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Birritu

is a quarterly megazine Published by:
The National Bank of Ethiopia, it presents indepth articles, researches & news on banking, Insurance & microfinance.

Birritu No.110

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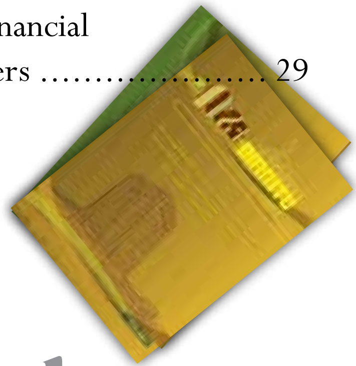

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Editors' Note

In this publication of Birritu No.110, a statement presented at the IMF meeting by H.E. Ato Teklewold Atnafu, Governor of the National Bank of Ethiopia (NBE); the full text of the press release given by NBE on lifting of the credit ceiling; and a directive on Customer Due Diligence of Banks are presented in the news and information column. A paper entitled "Finance and Growth Nexus in Ethiopia (A causality Analysis Using Alternative Proxies)" and "Enhancing Governance for Financial Institutions" are entertained in the research and educational columns respectively. Short Amharic poems are also part of this publication.
Have a pleasant reading!

International Monetary and Financial Committee

Twenty-third meeting

Statement by Honorable Takelewold Atnafu

Governor National Bank of Ethiopia

The 23rd meeting of the International Monetary and Financial Committee (IMFC) was held at the IMF Head quarters In Washington D.C. on April 16, 2011. On the occasion, H.E. Ato Teklewold Atnafu, Governor of the National Bank of Ethiopia (NBE), made a statement on behalf of the Africa Group 1 constituency which encompasses 21 African countries. In his statement, the Governor highlights the global economic and financial developments, economic and financial developments in Sub-Saharan Africa, global challenges, global solutions and the role of the IMF in low income countries as well as quota and governance reforms. He also underscored the impact of rising food and oil prices on low income countries (LICS).

The statement by H.E. Ato Teklewold Atnafu is presented as follows.

On behalf of Angola, Botswana, Burundi, Eriteria, Ethiopia, the Gambia, Kenya, Lesotho, Liberia, Malawi, Mozambique, Namibia, Nigeria, Sierra Leone, South Africa, Sudan, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe.

Photo File

H.E. Ato Takelewold Atnafu, Governor of NBE

A. Global economic and financial developments

We are encouraged that the global economic recovery is gaining strength, although economies are recovering at different speeds, owing to regained private consumption in advanced economies, reduced excess capacity in emerging and developing economies, improved market confidence, and strengthened financial conditions.

Notwithstanding these achievements, we call on the international community to steadfastly maintain cooperation in policy response, and to resolutely address the following emerging challenges. We urge the advanced economies to tackle the problem of high unemployment within the framework of appropriate fiscal consolidation efforts and sustained growth in domestic demand. Likewise the emerging and developing economies should tackle youth unemployment which has been associated with social unrest. Further we call on the advanced economies to enhance policy coordination in managing and reducing high sovereign and banking risks that continue to undermine achievement of sustainable financial stability. On the challenges of global rebalancing, we urge the Fund to take a proactive role in advancing dialogue on the appropriate and coordinated policy measures in this respect with the view of creating conditions for a sustained global growth.

B. Economic and financial developments in sub-Saharan Africa

Following the brief interruption of sub-Saharan Africa's (SSA) economic expansion of the last decade by the global economic and financial crisis, output growth in most of the region's economies has recovered to pre-crisis levels. This is largely due to strong pre-crisis macroeconomic policy buffers which enabled countries to pursue countercyclical policies, aided by positive terms of trade and robust domestic demand growth. However, growth prospects within the region differ considerably. Output growth in the region's low income countries as of this year reverted to the average growth rates that prevailed during the first eight years of the new millennium while economic recovery in the oil exporting countries will be entrenched by the current strengthening of global oil prices. However, recovery in the region's middle income countries remain subdued with output gaps not likely to narrow in the near-term. In spite of the promising growth outlook, the combined effects of the 2008 food and energy price hikes and the subsequent global recession, have degraded the region's progress towards closing its huge infrastructure gap and meeting the MDGs.

The outlook is blurred by near-term challenges that could potentially threaten the impressive growth prospects for the region. A potential turn for the worse in Europe, in particular, could adversely impact economic activity in many countries of the region as Europe still remains their main trading partner. Furthermore, a prolonged and larger-than-anticipated increase in food and energy prices could have adverse implications for the oil-importing countries with major social and fiscal costs. Thus, though the growth outlook for the region is promising, we consider that SSA countries should implement appropriate fiscal and monetary policies to address the near-term challenges that threaten the region's good economic performance.

C. Global challenges, Global Solution: the Role of the IMF

The global financial and economic crisis challenged our practice of macroeconomic policy, shared benefits of globalization, relevance of policy coordination in enhancing macroeconomic stability and supporting growth, and the link between the macro economy and the financial sector. Although we have taken key steps to reverse the crises and support the recovery, the recent trends suggest that sustained effort in these areas by all countries and key institutions is needed to ensure sustained growth momentum going forward. We see IMF playing a key role in supporting the growth process through its strengthened financing and policy advice.

To that end, we share the view that jobless growth in all economies is not self-sustaining as growing fiscal risks and social unrest threatens macroeconomic stability. The persistently high unemployment in advanced economies is complicating fiscal consolidation, thus delaying the recovery and compounding fiscal weakness. In developing economies, youth unemployment together with existing infrastructure gaps and the yet to recover external trade continue to constrain growth rates well below potential. We, in this regard, urge the Fund to proactively provide leadership, in collaboration with other institutions, in promoting inclusive growth through, inter alia, policy advice and appropriate financing.

We are aware that global rebalancing is critical in sustaining the global growth momentum and in light of this global commitment to macroeconomic policy coordination is required. As economies begin to gradually recover, unified commitment to policy coordination that featured prominently during the crisis is withering and giving rise to tensions that seems to center around global imbalances and response to capital flows. In this regard, we welcome the new Euro zone economic governance framework- "pact for the Euro"- as it enhances policy coordination. We also appreciate the efforts made so far by the IMF especially in advising on the management of capital flows and hope that it can provide a good platform for enhancing cooperation.

Although sub-Saharan Africa had limited integration with the global financial system and therefore insignificant spill covers, this is changing rapidly. We, in this regard, want to draw attention to the importance of focusing on financial sector developments in sub-Saharan Africa. There is growing South-South banking FDI, cross-listings of firms in stock markets, mobilization of funds from the bond markets by banks, government appetite for sovereign bonds with increasing demand to finance infrastructure projects from the market and the spreading of universal banks. Furthermore, "too important to fail institutions" are emerging. These provide opportunities for strengthening interconnectedness in the financial sector and without strong regulatory institutions financial stability may be compromised. In this regard, we are encouraged by the IMF's recent Vulnerability Exercise for Low Income Countries (VE-LICs), and urge that additional support measures be structured along the lines of the findings of these vulnerability assessments.

D. The role of the Fund in the Low Income Countries (LICs)

On broader context, the IMF should continue to focus on its core areas of expertise as well as be more responsive to the financing needs of LICs. Accordingly, as LICs endeavor to improve their economic management, and take advantage of the opportunities for global trade and financial flows, the IMF must stand ready to support these efforts through its policy support and financing instruments. We, in this regard, consider the rapid response of the IMF in overhauling its concessional lending facilities for LICs that created a new architecture of flexible and tailored facilities as an important milestone towards achieving this goal.

It is in this spirit, and in light of the changing global challenges and solutions noted above, that we strongly urge the Fund to sharpen its role in LICs well beyond its pre-crisis interventions by further adapting its toolkit to the new financing needs. To that end, we call for the scaling up of resources in Fund lending arrangements with LICs, enhancement of the access levels, and the extension of an interest free moratorium for another three years. Furthermore, it is imperative that low income countries facing high and unsustainable debt burdens benefit from a comprehensive debt relief process. We also ask for the support of Governors on the use of the bulk of the windfall profits from the sale of IMF gold to enhance the PRGT resources. Equally important is the work required to enhance and deepen the financial systems in LICs. This is essential for the proper functioning of monetary policy, development of financial markets, and the promotion of growth and poverty alleviation. The Fund's enhanced technical assistant (TA) in these critical areas would be valuable.

Additionally, the Fund's collaboration with donors is critical, particularly in dealing with the needed financial support to LICs for achieving the MDGs. In this regard, the issue of volatility of aid, tightening of disbursement standards and attendant delays, non-uniformity of disbursement procedures, and a layer of conditionalities, all of which can undermine the success of a financial program in LICs need to be re-examined, going forward. In light of this, the Fund should continue to play a catalytic role and proactively address these deficits. Furthermore, a special committee that was set up to study the impact of the 2008 fuel and food price increases on LICs should be revived and strengthened, given that fuel and food price hikes are once again in record territories and are becoming permanent fixtures on the global economic landscape. Finally, we welcome the improvement in the provision of TA by making it more collaborative and more regional through the strengthening of AFRITACs. We urge that the decision to eliminate charges for TA should be a permanent feature.

E. Quota and governance reforms

Quota reform

We welcome the December 2010 agreement by all members to double the Fund's total quota shares. This maintains the quota-based nature of the Fund, and ensure its ability to serve its membership in times of crisis. We, in this regard, invite all members to quickly consent to the respective quota share increases to enable the increase in quotas to be come effective within the prescribed timeline-by December 31, 2011.

We also welcome the agreement on a major realignment of quota shares among members that will result in a shift of more than 6 percent of quota shares to dynamic emerging market and developing countries (EMDCs) and more than 6 percent from over-represented to under-represented countries. This notwithstanding, we are disappointed by the smaller shift from the advanced economies to dynamic EMDCs of about 2.4 percent, leaving a disproportionate burden of the realignment of over 3.6 percent to be borne by other EMDCs including 19 members that are PRGT- eligible. As a result, the affected countries have become diminished partners. We, therefore, urge all member to pursue a more balanced realignment at the forthcoming 15th general review of quotas.

