced by the provisions outlined in the establishment proclamation (proclamation no.591/2008) [39]. However, the requirement for parliamentary approval to set policies, combined with the fact that the board of directors, responsible for formulating monetary policies and implementing measures, comprises individuals appointed by the executive or who are government officials, significantly diminishes the bank's independence in monetary policy formulation. This situation continues in the Draft National Bank of Ethiopia Proclamation, which maintains similar provisions, reinforcing the existing constraints

on the bank's independence [37]. Therefore, based on these metrics, the National Bank of Ethiopia cannot be considered independent in formulating its monetary policy.

4.2.4. Primary Objective of the Central Bank

The primary objective of a National Bank is price stability, which is considered its sole objective or the highest priority if all other objectives are clearly subordinated to it. Conversely, if the statute includes other objectives such as financial stability, maximum employment, or support for government policies, objectives that are not clearly subordinated, then price stability cannot be regarded as the primary objective.

Initially, under Article 3 of Order No.30/1963, the National Bank of Ethiopia (NBE) focused on fostering monetary stability, ensuring favorable credit and exchange conditions, and facilitating balanced economic growth within the Ethiopian Empire [19]. This emphasis shifted with Proclamation No.99/1976, which expanded the bank's objectives to include fostering balanced and accelerated economic development, promoting high levels of production, employment, and real income, and encouraging the full development of Ethiopia's productive capacity [2]. Notably, there was no explicit mention of price stability under this proclamation. The focus on monetary stability as the primary objective emerged with the enactment of Proclamation No.83/1994. Under this proclamation, the NBE was entrusted with fostering monetary stability, maintaining a sound financial system, and establishing credit and exchange conditions conducive to the balanced growth of Ethiopia's economy [27]. Subsequently, Proclamation No.591/2008 reinforced the importance of price stability as a key objective. Article 4 of Proclamation No. 591/2008 delineates the core objectives of the National Bank of Ethiopia (NBE), highlighting its mandate to maintain stable prices and exchange rates, foster a healthy financial system, and to undertake activities driving rapid economic development in Ethiopia [39]. However, while price stability is highlighted as a key objective, the proclamation does not explicitly designate it as the primary objective or subordinate other objectives to it. This lack of clear prioritization makes it difficult to assert that price stability is the NBE's foremost goal, ultimately undermining its independence.

The Draft National Bank of Ethiopia Proclamation introduced a significant change by designating price stability as the primary objective of the bank, emphasizing its responsibility to formulate and implement monetary policy aimed at maintaining price stability [37]. While the bank is also entrusted with ensuring the stability and soundness of the financial system and supporting the nation's overall growth, these objectives are explicitly subordinate to the price stability mandate. This is reflected in the phrasing used, which indicates that other objectives are to be pursued "without prejudice" to the primary goal of price stability, thereby reinforcing the latter's dominant status in the bank's operational framework. This emphasis on price stability is particularly important because it can often conflict with other objectives, especially

those related to supporting national growth, which may be influenced by the government's fiscal policy. For instance, addressing budgetary deficits may require measures such as increasing the money supply, which risks jeopardizing price stability and potentially leads to high inflation. Therefore, if the draft proclamation is approved as it stands, it can be said that price stability will indeed be the primary objective of the National Bank of Ethiopia.

4.2.5. Government Lending Restrictions

Under this criterion, an assessment will be made regarding the constraints on the National Bank's direct lending to the government, focusing on both long-term and short-term lending mechanisms. It will evaluate the prohibition against providing direct lending, which includes loans, advances, primary market purchases of securities, or guarantees that exceed a duration of 90 days. Additionally, this criterion will address the restrictions imposed on the central bank concerning loans, advances, primary market purchases of securities, or guarantees to the government for periods of 90 days or less in the short term. These restrictions are vital for maintaining the independence of the central bank, as they limit the potential for monetary financing of government deficits and help safeguard the integrity of monetary policy.

Proclamation No. 99/1976 and Proclamation No. 83/1994 establish structured frameworks for government borrowing from the central bank, with nuanced differences in lending restrictions. While both proclamations impose limits on direct advances, treasury bills, and government bonds to promote fiscal discipline and monetary stability, they do not prohibit long-term and short-term direct lending to the government. Instead, they set specific limits that may subject the bank to external influences regarding its lending practices. Under Proclamation No. 99/1976, direct advances to the government are capped at 25% of the previous fiscal year's revenue [2]. In contrast, Proclamation No. 83/1994 further tightens this restriction, limiting direct advances to 15% of the average annual revenue over the preceding three fiscal years [27]. Both proclamations also establish parameters for treasury bill purchases, with Proclamation No. 99/1976 capping these purchases at 20% of the previous fiscal year's revenue, while Proclamation No. 83/1994 raises the limit to 25% of the three-year average revenue [2, 27]. Repayment conditions also differ, with Proclamation no.99/1976 requiring repayment within six months and Proclamation no.83/1994 mandating repayment within one year for advances made in the preceding fiscal year [2, 27].