Quota formula- We welcome the agreement for the immediate start of the comprehensive review of the current quota formula and for completing this review by January 2013. The critical weaknesses in the quota formula was well acknowledged by all Governors in their 2008 Resolution 63-2 and further observed during the 14th general review of quotas. We therefore underscore the need for an early start in the review of the quota formula, and for the IMFC to be kept abreast of the progress and the need for Ministerial guidance starting with the 2011 Annual Meetings.

Governance reform

We welcome the membership's commitment to maintain the Executive Board size at 24 and an agreement on an all-elected Board. To that end, we urge the membership to swiftly ratify the proposed amendment to the Articles of Agreement for all Executive Directors to be elected.

3rd chair for SSA- The decision by the Advanced European countries to reduce their combined Board representation by two chairs in favor of a greater voice and representation of developing countries is a commendable development. We urge all membership to support an increase in the number of developing country Executive Directors to achieve the objective of improving the voice and representation of these countries.

It is in this spirit that we continue to pursue a third Chair for Sub-Sharan Africa at the fund. As we have stated in the past, our request seeks to address more effectively the representation deficit of our region and, therefore, the workload of the current two chairs. We seek support from all members that one of the chairs to be released by the advanced European countries be for SSA.

We wish to further recall SSA's pursuit for a collective and coordinated representation at the BWIs. As stated in the past, the decision by the Board of Govenrors at the World Bank presents an opportunity for the region to enhance its representation, but also poses challenges in the event parity in the representation at the BWIs is not maintained. While we acknowledge the different mandates of the BWIs, we can not deny the historical parallelism that has been maintained over the years, including many elements with respect to representation. We, therefore, continue to call on the support of Governors for our pursuit for a third chair.

Outstanding governance reforms

IMFC reform process- While we fully reaffirm our support for strengthening the IMFC as a vehicle for enhancing Ministerial engagement, we remain unconvinced that we are close to seeing the IMFC as the vehicle for IMF governors' involvement in the strategic oversight of the IMF. While we were encouraged by the earlier decisions to adjust the IMFC meetings and deliberations to meet this objective, we reiterate our concerns over the holding of the IMFC and DC meetings on the same day and over the narrow scope of the IMFC agenda setting. We urge that a forum for effective Ministerial engagement building on the current informal restricted session be strengthened. We share the view that the IMFC communiqué should reflect the discussions and conclusions of the members. We see these as reforms that will enhance the role and engagement of Ministers in providing strategic guidance to the fund.

Selection of Fund Management

Reaffirming our strong support for the proposals for a transparent, non-region-specific process for selecting the Fund's management, we call for progress on this front in view of the approaching election cycle.

የብድር ጣሪያ መነሣትን እና በተመረጡ የልማት ዘርፎች የንግድ ባንኮችን ተሳትፎ ለማሳደግ የሚወሰዱ እርምጃዎችን በተመለከተ የተሰጠ መግለጫ

የኢትዮጵያ ብሔራዊ ባንክ

መግቢያ

ይህ መግለጫ መንግሥት ከመጋቢት 26፣ 2003 ጀምሮ ተግባራዊ እንዲሆኑ በወሰናቸው ሁለት አበይት ጉዳዮች ማለትም:-

ሀኛ/ በንግድ ባንኮች ላይ ተጥሎ የነበረው የብድር ጣሪያ ስለመነሣቱ፣ እና

ለኛ/ ባንኮች የረዥም ጊዜ የልማት ፕሮጀክቶች ፋይናንስ በማድረግ ረገድ የሚኖራቸውን ድርሻ ለማጐልበት በተወሰደው እርምጃ ላይ ያተኮሩ ናቸው፡፡

1. የንግድ ባንኮች የብድር ጣሪያ መነሣቱን በተመለከተ

እንደሚታወሰው ከሁለት ዓመት በፊት የኢትዮጵያ ብሔራዊ ባንክ በወቅቱ የተከሰተውን የዋጋ ንረት ለማርገብ ሲል ቀጥተኛ የገንዘብ ፖሊሲ መሣሪያ (direct monetary policy instrument) የሆነውን በባንኮች ላይ የብድር ጣሪያ ጥሎ ነበር፡፡ በተደጋጋሚ ይገለፅ እንደነበረው በወቅቱ ተከስቶ የነበረው የዋጋ ንረት ሁለት ዋና ዋና ዓለምአቀፋዊ እና አገራዊ ይዘቶች ያሏቸው ምክንያቶች ነበሩት፡፡ እነዚህም:-

ሀኛ/ ከምስራቅ እስያ አገሮች በተለይ ከህንድና ቻይና ፈጣን ዕድገት ጋር ተያይዞ የምግብ፣ የነዳጅ፣ የብረት እና ተጓዳኝ የግንባታ ዕቃዎች ዋጋ በከፍተኛ መጠን መናርን ተከትሎ ወደ ሀገር ውስጥ በሚገቡና በኤክስፖርት መልክ ውጭ በሚላኩ የግብርና ምርቶች ላይ የዋጋ ንረት ማስከተሉ፣ እና

ለኛ/ በአገራችን ለተከታታይ ዓመታት የተመዘገበው ከፍተኛ የኢኮኖሚ ዕድገት አጠቃላይ የምግብ ሰብል እና የምርት ግብዓቶችን ፍላጐት በማሳደግ የዋጋ ንረት እንዲባባስ ማድረጉ ናቸው፡፡

በመሆኑም በወቅቱ የተከሰተውን የዋጋ ንረት ለመቋቋም መንግሥት ሦስት ዋና ዋና እርጃዎችን ወስዷል፡፡

1ኛ/ <u>የመንግሥት በጀት ጉድለትን መቆጣጠር፡፡</u> የመንግሥት የበጀት ጉድለት ከጠቅላላ የሀገር ውስጥ ምርት 2.0 በመቶ በታች እንዲሆን ከመደረጉም በተጨማሪ ከኢትዮጵያ ብሔራዊ

ባንክ ለበጀት ጉድለት መሸፈኛ እንዲሆን በሚወሰደው ብድር መጠን ላይ ገደብ ጥሏል፡፡

2ኛ/ ጥብቅ የሆኑ የገንዘብ ፖሊሲ እርምጃዎችን (Tight Monetary Policy) መውሰድ፡፡

በገንዘብ ፖሊሲ ረገድ የተወሰዱት ዕርምጃዎች ሦስት ሲሆኑ እነሱም፡-

ሀ/ የባንኮችን መጠባበቂያ (reserve requirement ratio) እና ገንዘብ አከል ተቀማጭ (liquidity requirement ratio) ከፍ ማድረግ፡፡

ንግድ ባንኮች በብሔራዊ ባንክ እንዲያስቀምጡ የሚገደዱት መጠባበቂያ ከጠቅላላው የተጣራ ተቀማጫቸው (total net deposits) በመጀመሪያ ከ5 በመቶ ወደ 10 በመቶ፣ ከዚያም ወደ 15 በመቶ ከፍ እንዲል ተከታታይ እርምጃ የተወሰደ ሲሆን፣ ገንዘብ አከል ተቀማጫቸውም (liquidity requirement) ከጠቅላላው ወቅታዊ ተቀማጭ (total net current deposits) ከ15 በመቶ ወደ 25 በመቶ ከፍ እንዲል ሆኗል፡፡

ለ/ የግምጃ ቤት ሠነድ በሰፊው መሸጥ

የመንግሥት የበጀት ጉድለት ፋይናንስ ከማድረግ በተጨማሪ በባንኮች እጅ ያለውን ትርፍ ተቀማጭ ገንዘብ ለመሰብሰብ ተጨማሪ የግምጃ ቤት ሰነድ እንዲሸጥ በማድረግ በባንኮች እጅ የነበረውን ትርፍ ተቀማጭ ገንዘብ (excess reserves) ወደ ብሔራዊ ባንክ እንደሰበሰብ ተደርጓል፡፡

ሐ/ በንግድ ባንኮች ላይ የብድር ጣሪያ (credit ceiling) ማስቀመጥና ተግባራዊነቱን በየወሩ መቆጣጠር፡፡

እያንዳንዱ ባንክ በበጀት ዓመቱ ውስጥ ምን ያህል ማበደር እንደሚገባው ተሰልቶ ጣሪያ በማስቀመጥ የገንዘብ አቅርቦት ዕድገትን ለመቆጣጠር ተችሏል፡

3ኛ/ አቅርቦትን ማሳደግ (supply side measures)

በዚህ ረገድ መንግሥት ዋና ዋና የፍጆታና የኢንቨስትመንት ግብዓቶች ሊሆኑ ይችላሉ ያላቸውን ሲሚንቶ፣ የምግብ ዘይት፣ ስንዴ፣ ስኳር እና የመሳሰሉትን ሸቀጦች ወደ ሀገር ውስጥ ከማስገባት እና በተመጣጣኝ ዋጋ ለገበያ ከማቅረብ በተጨማሪም በሀገር ውስጥ የሚመረቱ በቆሎ፣ ጤፍ፣ እና አንዳንድ የእህል ምርቶች ወደ ውጭ እንዳይላኩ ጊዜያዊ ገደብ በመጣል በነዚህ ምርቶች ላይ ተከስቶ የነበረውን የዋጋ ንረት ለማርገብ ተችሏል፡፡

መንግሥት ከላይ የተዘረዘሩትን ዕርምጃዎች በመውሰዱ ምክንያት ዓመታዊ አማካይ የዋጋ ንረት በ2001 የበጀት ዓመት ከነበረበት 36.4 በመቶ በ2002 የበጀት ዓመት መጨረሻ ወደ 2.8 በመቶ ሊወርድ ችሏል፡፡ በተመሳሳይ፣ አማካይ ዓመታዊ የምግብ ዋጋ ንረት ከ44.3 በመቶ ከዜሮ በታች ወደ 5.4 በመቶ ወርዷል፡፡

በ2003 የበጀት ዓመት የዋጋ ንረት ግብም ከነጠላ አሃዝ እንዳይበልጥ ማድረግ በመሆኑ ይህንን ግብ እንዳይጣስ መንግሥት በትኩረት እየሠራ ነው፡፡ ይህንንም ለማረጋገጥ መንግሥት ከአራት አቅጣጫ እርምጃዎችን በመውሰድ ላይ ይገኛል፡፡

(1) የበጀት ጉድለት ከአጠቃላይ አገራዊ ምርት ከ1.5 በመቶ እንዳይበልጥ ማድረግ፡፡ ከዚህም ውስጥ የኢትዮጵያ ብሔራዊ ባንክ የፋይናንስ ድርሻ ከ¼ ያልበለጠ ሆኖ ቀሪው ¾ በመቶ ሰነድ በመሸጥ የሚሸፈን ይሆናል፡፡

(2) የገንዘብ ፖሊሲያችን ለዋጋ ንረት የማያጋልጥ ሆኖ እንዲቀጥል ማድረግ፡፡

የገንዘብ ዕድገት ከሀገር ውስጥ ምርት ዕድገትና ከኢኮኖሚው የመሻሻል ሂደት ጋር የተጣጣመ ተደርጐ የተቀረፀ ሲሆን፣ ይህም በተቀመጠለት ግብ መሠረት እየተከናወነ ይገኛል፡፡

(3) የንግድ ሥርዓቱን ማስተካከል፡፡

ጥቂት ወራት ወዲህ በአገራችን መጠነኛ የዋጋ

ንረት እየተስተዋለ ይገኛል፡፡ ለዚህም ክስተት በዋናነት የሚጠቀሱት የነጋዴዎች አላግባብ ትርፍ መፈለግ (oligopolistic behavior) ሲሆን፣ ይህንም ለመከላከል መንግሥት በገበያ ውድድር እና በፈቃድ አሰጣጥ ላይ ያተኮሩ ሁለት አዋጆችን አውጥቶ ተግባራዊ በማድረግ ላይ ነው፡፡

(4) <u>አቅርቦትን ማሻሻል</u>፡፡

በአቅርቦት በኩል እንደ ዘይት፣ ሲሚንቶ እና ስኳር ያሉ ሸቀጦችን ወደ ሀገር ውስጥ አስገብቶ በተመጣጣኝ ዋጋ ለህብረተሰቡ እያከፋፈለ ይገኛል፡፡

በጥቅሉ፣ በአሁኑ ጊዜ መንግሥት የዋጋ ንረትን ለመቆጣጠር እየወሰደ ያለው እርምጃ ውጤታማ በመሆኑና በባንኮች ላይ ተጥሎ የነበረው የብድር ጣሪያ መቀጠሉ አስፈላጊ ሆኖ ስላላገኘው፣ ከዛሬ መጋቢት 26 ቀን 2003 ዓ.ም ጀምሮ በባንኮች ላይ ተጥሎ የነበረው የብድር ጣሪያ ተነሥቷል፡፡

II. በተመረጡ የልማት ዘርፎች የባንኮችን ተሳትፎ ለማጐልበት የሚወሰደውን እርምጃ በተመለከተ

እንደሚታወቀው በሚቀጥሉት አምስት ዓመታት በሁሉም ዘርፎች ከፍተኛ ጠቀሜታ ያላቸውን የልማት ፕሮጀክቶች ያካተተ የአምስት ዓመት የዕድገትና የትራንስፎርሜሽን ዕቅድ መንግሥት አውጥቷል፡፡ ይህንን ዕቅድ ተግባራዊ ለማድረግ ደግሞ ከፍተኛ ፋይናንስ የሚጠይቁ የግልና የመንግሥት ኢንቨስትመንት ፕሮጀክቶች እንደሚሆኑ ይጠበቃል፡፡ እነዚህን ፕሮጀክቶች ፋይናንስ ለማድረግ መንግሥት የተለያዩ የሀገር ውስጥ ቁጠባን የሚያሳድጉ ስልቶችን ቀይሶ ተግባራዊ በማድረግ ላይ ነው፡፡ ከዚህም አንዱ አበረታች ውጤት ተገኝቷል፡፡

ከዚህ ጋር ተያይዞ የሌሎች ታዳጊ አገሮችን ልምድ ጨምሮ በሀገራችን ያለውን እውነታ ስንዳስስ ከ90 በመቶ በላይ የሚሆነውን ለኢንቨስትመንት የሚውል የቁጠባ ገንዘብ የሚያሰበስቡት ባንኮች ናቸው፡፡ ይሁን እንጂ ባንኮች ከሚሰበስቡት የቁጠባ ገንዘብ ከ90-95 በመቶ የሚሆነውን የሚያውሉት ንግድ እና ተዛማጅ ሥራዎችን ፋይናንስ ለማድረግ በመሆኑ ለሀገር ዕድገት ከፍተኛ ጠቀሜታ ያላቸው የልማት ፕሮጀክቶች (long-term development projects) በቂ ፋይናንስ እያገኙ አይደለም፡፡ በዚህም የተነሣ መንግሥት ባንኮች የረጅም ጊዜ ኢንቨስትመንትን ፋይናንስ በማድረግ ረገድ በመሳተፍ ለአምስት ዓመቱ የዕድገትና ትራንስፎርሜሽን ዕቅድ ዕውን መሆን የራሳቸውን አስተዋጽኦ ማድረግ የሚችሉበተን ስልት ቀይሷል፡፡ ይህም ስልት በሌሎች ሀገራት የሚሠራበትን ልምድ በማየት ከአገራችን ነባራዊ ሁኔታ ጋር እንዲጣጣም ተደርጐ የተዘጋጀ ነው፡፡

በዚህ መሠረት ከመጋቢት 26፣ 2003 ዓ.ም ጀምሮ ባንኮች ጠቅላላ ከሚሰጡት ብድር (total new loan disbursement) ውስጥ 27 በመቶውን በተመረጡ የረዥም ጊዜ የግልና የመንግሥት የልማት ፕሮጀክቶች ላይ እንዲያውሉ ተወስኗል፡፡ እንደአስፈላጊነቱ የኢትዮጵያ ብሔራዊ ባንክ ይህንን ጥምርታ ከፍ ሊያደርገው ይችላል፡፡

በዚህ ጉዳይ ላይ ሁሉም የመንግሥትና የግል ባንኮች ፕሬዚዳንቶች እና ከፍተኛ የሥራ ኃላፊዎች በተገኙበት ውይይት ተደርጎ ስምምነት ላይ ተደርሷል፡፡ በተለይ በአሁኑ ጊዜ ኢትዮጵያ በዐባይ ወንዝ ላይ ለመሥራት ያሰበችው ከፍተኛ የኃይል ማመንጫ ፕሮጀክት ሙሉ በሙሉ በራሷ ወጪ የሚሸፈን በመሆኑ የሁሉም ባንኮች ኃላፊዎች መንግሥት ከአገር ውስጥ ቁጠባ ለማሰባሰብ እየወሰደ ያለውን እርምጃ በሙሉ ልብ እንደሚደግፉ ገልጸዋል፡፡

አሠራሩን በተመለከተ፡-

1ኛ/ የ 5 ዓመት የኢትዮጵያ ብሔራዊ ባንክ ሰነድ የተዘጋጀ ሲሆን ፣ ባንኮች በየወሩ በብድር ከሚሰጡት ገንዘብ ውስጥ 27 በመቶውን ሰነዱን እንዲገዙበት ይደረጋል፡፡

2ኛ/ ብሔራዊ ባንክ ሰነዱን ለያዙ ባንኮች በዓመት 3 በመቶ ወለድ ይከፍላል፡፡

3ኛ/ የተሰበሰበውን ገንዘብ ወደ ኢትዮጵያ ልማት ባንክ በብድር መልክ ፈሰስ በማድረግ ለትላልቅ የግልና የመንግሥት ኢንቨስትመንት ፕሮጀክቶች እንዲውል ይሆናል፡፡

ባንኮች ይህንን ሰነድ በመግዛታቸው ሀገራችን እያካሄደች ላለችው የ5 ዓመቱ የዕድገትና ትራንስፎርሜሽን ዕቅድ ትግበራ መሣካት አስተዋጽኦ ከማበርከታቸው በተጨማሪ ሀገራችን ከምታስመዘግበው ፈጣን ዕድገት ዋነኛ ተጠቃሚዎችም እራሳቸው መሆናቸው ግልፅ ሊሆን ይገባል፡፡

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መጋቢት 2003

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LICENSING AND SUPERVISION OF BANKING BUSINESS

Customer Due Diligence of Banks
Directives No. SBB/46/2010

WHEREAS, sound know your customer policies and procedures constitute an essential part of internal control and risk management aspects of banks;

WHEREAS, there is a need to strengthen internal control and risk management systems of banks to prevent them from exposure to undue reputational, operational, legal and concentration risks that may result from abuse of money launderers and terrorist financiers;

WHEREAS, conducting customer due diligence is a key part of customer identification, internal control and risk management of banks;

WHEREAS, there is a need to ensure that banks have sound policies, procedures and controls in place that enable them to identify their new and existing customers ;

Now, therefore, in accordance with article 53 of Banking Business Proclamation Number. 592/2008 and articles 3(2) and 3(3) of Prevention and Suppression of Money Laundering and Financing of Terrorism Proclamation number 657/2009, `the National Bank of Ethiopia hereby issues these directives.

1. Short Title

These directives may be cited as "Customer Due Diligence of Banks Directives No. SBB/46/ 2010".