The current Proclamation No. 591/2008 designates the National Bank of Ethiopia (NBE) as the government's fiscal agent and banker, empowering it to facilitate various transactions, including advances and the trading of treasury bills and government bonds. This proclamation outlines the NBE's authority to extend credit and advances to the government while emphasizing the importance of consultation to promote economic stability [39]. Notably, the proclamation does not

prohibit long-term or short-term direct lending to the government; rather, the amounts for such lending are determined through consultation with the government. These stipulations illustrate that the bank may be subject to influence in its credit extensions to the government, thereby reducing its independence.

The draft National Bank of Ethiopia Proclamation establishes critical provisions regarding the NBE's lending to the government. It prohibits direct or indirect credit unless explicitly authorized and allows temporary overdrafts for up to 12 months, limited to 15% of the average annual domestic revenue from the previous three years [37]. These overdrafts must be repaid at maturity, with no rollovers permitted. While this framework aims to maintain fiscal discipline, it also exposes the NBE to potential influence, particularly during emergencies, as the government may request additional advances beyond the stipulated limits. Unlike Proclamation No. 591/2008, which permitted broader lending discretion, the draft proclamation imposes stricter limits on credit extensions to the government and explicitly prohibits the NBE from purchasing government securities in the primary market. However, these stipulations still suggest a risk to the National Banks' independence, as the bank may be pressured to accommodate government financing needs. While there is progress from the current proclamation in terms of these restrictions, it cannot be said that the bank is fully independent in this regard, as the draft does not rule out or prohibit short-term and long-term direct government lending.

4.2.6. Financial Independence

This index assesses the financial autonomy of the central bank by examining its capitalization structure, specifically whether it maintains independent capitalization separate from the government or public entities. Key factors include the existence of its own paid-up capital, control over distributions to the government, the establishment of a reserve fund, and the ability to exclude unrealized gains from net profit calculations. Collectively, these elements reflect the central bank's capacity to operate without undue influence from governmental financial interests, thereby enhancing its overall autonomy in monetary policy implementation.

The paid-up capital of the National Bank has seen steady increases over time: from 10,000,000 birr under Order No. 30/1963 to 30,000,000 birr under Proclamation No. 99/1976, further to 50,000,000 birr under Proclamation No. 83/1994, and finally to 500,000,000 birr under Proclamation No. 591/2008 [2, 27, 39]. These proclamations mandate that 20% of the net profit be allocated to the General Reserve Fund until it matches the paid-up capital, with the remaining 80% directed to the Ministry of Finance [2, 27, 39]. However, as soon as the General Reserve Fund matches the capital of the bank, the proclamations provide varying allocation of the net profit. Under Proclamation No. 99/1976, 10% of the net profit is to be credited to the General Reserve Fund, and 90% to the Ministry of Finance, while Proclamation No. 83/1994 in-

creases the allocation to 20% to the General Reserve Fund and 80% to the Ministry of Finance [2, 27]. However, Proclamation No. 591/2008 mandates that the entire net profit be channeled to the Ministry [39].

In the event of net losses, all proclamations stipulate that they are debited to the General Reserve Fund, with provisions to replenish it to the paid-up capital threshold in case of deficits [2, 27, 39]. Moreover, the government is obliged to uphold the paid-up capital at all times under all of the above proclamations [2, 27, 39]. Proclamation No. 591/2008 specifically states that the capital of the bank is wholly owned by the government [39]. These provisions of the proclamations potentially constrain the financial independence of the National Bank, given that its capital is wholly owned by the government, profits are directed to a fund under government control, and the government is mandated to uphold the bank's capital at all times.

The draft National Bank Proclamation reiterates that the NBE's capital is fully owned by the government, consistent with previous proclamations [37]. The capital structure remains largely unchanged, with the paid-up capital and its management subject to governmental oversight. This underscores a continuation of the trend observed in earlier legislation, where the NBE's financial independence is significantly curtailed by the government's control over its capital resources. By maintaining the requirement for the government to uphold the paid-up capital and directing profits to government control, the draft further solidifies the limitations on the NBE's ability to function independently in its financial and monetary policy roles.

4.2.7. Lending Outside the Financial System

The index evaluates the extent to which the central bank is restricted from providing loans, advances, or guarantees to entities outside the regulatory oversight of financial authorities. It also assesses the prohibition of engaging in quasi-fiscal activities, specifically through the allocation of credit to non-financial institutions.

The National Bank of Ethiopia's lending authority exhibits a remarkable consistency across multiple proclamations, notably No. 99/1976, No. 83/1994, and No. 591/1991. Each of these legislative documents expressly authorizes the bank to provide direct credit exclusively to the government, banks, and other financial institutions [2, 27, 39]. The draft National Bank of Ethiopia proclamation maintains this restriction, reinforcing the bank's commitment to limit its lending activities to regulated entities [37]. This unwavering adherence to regulatory limitations on lending beyond the financial system underscores the National Bank's steadfast commitment to maintaining a uniform approach to its lending practices across different legislative periods.