2. Definitions

For the purpose of these directives, unless the context provides otherwise:

1) "beneficial owner" refers to the natural person(s) who ultimately owns or controls a bank customer, in case the customer is legal person or arrangement, and/or the person on whose behalf a transaction is being conducted;

2) "correspondent banking" is the provision of banking services by one bank (the correspondent bank) to another bank (the respondent bank);

3) "cross-border transfer" means any wire transfer where the originator and beneficiary persons are located in different jurisdictions at the time of initiating the transfer. This term also refers to any chain of wire transfers that has at least one cross-border element;

4) "domestic transfer" means any wire transfer where the originator and beneficiary persons are located in the same jurisdiction at the time of initiating the transfer. This term, therefore, refers to any chain of wire transfers that takes place entirely within the borders of a single jurisdiction, even though the system used to effect the wire transfer may be located in another;

5) "high risk categories" means customers, businesses or transactions that need to be subjected to more regular reviews, particularly against the know-your-customer information held by the bank and the activity in the account. Such categories shall include, but not be limited to:

   (a) complex, unusual or large transactions,
   (b) relationships or transactions with countries known to have material deficiencies in anti money laundering and terrorist financing strategies,
   (c) politically exposed persons,
   (d) non-resident customers such as those staying in the country for less than one year or those in short visit or travel,
   (e) legal persons or arrangements such as trusts that are personal asset holding vehicles, and
   (f) Companies that have shares in bearer form;

6) "Legal person" refers to a body corporate, foundation, partnership, non-profit organization or association, or any similar body that can establish customer relationship with a bank or other financial institution, or otherwise own property;

7) "Money laundering" shall have the meaning ascribed under article 2(10) of the Proclamation to provide for Prevention and Suppression of Money Laundering and Financing of Terrorism number 657/2009;
8) "Originator" is bank account holder, or where there is no account, the person that places an order with the bank or other financial institution to perform the wire transfer;
9) "Payable-through accounts" refers to correspondent accounts that are used directly by third parties to transact business on their own behalf;
10) "person" means any natural or juridical person;
11) "politically exposed persons"are individuals in a foreign country who are or have been entrusted with senior government functions, such as heads of state or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials;
12) "Shell bank" means a bank that has no physical presence in the country in which it is incorporated and licensed, and which is unaffiliated with a regulated financial services group that is subject to effective consolidated supervision.
13) "senior management" means a team of executives at the highest level who have the day-to-day responsibilities of managing a bank as defined by each bank;
14) "terrorist financing" means an offence defined under article 5(1)(d) of Anti-Terrorism Proclamation number 652/2009;
15) "wire transfer" refers to any transaction carried out on behalf of an originator person through a bank or other financial institution by electronic means with a view to making an amount of money available to a beneficiary person at another bank or financial institution. The originator and the beneficiary may be the same person.

3. Customer Acceptance Policy, Procedure, and Compliance Arrangement

a. Banks shall establish and maintain internal procedures, policies and controls to prevent money laundering and terrorist financing, and communicate these to their employees and the National Bank of Ethiopia; at a minimum these procedures, policies and controls shall cover:

a) explicit criteria for identification and acceptance of customers,
b) appropriate risk management systems to determine whether a potential customer, an existing customer or beneficial owner is a politically exposed person or high risk categories of customers,
c) record retention techniques, methods and period ;
d) unusual and suspicious transactions detection, techniques, methods and the reporting obligation;

e) measures to be taken to prevent the misuse of technological developments in money laundering or terrorist financing schemes; and
f) specific risks associated with non-face to face business relationships or transactions.

b. Banks shall develop appropriate compliance management arrangements which at a minimum include:

i. designation of a compliance officer at the management level; and
ii. ensure application of all laws related to anti-money laundering and combating terrorist financing; these directives; and internal policies, procedures and controls when establishing customer relationships and conducting ongoing due diligence.

c. Banks shall maintain an adequately resourced and independent internal audit function to test compliance with laws; directives of the National Bank of Ethiopia; and internal policies, procedures and controls.

4. Customer Identification and Due Diligence

1) banks may not keep anonymous accounts or accounts in fictitious names;
2) Banks shall not enter into, or continue, correspondent banking relationships with shell banks.
3) Banks shall undertake customer due diligence measures when:
   i. establishing business relations with a customer;
   ii. carrying out occasional cash transaction with a customer, which at a minimum exceeds Birr 200,000, USD 10,000 or equivalent in other foreign currencies; this shall include situations where the transaction is carried out in a single operation or in several operations that appear to be linked or structured;
   iii. there is a suspicion of money laundering or terrorist financing, regardless of any exemptions or thresholds that are referred to under these directives; and
   iv. they have doubts about the veracity or adequacy of previously obtained customer identification data.
4) Banks shall identify the customer, whether regular or occasional, natural or legal person or legal arrangement, and verify that customer's identity using as much as possible reliable, independent source documents, data or information.
5) Identification requirements for natural persons shall include, at a minimum:
   a) given or legal name and all other names used;
   b) permanent address;
   c) telephone number, fax number and e-mail address, if available;

d) date and place of birth, if possible;
e) nationality;
f) occupation, public position held and/or name of employer;
g) type of account; and
h) signed statement certifying accuracy of the information provided.

6) For customers that are legal persons or legal arrangements, banks shall:
   a) take reasonable measures to understand the ownership and control structure of the customer and determine who the natural persons that ultimately own or control the legal person or arrangement are; this shall include those natural persons who exercise ultimate effective control over the legal person or arrangement;
   b) verify that any person purporting to act on behalf of the customer is so authorized, and identify and verify the identity of that person;
   c) verify the legal status of the legal person or legal arrangement at a minimum by obtaining proof of incorporation or similar evidence of establishment or existence and information concerning the legal person's or legal arrangement's :
      i. name,
      ii. legal form,
      iii. some form of official identification number such as tax identification number (if available),
      iv. address which includes country, city/town/kebele in which the head office is located and if available, house number, mailing address, telephone number and fax number,
      v. names of directors, if applicable, and the chief executive officer,
      vi. provisions regulating the power to bind the legal person or arrangement;
      vii. the resolution of the board of directors (if applicable) or any other authorized body or person to open an account; and
      viii. identification of those who have authority to operate the accounts.

7) In carrying out transactions with any person, a bank shall identify the ultimate beneficial owner and take reasonable measures to verify the identity of the beneficial owner using relevant information or data obtained from a reliable source such that the bank is satisfied that it knows who the beneficial owner is; particularly, for all customers, the bank shall determine whether the customer is acting on behalf of another person, and shall then take reasonable steps to obtain sufficient identification data to verify the identity of that other person.

8) Establishment of a bank's new business relationship with a politically exposed person shall be approved by a senior management member of the bank.
9) Where a customer has been accepted and the customer or beneficial owner is subsequently found to be, or subsequently becomes a politically exposed person, continuation of business relationship with such person shall be approved by a senior management member of the bank.
10) Banks shall take reasonable measures to establish the source of wealth and the source of funds of customers and beneficial owners identified as politically exposed persons.
11) Banks shall obtain information on the purpose and intended nature of the business relationship.
12) Banks shall perform enhanced due diligence on high risk categories of customers, business relationships or transactions.
13) Banks shall give special attention to business relationships and transactions with persons, including legal persons and other financial institutions, from or in countries which do not or insufficiently apply anti-money laundering and combating terrorist financing laws.

5. Account Monitoring

1) Banks shall conduct ongoing due diligence measure on existing customers and business relationships, including scrutiny of transactions undertaken throughout the course of that relationship, to ensure that:

    a) the transactions being conducted are consistent with the bank's knowledge of the customers, their business and risk profile, and where necessary, the source of funds; and

    b) documents, data or information collected under the due diligence process is kept up-to-date and relevant by undertaking reviews of existing records, particularly for higher risk categories of customers or business relationships.

2) Where banks are in a business relationship with a politically exposed person, they shall conduct enhanced ongoing monitoring.
3) Banks shall pay special attention to all complex, unusually large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose such as significant transactions relative to a relationship, transactions that exceed certain limits, very high account turnover inconsistent with the size of the balance, or transactions which fall out of the regular pattern of the account's activity.

4) Banks shall examine as far as possible the background and purpose of transactions specified under sub article 5.3 herein above and set forth their findings in writing.

6. Cross Border Correspondent Banking

1) With respect to cross-border correspondent banking and other similar relationships, banks, in addition to performing normal customer due diligence measures, shall:
   a) gather sufficient information about a respondent institution to understand fully the nature of the respondent's business and to determine from publicly available information the reputation of the institution and the quality of supervision, including whether it has been subject to a money laundering or terrorist financing investigation or regulatory action;
   b) assess the respondent institution's anti-money laundering and combating terrorist financing controls, and ascertain that they are adequate and effective;
   c) obtain approval from a senior management member of the bank before establishing new correspondent relationships; and
   d) document the respective anti-money laundering and combating terrorist financing responsibilities of each institution;

2) Where a correspondent relationship involves the maintenance of "payable-through accounts", banks shall be satisfied that:
   a) their respondent financial institution has performed all the normal customer due diligence obligations set out in these directives on those of its customers that have direct access to the accounts of the correspondent financial institution; and
   b) the respondent financial institution is able to provide relevant customer identification data upon request to the correspondent bank.

3) Where a correspondent bank fails to comply with national anti-money laundering and combating terrorist financing laws, banks shall not open an account, commence business relations or perform transaction or shall terminate the business relationship with such correspondent financial institutions, and shall consider making a suspicious transaction report in relation to correspondent financial institutions.
4) Banks shall satisfy themselves that respondent financial institutions in foreign countries do not allow business relationship with shell banks.

7. Wire Transfers

1) For all wire transfers, of Birr 10,000 or USD 1000 or more, ordering banks shall be required to obtain and maintain the originator's:
   a) full name,
   b) account number or a unique reference number, if no account number exists,

c) complete address, and
d) date and place of birth (if possible).

2) For cross-border wire transfers of USD 1,000 or more or for domestic transfers of Birr 10,000 or more, the ordering financial institution or bank shall be required to include full originator information in the message or payment form accompanying the wire transfer.
3) Where several individual cross-border wire transfers of USD 1 000 or more from a single originator are bundled in a batch file for transmission to beneficiaries in Ethiopia, the ordering foreign financial institution only needs to include the originator's account number or unique identifier on each individual cross-border wire transfer, provided that the batch file (in which the individual transfers are batched) contains full originator information that is fully traceable.
4) Banks shall adopt effective risk-based procedures for identifying and handling wire transfers that are not accompanied by complete originator information.

8. Exemptions

1) Identification of a customer does not need to be verified where the customer is itself a regulated bank or other financial institution that is subject to anti-money laundering and combating terrorist financing laws and regulations;
2) Credit and debit card transactions are exempted from standard customer due diligence, provided that they are not used as a payment tools to effect a money transfer.

9. Record Keeping

1) Banks shall maintain all necessary records on transactions, both domestic and international, as stipulated in Ethiopian National Archives and Library Proclamation No. 179/1999.
2) Transaction records to be maintained by banks shall be sufficient to permit reconstruction of individual transactions so as to provide, if necessary, evidence for prosecution of criminal activity.
3) Banks shall ensure that all customer and transaction records and information are available on a timely basis to the National Bank of Ethiopia and other competent law enforcement authorities.

10. Reporting

A bank shall report to Financial Intelligence Center of Federal Democratic Republic of Ethiopia

1) when it suspects or has reasonable grounds to suspect that funds are the proceeds of a criminal activity;
2) where there are reasonable grounds to suspect that funds are linked or related to, or to be used for terrorism, terrorist acts or by terrorist organizations or those who finance terrorism;
3) all cash deposits or withdrawals exceeding Birr 200,000 and/or USD 10,000 or its equivalent in other foreign currency; and
4) all suspicious transactions, including attempted transactions regardless of the amount of the transaction.

11. Training programs

1) Banks shall establish ongoing employee training programs which at a minimum incorporate:
   a) responsibilities under the bank's arrangements for money laundering and terrorist financing prevention;
   b) policies, procedures controls and practices for obtaining identification evidence; applying "know your customer" standard; account monitoring; enhanced due diligence; record keeping; and reporting knowledge or suspicion of money laundering and terrorist financing;
   c) audit function to ensure the bank's compliance with anti-money laundering and combating terrorist financing laws, directives, and internal policies and procedures;
   d) domestic laws and bank standards related to money laundering and terrorist financing;
   e) relevant typologies of money laundering and terrorist financing; and
   f) potential risks, including reputational, operational, legal and concentration risks of becoming involved in laundering the proceeds of crime or terrorist financing.

2) A bank shall provide to the National Bank of Ethiopia the dates and descriptions of all anti-money laundering and combating terrorist financing staff training events, at the beginning of each financial year of the bank.

12. Effective Date

This Directive shall enter into force as of the 4th day of March 2010.

Finance and Growth Nexus in Ethiopia

(A Causality Analysis Using Alternative Proxies)

By - Fikadu Digafie (NBE)

I. Introduction

Though it has been studied extensively in recent years, the relationship between economic growth and financial development is not a new topic. It goes back to Schumpeter (1912), who stressed the significance of financial services in endorsing economic growth.

Building on the effort of Schumpeter, various researchers (Levin 2004, Levine and Kunt 2001, Fry 1995, Roger Kelly and George Mavrotas 2003, Levine et al, 1999 etc) among others have undertaken the study on financial sector development and economic growth relationship.

This study explores the causal relationship between financial development and economic growth in Ethiopia. The main purpose of the study is to fill the research gap regarding financial development and economic growth causality issues in Ethiopia despite the area has been extensively studied since Schumpeter's attempt in 1912 both at individual countries and cross-country levels. Due to the absence of unanimous consensus on the causal relationship between economic growth and financial development as revealed by (Robinson, 1996 and Stigliitz 1994), indicated in Roger Kelly and George Mavrotas 2003 among others, pre hypothesised one way regression analysis is improper way of investigating growth-finance relationship. Many researchers are of the view that there still exists great dichotomy regarding the role of financial intermediaries in facilitating sustainable economic growth in the long-term on the one hand and economic growth's role in attracting financial development on the other hand (Cletus C. Agu and Jude Okechukwu Chukwu, 2008). Therefore, this study attempts to evaluate the causality issue between finance and economic growth that helps to understand how the country's remarkable improvements during the last two decades in both fronts relate to each other for further improvement and policy direction.

The finding of the study can help in identifying whether economic growth leads financial development to flourish or financial development leads economic growth or bidirectional causality exist in the finance-growth nexus in Ethiopia which in turn can be used as a policy instrument to make proper focus on the vital sector to achieve the final objective of sustainable economic growth and poverty alleviation. It also helps as an initial attempt and hence brings the issue forwards for further debate and investigation.

National Bank of Ethiopia's official annual time series statistics is used for this study where some five major quantitative indicators of financial sector development proxies (private credit to GDP ratio, Private credit to total domestic credit ratio, domestic credit to GDP ratio, broadly defined money supply to GDP ratio and banks' deposit liability to GDP ratio) are employed along with per capita GDP growth to see the causal relationship between those quantitative proxies of financial development and economic growth. The study employees the standard procedure of testing for causality, the Johansen co integration Test.

The rest of the paper is organized as follows. Section two assesses the theoretical debate and empirical findings on the outlook of the relationship between economic growth and financial development. Section three deals with econometric methodology, time series property of the data and findings of the study while Section four provides conclusion and recommendations.

II. Literature Review

Growth has for many years been supposed as a central issue in development economics, being viewed as an essential prerequisite for development. Omitting the role of finance, the stress of development economics has been planning and resource allocation mechanism that were taken apart from that promoted by conventional market oriented economists (Watchel 2003). Schumpeter (1912) was probably the first scholar to recognize the role of finance in innovation and production process. Followed this acknowledgment of the role of finance in economic growth by Schumpeter, a host of authors have come across with the discussion of financial intermediations contributions to economic growth (Gurley and Shaw 1955, Goldsmith 1969 and McKinnon 1973) were among others for instance as cited in Watchel 2003 .

Theoretically, it is assumed that financial intermediation promotes growth by directing resources from saver to investment projects. Based on empirical findings by authors such as (Levine, 1997; Pagano, 1993 (cited in Waqabaca 2004) and Wachlet 2002, 2003), financial intermediation plays four major roles in economic growth. Firstly, financial intermediation improves the selection of funds-seeking investors and then scrutinizes the funds-receiving investor that improves the allocation of recourses. Secondly, financial sector encourages the mobilization of savings. Thirdly, by screening and monitoring costs through economies of scale, financial intermediaries lower cost of transaction and finally, financial intermediaries provide for risk management and liquidity.

Patrick (1966) stated two possible causal relationships between financial development and economic growth on the other hand. The first is 'demand following' where the demand for financial services as dependent upon the growth of real output and upon the commercialization and modernization of agriculture and other subsistence sectors. Therefore, financial development is a response to real sector advancement and its demand for financial sector services. The second is 'supply leading' transfer resources from low-growth sector to high-growth sector and to stimulate an entrepreneur response in this modern sector. This means that, the creation of developed financial sector occurs in advance of demand for them.

Although it seems that there is theoretical consensus on the role of financial intermediation in economic growth, there is still a hot debate yet unsettled on these issues. It has been questioned by Robinson (19962) and Stigliitz (1994) whether financial system is significant in promoting economic growth. They argued that economic growth creates further demand for financial services that in turn might bring more advanced financial sector. This unsettled issue gives rise to three conflicting hypothesis about the causal relationship between economic growth and financial intermediation. The debate is on whether financial intermediation causes economic growth or economic growth causes financial intermediation with the third possibility of bidirectional causation between the two.

Various econometric examinations on the causality between financial development and economic growth have been carried out so far. Gelb (1989), Fry (1997), King and Levine (1973), Rajan and Zingales (1998), and Levine and Zeros (1998) were among others. Using national cross-sectional data, they found results that tend to support the hypothesis that the causality runs from financial advancement to economic growth, supply-leading hypothesis. Since demand-following hypothesis and bidirectional causation are also prevalent, it could be dangerous to accept generalization of finance leading growth unless prior investigation has been done as policy based on this generalization might result in wrong outcomes in any country. Study reveals that causality predominantly runs from growth to finance in Middle East and North African countries (Traelsi, 2004). Waqabaca (2004) and Ang and McKibbin (2005) carried out country case studies of Fiji and Malaysia, respectively and found that the demand-following hypothesis prevailed in both countries. Causality test undertaken by Demetriabes and Hussein (1996), for 16 developing countries revealed that there is substantial evidence of bidirectional causalities and some facts of reverse causation.

On the contrary, there are evidences that indicate the presence of weak or the absence of robust link between financial intermediation and economic growth. For instance, it is found that the causal link between economic growth and financial development is week, mostly for the smaller countries (Neusser and Kugler, 1996). Country case study of China by Chang (2002) supports neither supply-leading hypothesis nor demand-following hypothesis while Shan and Morris (2002) reject the supply-leading hypothesis but neither found the demand-following hypothesis in their study on 19 OPEC countries. Evidence obtained by Kar and Pentecost (2000) for Turkish economy revealed that different financial intermediation measures indicates different results as some proxies of financial development causes growth while growth causes finance for some proxies, evidence of sensitivity of the choice of proxies for financial development measurement.