4.2.8. Monetary Policy Audit

The index evaluates whether the law explicitly restricts state audit bodies, such as national audit offices or comptrol-

ler-generals, to assessing operational efficiency rather than probing into the monetary policy decisions of the central bank. This distinction is crucial as it ensures that the central bank's independence is preserved by limiting external scrutiny to its operational aspects, thereby safeguarding its authority to formulate and implement monetary policy without interference from state auditors.

Previous proclamations of the bank, except for Proclamation No. 591/2008, did not contain provisions regarding auditing the bank, whether for operational or monetary policy purposes. In relation to the index on monetary policy audit, Article 8 of the proclamation No. 591/2008 outlines the annual appointment of an external auditor by the Board of Directors of the National Bank, whose audit report must be reviewed and approved by the Bank's Audit Committee before submission to the government within six months of the financial year's end [39]. While this provision focuses on financial accountability, it does not explicitly address restrictions on state audit bodies' oversight powers regarding monetary policy decisions. The absence of explicit mention regarding state audit bodies within the National Bank of Ethiopia's establishment proclamation may suggest a potential gap in their oversight framework. This absence does not necessarily imply a prohibition of state audit bodies' oversight powers. The draft National Bank of Ethiopia Proclamation retains this framework with minor adjustments, including the introduction of an internal audit function and the requirement for the financial statements of the external auditor to be submitted to the House of Peoples' Representatives rather than the government.

5. Concluding Remarks

The assessment of the National Bank of Ethiopia's (NBE) legal independence highlights both notable advancements and persistent challenges within its current framework, particularly regarding the Draft National Bank of Ethiopia Proclamation. This draft represents a significant step forward in recognizing the necessity of a robust and autonomous central bank by explicitly designating price stability as the primary objective of the NBE. Furthermore, it introduces important provisions such as excluding policy-related grounds for the dismissal of governors and board members, extending their terms beyond the electoral cycle, and allowing the board of directors to determine the remuneration for the governor and vice governor. These measures collectively aim to enhance the operational autonomy of the NBE and establish a clearer mandate focused on maintaining monetary stability.

Despite these promising developments, several structural constraints continue to impede the NBE's independence. The absence of non-executive involvement in the appointment process for governors and board members remains a significant concern. This oversight undermines the credibility of the bank's leadership and may lead to perceptions of political influence in its operations. Additionally, the executive's control over these appointments could compromise the NBE's

ability to make impartial decisions essential for effective monetary policy implementation. Moreover, the lack of explicit prohibitions against simultaneous high-ranking executive positions for governors and board members raises potential conflicts of interest that could hinder the bank's commitment to price stability. The draft's failure to prohibit direct government lending, both short-term and long-term, further complicates the NBE's operational autonomy; as such practices could create an undue burden on the bank to finance the government, undermining the integrity of its monetary policy.

To address these critical issues, it is imperative that the Draft National Bank of Ethiopia Proclamation be strengthened prior to its approval by Parliament. Incorporating provisions that ensure non-executive participation in the appointment process would enhance accountability and public trust in the NBE's governance. Specifically, governors and board members should be appointed with half designated by the legislature and half by the executive, or the legislature should approve the nominations made by the executive. Additionally, establishing clear prohibitions against conflicts of interest and direct government lending would safeguard the bank's operational independence. Clarifying the role of state audit bodies to limit their oversight strictly to financial audits and operational efficiency assessments, without encroaching on monetary policy decisions, would further preserve the NBE's autonomy in this crucial area.

Implementing these recommendations will significantly bolster the NBE's independence, thereby enhancing its capacity to effectively achieve monetary stability and contribute to sustainable economic growth in Ethiopia. A robust legal framework that empowers the NBE is essential for navigating future economic challenges while safeguarding its critical role in shaping the nation's financial landscape. Ultimately, the success of these reforms will hinge on the commitment of all stakeholders to uphold the principles of central bank independence, ensuring that the NBE can fulfill its mandate free from undue external pressures and influence.

Abbreviations

BP	Bade and Parkin
CBI	Central Bank Independence
CBLD	Central Bank Legislation Database
CEO	Chief Executive Officer
CWN	Cuikerman, Webb, Neyapti
GMT	Grilli, Donato Masciandaro, and Guido Tabellini
IMF	International Monetary Fund
MPC	Monetary Policy Committee
NBE	National Bank of Ethiopia

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Author Contributions

Hamza Abdu Kiyar is the sole author. The author read and approved the final manuscript.

Conflicts of Interest

The author declares no conflicts of interest.

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Biography



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Research Fields

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