III. Methodology

3.1 Specification of Equation

Given the conflicting hypothesis on the causality between financial intermediation and economic growth, it is common to apply Granger causality test. Furthermore, the co-integration technique initiated by Engle and Granger (1987) has an important role in testing causality. As to this technique, once a number of variables (say x and y demonstrating financial development index and real per capita GDP growth, respectively) are found to be co-integrated, there always exists corresponding error correction representation that indicates changes in the dependent variable are a function of the level of disequilibrium in the co-integration relationship. A result of co-integration is that either GDP_t or financial development (FD_t) or both must be caused by the lagged error correction term which itself is a function of GDP_{t-1}, and FD_{t-1}. Therefore, the relationship between GDP and FD can be stated in vector autoregressive (VAR) as follow:

$$y_t = \alpha_1 + \delta_1(x_{t-i}) + \psi_1(y_{t-i}) + \varepsilon_{1t}$$

(1)

$$x_t = \alpha_2 + \delta_2(x_{t-i}) + \psi_2(y_{t-i}) + \varepsilon_{2t}$$

Where:

- x is financial development indicator
- y is real per capita GDP growth
- t represents period
- i refers to number of lags

- ε refers to error term

- $\delta_1, \delta_2, \psi_1, \psi_2$ measures elasticity of change in dependent variable to changes in the explanatory variables

- α_1, α_2 are constants

In this system, FD_t granger causes GDP_t if δ_1 is statistically different from zero. Likewise, GDP_t granger causes FD_t if ψ_2 is statistically significant. In this case, causality between GDP_t and FD_t will never exist if none of the two situations is true. If both are true, there will be bidirectional causality between economic growth and financial development. However, this conventional Granger Causality Test works only if the variables are stationary at level (Eview 6 users guide, Gujarati, 1995).

If the variables involved have a unit root, there are different options to test for causality based on whether such variables are co-integrated or not. If the non-stationary variables are not co-integrated, they enter equation (1) in differenced form. If non-stationary variables are co integrated, Vector Error Correction Model (VECM), representations of VAR used in the conventional test. Several researchers used this approach in the finance-growth nexus among others is Kar and Pentecost (2000) and Boulila and Trabelsi (2004). Kouassi, Iyoha and Kymn (2005) as indicated in Kar and Pentecost (2000) on the other hand presented mathematical equation for causality test as follow

$$\Delta y_t = \phi_1 + \lambda_1(\Delta x_{t-i}) + \lambda_1(\Delta y_{t-i}) + \theta_1 ECM_{t-1} + \varepsilon_{1t}$$

(2)

$$\Delta x_t = \phi_2 + \lambda_2(x_{t-i}) + \lambda_2(\Delta y_{t-i}) + \theta_2 ECM_{t-1} + \varepsilon_{2t}$$

In this specification, ECM is the error term obtained from equation (1) while Δ refers to difference. θ_1 and θ_2 are elements of the adjustment vector. Under this specification, there are two sources of causality. Equation (2) demonstrates unidirectional causality from FD to GDP if $\lambda_2 \neq 0$ and $\theta_2 \neq 0$. No causality in either direction occurs if f $\lambda_1 = 0$, $\lambda_2 = 0$ and $\theta_1 = 0$ $\theta_2 = 0$ (Powell and Sephooko 2006). The inclusion of ECM in (2) is to differentiate non-stationary, non-co-integrated variables from non-stationary, co-integrated variables where the later takes in to account the equilibrium relationship of the variables revealed by the existence of co-integrations.

According to Powell and Sephoko (2006), the causality testing options are:

- ✓ If x and y are I(0), Granger Causality with variables in level
- ✓ If x is I(0) & y is I(1) or y is I(0) & x is I(1), Granger Causality with I(0) variables in level and I(1) variables in difference
- ✓ If x and y are I(1), there are two different options
  - o x & y are not co-integrated, Granger Causality with variables in first difference
  - o x & y are co-integrated, Vector Error Correction Model (VECM) based Causality Test

3.2 The Data

In finance and growth relationship issue, economic growth can be measured by rate of change in real GDP, and rate of change in real per capita GDP but real change in per capita growth is used for this study. Financial sector development/deepening on the other hand can be measured by various quantitative [1] proxies. Though the traditional proxy used in the literature to measure financial deepening is a ratio of some broadly measured money supply, generally M_2 ratio to the level of nominal GDP, the following alternative financial intermediation measures are used in this study to avoid measurement preconception.

- o ***The Ratio of Private Credit to Total Domestic Credit (PC/DC)*:** A financial system that simply channels credit to the government or state owned enterprises may not be evaluating managers, selecting investment projects, pooling risks and providing financial services to the same degree as a financial system that allocates credit to the private sector. (Powell and Sephooko 2006) argues that government credit from banks in countries with a highly regulated financial system is regularly captive and that lending banks have no or less control over its use. As a consequence, momentous credit allocation of the banking sector can be accurately characterized by their lending to the private sector. This ratio has increased predominantly after the reform of 1993 as it was just 21.5 percent in 1993 but increased to about 68.4 percent in 2010 registering 45.0 percent annual growth rate on average during 1993-2010.

- o ***The Ratio of Domestic Credit to GDP (DC/GDP)*:** as loan is the major item in the asset side of the consolidated balance sheet of the financial sector, it measures the asset size of the financial sector (Odedokum, 1989 in Kar and Pentecost 2000). In Ethiopia, this ratio has

1 Quantitative measures of financial development indicators includes monetary aggregates ratios, credit ratios, deposit liability of commercial banks ratio, asset ratio, bank branch-population ratios among others.

increased from 6.2 percent in 1971 to 33.4 percent in 2010. It was 28 percent during economic reform of 1993 and registered annual increase of 34 percent on average during (1993-2010).

- ***The Ratio of Bank Deposit Liabilities to GDP (BD/GDP)***: the degree to which banks collect cash and generate deposits stand for the degree of financial intermediation. As a huge component of broad money stock is currency held out side banks in developing countries where a rising ratio of broad money to GDP may reveal the more extensive use of currency rather than an increase in the amount of bank deposits, it is better to get more representative measure of financial development. In this case, currency out side banks should be excluded from broad money supply (Kar and Pentecost, 2000). In Ethiopia, this measure of financial development was just 3.8 percent in 1971 increased to 12.5 percent in 1993. After the economic reform of 1993, it rises by about 18.3 percent annual average and reached 24.0 percent in 2010.

- ***The Ratio of Broad Money to GDP (M2/GDP):*** this proxy of financial development/deepening measures the degree of monetization in the economy. It shows the real size of the financial sector of a growing economy in which money provides payment and saving services (Kar and Pentecost, 2000). Between 1993 and 2010 the average broad money to GDP ratio increased by 17 percent on average and stood at 25.6 percent at the close of June 2010.

- ***The Ratio of Private Credit to GDP (PC/GDP):*** so as to obtain the more direct measure of financial intermediation, credit extended to the private sector is also used as an indicator of financial intermediation. It is assumed to contribute more to increase investment and productivity to a much larger extent than credit channelled to the public sector. On the other hand, loans to the private sector are given more stringently and that the improved quality of investment emanating from financial intermediaries evaluation of projects viability is more significant for private sector credit (Wachlet 2002). This series has also shown an up ward trend over the sample period, but most after economic reform of 1993. It rises from 6 percent in 1993 to 17.5 percent in 2010.

The benefits of using alternative proxies to measure financial development is subject to the conclusiveness of assumption made, provided that all indicators tell more or less the same story. The demand on reliability of each happens if the outcomes are blended.

3.3 Empirical Results

3.3.1 Unit Root Test

Unit root test is the starting point of the analysis of time series variables. Accordingly, ADF unit root test is used to see if the variables have unit root or not. All variables under this study passed the test and found to have unit root at level both without trend and with trend. As all variables have unit root, they should be taken through the test machine in first difference in order to establish the order of integration of such variables and all found to be stationary at first difference without trend and with trend. Tables 1&2 below are summary of the unit root results.

Table 1 Unit Root Test Results of variables in Level

Variables in level		Augmented DickeY-Fuller Statistics (ADF) Without Trends	Critical value at 5%	Augmented DickeY-Fuller Statistics (ADF) With Trends	Critical value at 5%
	GDP	-2.948 I (1)	-2.155	-3.540 I (0)	-6.289
	PC/DC	-2.946 I (1)	-2.697	-3.540 I (1)	-2.160
	DC/GDP	-2.943 I (1)	-1.425	-3.537 I (1)	-1.160
	BD/GDP	-2.943 I (1)	-1.126	-3.553 I (0)	-4.063
	M2/GDP	-2.954 I (1)	-2.203	-3.553 I (1)	-3.361
	PC/GDP	-2.943 I (1)	-0.743	-3.54 I (1)	-3.311

Table 2 Unit Root Test Result of Variables in First Difference

Variables in First Difference		Augmented DickeY-Fuller Statistics (ADF) Without Trends	Critical value at 5%	Augmented DickeY-Fuller Statistics (ADF) With Trends	Critical value at 5%
	dGDP	-2.954 I (0)	-7.359	-3.553 I (0)	-7.234
	dPC/DC	-2.951 I (0)	-5.963	-3.548 I (0)	-5.927
	dDC/GDP	-2.948 I (0)	-10.667	-3.544 I (0)	-10.619
	dBD/GDP	-2.951 I (0)	-6.999	-3.553 I (0)	-6.082
	dM2/GDP	-2.954 I (0)	-5.770	-3.553 I (0)	-6.240
	dPC/GDP	-2.951 I (0)	-6.788	-3.548 I (0)	-6.677

Note: d **stands for first difference**

3.3.2 Co integration Test

Under unit root test section, it has been tested that all variables have a unit root. As a result there are five bi-variat VARs to work with in testing for co integration between each of the five financial sector development proxies and real per capita GDP growth. In a bivariate system consisting in this case of FDs and GDP representing financial sector development and real per capita GDP growth rate, respectively, the maximum number of co integrating vector is one so that the null hypothesis is that there is no co integrating vector and the alternative is that there is one co integrating vector. As conventional Granger causality test works only if the variables are stationary at level, the Johansen approach is used in this analysis to test for co integration between growth and financial sector development. In performing the test, each of the five VARs were first estimated in levels to select appropriate order[2]. Schwarz information Criterion (SIC) is selected as it favours more prudent models relative to other familiar information criteria and then was used in this study. In Johansen approach[3], Eviews allows five possibilities (Eview 6 users' guideline II)

1. The level data have no deterministic trends and the co integrating equations do not Have intercepts:
2. The level data have no deterministic trends and the cointegrating equations have Intercepts:
3. The level data have linear trends but the cointegrating equations have only intercepts:
4. The level data and the cointegrating equations have linear trends:
5. The level data have quadratic trends and the cointegrating equations have linear Trends

In this case, care needs to be taken as inclusion or exclusion of deterministic components in the form of intercept and trends influences the distribution of the Johansen test statistics. Case 3 is selected as time series data has trends in level and the co integrating equations have only intercepts.

Table 3 Bivariate Unrestricted Co integration Test Result (Trace and MaXimal Eigenvalue)

VAR Elements	**Null**	**Alternative**	**Tests**			
			Trace Statistic	**5% Critical Value**	**MaXimal Eigenvalue Test**	**5% Critical Value**
GDP and PC/DC	r= 0	r=1	25.42*	15.49	15.94*	14.25
GDP and DC/GDP	r= 0	r=1	33.67*	13.94	26.21*	13.39
PGP and BD/GDP	r= 0	r=1	10.01	17.46	8.49	14.26
GDP and M2/GDP	r= 0	r=1	14.22	16.73	13.79	15.23
GDP and PC/GDP	r= 0	r=1	23.22*	16.59	16.94*	13.62

Note: r indicates the number of co integrating vectors

**** Rejection of null hypothesis***

2 In practice, the true lag order will hardly be known, but can be determined with consistent order selection criteria (Helmut L¨utkepohl August 2001)

3

As revealed by both Trace test and Max-eigenvalue tests, there is no co integration between growth and financial sector development measured by bank deposit liability to GDP ratio (BD/GDP) and broad money supply to GDP ratio (M2/GDP). However, Johansen co integration test evidence revealed the existence of long run relationship between economic growth and financial sector development peroxid by the ratio of the private sector credit to the total domestic credit (PC/DC), the ratio of domestic credit to GDP (DC/GDP) and the ratio of private credit to GDP (PC/GDP).

In two out of the five financial sector development proxies, there is no co integration between growth and financial development that leads one not to expect the causality between growth and financial sector development. However, the long-run relationship between economic growth and financial development is found to be positive in each co integrating vector between growth and finance measured by all three credit ratios suggesting one to expect causality in at least one direction. The long-run or equilibrium relationship between financial development and economic growth does hold for Ethiopia in the case of financial development measured by the three credit ratios. As observed from the use of several alternative quantitative proxies for financial development, this seems reasonably vigorous finding and overall three out of the five proxies indicate long-run relationship between growth and financial development in Ethiopia. This finding also revealed that one should be proxy sensitive to investigate finance-growth relationship in the Ethiopian case.

3.3.3 Granger Causality Test

Table 4 Summary of Finance and Growth Granger Causality Test

Null Hypothesis (H_0)	χ **2**	**P-Value**
GDP does not Granger Causes PC/DC	5.762391	0.0561*
PC/DC does not Granger Causes GDP	0.824206	0.6623
GDP does not Granger Causes DC/GDP	6.31307	0.0120*
DC/GDP does not Granger Causes GDP	3.623436	0.0570*
GDP does not Granger Causes BD/GDP	2.902997	0.2342
BD/GDP not Granger Causes GDP	3.910572	0.1415
GDP does not Granger Causes M2/GDP	0.838429	0.6576
M2/GDP does not Granger Causes GDP	0.66125	0.3580
GDP does not Granger Causes PC/GDP	12.10282	0.0070*
PC/GDP does not Granger Causes GDP	7.980942	0.0464*

*** Rejection of null hypothesis**

As revealed above, the presence of conitegration leads to the existence of at least unidirectional causality between the variables. The obtained evidence as summarized in table 4 above did not indicate causality between financial sector development measured by bank deposit liability to GDP ratio (BD/GDP) and broad money supply to GDP ratio (M2/GDP) as neither causes GDP growth nor caused by GDP. This strengthens the co integration result obtained. On the other hand, the existence of co integration between growth and financial intermediation using proxies such as private credit to total domestic credit ratio (PC/DC), domestic credit to GDP ratio (DC/GDP) and private credit to GDP ratio (PC/GDP) is supported by the Granger Causality test revealing a uni-directional causality in the case of GDP and DC/GDP ratio as GDP growth Granger Causes financial development to flourish and the bidirectional causality in the case of private credit to GDP ratio and private credit to total domestic credit ratio.

In this case, three important conclusions can be drawn from the finding. 1) mixed result obtained indicates that financial sector development is a proxy sensitive in case of Ethiopia 2) two proxies out of five neither supports 'demand-following' nor 'supply-leading hypothesis' and that economic growth and financial development are jointly determined, or they complement each other. 3) one 'demand-following hypothesis' evidence from growth to financial development in case of domestic credit to GDP ratio reveals that overall causality from growth to financial sector development seems stronger in the case of Ethiopia.

This finding is consistent with finding of Boulila and Trabelsi (2006) for some sample of Middle East and North African countries where strong causality runs from growth to finance, Yemane Wolde-Rufael's finding (2009) for Kenya, Celtu C. Agu and Jude O. Chukwus' finding (2008) for Nigeria where 'demand-following hypothesis' is very strong predominantly in case of private credit to GDP ratio and broad money supply to GDP ratio) while the overall result is bidirectional causality. The causality predominantly runs from growth to financial development in developing countries could be because of their lower level of modernization and the absence of surplus income to demand financial services for saving and investment in securities. The result obtained for Turkey by Muhsin Kar and Eric J. Pentecost (2000) on the other hand shows the absence of wholesale acceptance of the view that 'finance leads growth' just as there can be no wholesale acceptance of the view that 'finance follows growth' in Turkey whereas the finding by Powell L. Mohapi and Sephooko I. Motelle (2006) for Lesotho case indicates the absence of any long run relationship between growth and finance from all employed alternative proxies of financial sector development.

IV Conclusion and Recommendation

4.1 Conclusion

This study has endeavoured to evaluate the standing of the Ethiopian economy in the long-lasting debate of the role of financial development in economic growth. It is obvious that there is theoretical consensus that financial development facilitates economic growth. However, this theoretical consensus seems unable to hold up empirical investigation with robustness. Several cross-country investigation using OLS regressions, causality tests and panel regressions including country case studies employing time series data predominantly has ended with different results so far as some supports the theoretical arguments while the other totally rejects and the opposite holds factual.

As can be observed from these findings, the role of finance in a given economy cannot be a finished theoretical recommendation but quite an empirical issue. Hence, this investigation scrutinized the existence of long run relationship between financial development and economic growth in Ethiopia and then the direction of causality between the same. The study uses time series techniques of co integration and causality test employing bivariate VAR structure for a sample of periods ranging from 1971 to 2008. Five proxies of financial development were paired with the per capita GDP growth datum in the co integration and causality tests. Co integration was found between three out of five proxies (the ratios of private credit to total domestic credit, total domestic credit to GDP and private credit to GDP) and economic growth captured by real per capita GDP growth while no co integration was found between financial development measured by broadly defined money supply to GDP ratio and bank deposit liability to GDP ratio. Causality also exists between that co integrated proxies with growth where demand-following hypothesis prevails in the case of domestic credit to GDP ratio. In the case of other two co integrated proxies of financial development, private credit to total domestic credit and private credit to GDP ratios, neither demand-following hypothesis nor supply-leading hypothesis exist that leads one to conclude that growth and financial development are determined jointly or they complement each other in case of Ethiopia.

The overall picture can witness that in three out of five proxies, there is co integration between growth and financial development and one unidirectional and two bidirectional causalities in the case of Ethiopia. Given the alternative proxies used, one can argue that this finding seems vigorous and unbiased despite quantitative indicators are not comprehensive measure of financial development.

4.2 Recommendation

- The emergence of 'demand-following hypothesis' in the case of domestic credit to GDP ratio can lead one to recommend that aggressive growth enhancing policy should be directed towards increasing individual income so as to create surplus that in turn increases the demand for financial services like deposit and investment in financial market securities. That is growth should be enhanced to scale up the demand for financial services.
- The presence of bidirectional causality can help one to recommend that financial development policies and strategies should get more emphases so that real growth would be enhanced by financial sector development whereas real sector development should get equal attention to attract financial development. For instance individual income should be increased so as to encourage the demand for financial services like deposit and investment in financial securities on the one hand and financial facilities like credit availability, modern business transactions service and other financial services that help the real sector to function smoothly should be expanded to meet the demand of the real sector economy i.e. both sectors are complementary to each other and should feed each other properly to grow simultaneously.
- Financial sector development should be properly peroxid as this study has come across with a sort of proxy sensitivity. As to our argument, broad money to GDP ratio might reveal the underdevelopment of the sector rather than development as it could be high just because of high currency in circulation in one hand and lack of other opportunities for depositors (no capital market, inefficient security market, investment inelasticity because of lengthy process in getting land, the high price of land leasing system, lack of entrepreneur ability combined with risk averseness, lack of adequate infrastructural development outside of big cities, and other economic and non-economic factors. Hence, the absence of long run relationship between financial developments proxied by broad money to GDP is painstaking given the real situation in the country and hence should not be recommendable quantitative indicator of financial development indicator.
- On the other hand, deposit liability ratio of commercial banks could be high just because of less investment prospects for deposit holders (lack of legitimate borrower who can either present genuine project proposal or sufficient collateral, lack of other lending opportunities such as security markets and other problems such as lack of genuine competition in the financial sector that triggers financial institutions to adopt different approaches to be competitive in the market unlike the existing situation where liquidity shortage is not a problem for all institutions. In this case too, deposit liability is not a good proxy of financial development in the Ethiopian current situation.

- Financial development should be measured by banks' credit extended to the economy as the Ethiopian financial sector is simply 'bank based' system. Credit ratios are better measurement of financial development in Ethiopia as far as we use quantitative indicators. However, a quantitative indicator by itself is not comprehensive measurement of the sector as qualitative measures are also equally important.

- Finally, the inadequacy[4] of the financial development indictors used in this study might affect the robustness of this causality direction and relationship between growth and financial sector development that in turn calls for the construction of comprehensive financial sector development index using both quantitative and qualitative indicators and the researcher need to highlight the importance of comprehensive index of financial development for further rigours study on this topic to come across with more reliable findings. In this case, the NBE should consider the construction of comprehensive financial development index for Ethiopia which in turn helps in carrying out further research on this debatable issue of financial development and economic growth causality on the one hand and as a policy tools on the other hand.

4 Incomprehensive as it lacks qualitative elements such monetary policy, regulation and supervision, financial sector openness, institutional environment, financial sector and non-bank financial sectors. The researcher argued that these qualitative components are equally important in constructing comprehensive index of financial sector development in addition to quantitative indicators/ratios and hence any financial sector indicators lacking these qualitative elements could not be complete enough to capture the true level of the sector (Susan Creane et al, 2004)

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ENHANCING GOVERNANCE FOR FINANCIAL INSTITUTIONS:

ISSUES AND BARRIERS

By- Muhidin Shifa (NBE)

ABSTRACT

The threat of management malpractice and financial failures in international financial industry necessitates the establishment of universal standards for corporate governance of financial institutions. This paper addresses some important issues and concepts in the governance of financial institutions and why international standards are needed to guide financial institutions in assessing and protecting against business risk exposure in the industry.

1. INTRODUCTION

Some major scams and corporate collapses across the globe in the last few decades have made stakeholders realize the importance and urgency of good corporate governance. An increasing volume of empirical evidence indicates that well-governed companies receive higher market valuations. However, improving corporate governance will also increase all other capital flows to companies in developing countries: from domestic and global capital; equity and debt; and from public securities markets and private capital sources.

Financial institutions must be managed prudently. The board is the focal point of the corporate governance system. It is ultimately accountable and responsible for the performance and conduct of the institution. Delegating authority to board committees or management does not in any way mitigate or dissipate the discharge by the board of directors of its duties and responsibilities.

In the case of a policy established by the board, the board would need to be satisfied that the policy has been implemented and that compliance has been monitored. The responsibilities of the governing body must be consistent with the rules on governance structure established in the jurisdiction.

Sound standards for corporate governance have now emerged and companies will have to change their behavior and values in accordance with these standards. These standards include board oversight, management oversight, board composition, separation of power, remuneration policy, related party transactions, external auditors, proper succession planning among others.

2. DEFINITIONS OF 'CORPORATE GOVERNANCE'

The Organization for Economic Cooperation and Development paper defines corporate governance as involving "a set of relationships between a company's management, its board, its shareholders, and other stakeholders. Corporate governance provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently.

Corporate governance includes corporate discipline, transparency, independence, accountability, responsibility, fairness and social responsibility. Timely and accurate disclosure on all material matters regarding the company, including the financial situation, performance, ownership and governance arrangements, is part of a corporate governance framework. Corporate governance also encompasses compliance with legal and regulatory requirements. Good governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital. It includes how financial institutions:

- Set corporate objectives including generating economic returns to owners;
- Run the day-to-day operations of the business;
- Consider the interests of recognized stakeholders;
- Align corporate activities and behaviors with the expectation that financial institutions will operate in a safe and sound manner, and in compliance with applicable laws and regulations; and
- Protect the interests of financial service consumers.

3. SETTING "TONE AT THE TOP"

Tone at the Top refers to how an organization's leadership creates the tone at the top - an ethical (or unethical) atmosphere in the workplace. Management's tone has a trickle-down effect on employees. If top managers uphold ethics and integrity so will employees. But if upper management appears unconcerned with ethics and focuses solely on the bottom line, employees will be more prone to commit fraud and feel that ethical conduct isn't a priority. In short, employees will follow the examples of their bosses

Having the right "tone at the top" is one of the most important factors in ensuring that the board meets all its duties. Ton at the top will establish the ethical culture of the corporation's relationships with employees, business community and regulators

The board of directors should participates in creating it and oversea how it is being communicated to all employees and constituents of the corporation.

Ethical and responsible decision making is not only important for public relations, but it is also a necessary element in risk management and avoiding lawsuits. Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making.

It is important to understand, though, that reliance by a company on the integrity and ethics of individuals is bound to eventual failure. Because of this, many organizations establish Compliance and Ethics Programs to minimize the risk that the firm steps outside of ethical and legal boundaries.

4. WHY GOVERNANCE?

4.1. Business vs. Regulatory Concerns

In an increasingly complex business environment influenced by globalization and other rapid changes in the financial scene, good corporate governance is crucial to ensure that the business of a financial institution is managed in a safe and sound manner. Weak governance can undermine public confidence in a financial institution as well as the financial system and markets in which it operates.

Supervisory experience underscores the necessity of having the appropriate levels of accountability and checks and balances within each institution. Put plainly, sound corporate governance makes the work of supervisors infinitely easier. Sound corporate governance can contribute to a collaborative working relationship between the institutions' management and the regulator.

It is crucial that financial institutions are soundly and prudently managed. Regulators have a strong interest in ensuring that there is effective corporate governance at the entire financial industry for they are entrusted to safeguard the interests of present and future depositors and policyholders, beneficiaries and insurance claimants.

Good corporate governance makes for good business sense. It increases the confidence of shareholders in the company. This leads to better stock prices. Research has shown that good corporate governance brings down the cost of capital for the company. It importantly affects firms' access to financing, their cost of capital, valuation, and performance. Better corporate governance leads to higher returns on equity and greater efficiency in firms' operations. Good disclosure practices lead to a more liquid market for the company. This lowers cost of debt for the company. Thus for CEOs of today, there is a clear business case for complying with principles of good corporate governance.

5. PARTIES TO CORPORATE GOVERNANCE

Parties involved in corporate governance include the regulatory body, the Board of Directors, the Chief Executive Officer, management, shareholders and Auditors. Other stakeholders who take part include suppliers, employees, creditors, customers and the community at large.

The shareholder delegates decision rights to the Board of Directors to act in the principal's best interests. This separation of ownership from control implies a loss of effective control by shareholders over managerial decisions. Partly as a result of this separation between the two parties, a system of corporate governance controls is implemented to assist in aligning the incentives of managers with those of shareholders. With the significant increase in equity holdings of investors, there has been an opportunity for a reversal of the separation of ownership and control problems because ownership is not so diffuse.

A board of directors often plays a key role in corporate governance. It is their responsibility to endorse the organization's strategy, develop directional policy, appoint, supervise and remunerate senior executives and to ensure accountability of the organization to its owners and authorities.

All parties to corporate governance have an interest, whether direct or indirect, in the effective performance of the organization. Directors, workers and management receive salaries, benefits and reputation, while shareholders receive capital return. Customers receive goods and services; suppliers receive compensation for their goods or services. In return these individuals provide value in the form of natural, human, social and other forms of capital.

A key factor is an individual's decision to participate in an organization e.g. through providing financial capital and trust that they will receive a fair share of the organizational returns. If some parties are receiving more than their fair return then participants may choose to not continue participating leading to organizational collapse.

6. BARRIERS TO EFFECTIVE CORPORATE GOVERNANCE

There are a number of factors that help to explain why corporate governance practices don't function effectively. Taken together, these factors provide a checklist for identifying and assessing problem areas.

6.1. Temptation to Micro-Management. Practically everyone can share hair-raising stories about boards that spent untold hours discussing trivial subjects while neglecting major agenda items deserving their more careful deliberation. It is critical that the board focuses its attention on items of critical importance to the organization. In order to do this, the board must avoid the temptation to micro-manage or meddle in lesser matters or in areas that are more appropriately handled by the professional staff. The average board, meeting monthly for two hours, has approximately 24 hours of meeting time per year to make all of the major decisions as well as address critical issues that come before it unannounced. It is simply impossible to do an effective job with in those 24 hours of meeting time, even if only a few hours are wasted on trivia.

6.2. Ineffective Nominating Committee. Many boards lack an effective nominating committee. It should be considered that the work of the nominating committee has lasting impact on organization -- and this committee's work determines who board leaders will be for many years into the future. The nominating committee should be well organized, have a clear sense of recruiting priorities as well as expectations for individual board members especially in the area of fund-raising. These elements are frequently missing in many organizations. If the nominating committee or board recruiting committee is poorly organized, board members in turn are not likely to have a good understanding of the organization and their role as board members.

6.3. No Plan for Rotation. Another problem is the lack of a plan for orderly rotation of board members on and off the board. If the same people serve year after year, there is no way for new blood and new ideas to come into the board. Despite their sense of commitment, these same people will make the organization a "closed corporation." Rotation prevents the ingrown possessiveness sometimes found on self-perpetuating boards. In a time of rapid change, the presence of new people who bring a new perspective will promote creativity and innovation in board decision-making.

6.4. Failure to remove unproductive members. Another problem that leads to poor performance is the failure to remove unproductive board members. People who are not carrying out their commitments as board members become major blocks to overall board effectiveness. There needs to be a process for evaluating board member performance and making recommendations regarding their future service with the board.

6.5. Too small. Sometimes a board is ineffective because it is simply too small in number. When we consider the awesome responsibilities of board leadership, it's easy to see why we need enough people to do the work. While it is difficult to specify an appropriate size for all boards, in general, a board should range in number from 11 to 21 members. We need enough members to lead and form the core of the committees and, in general, share in the other work of the board. We also need sufficient numbers to reflect the desired diversity in the board as well as assure the range of viewpoints that spurs innovation and creativity in board planning and decision-making.

6.6. Lack of functioning committee structure. The lack of a functioning committee structure is another reason why boards fail to perform at an acceptable level. While it is true that major decisions are made in board meetings, it is also true is that most of the work that supports and implements this decision-making occurs at the committee level. If the board has a committee structure that functions inadequately, this can lead to poor performance in general.

6.7. No strategic plan. The lack of a strategic plan, in most cases, will also lead to poor corporate governance. If the organization lacks a strategic plan that provides clear direction -- so critical in this period of rapid change -- the board can spend significant amounts of time talking about topics that simply don't matter. Related to the absence of a strategic plan is the lack of a long-range service delivery and financial development plan that will advance the strategic plan.

6.8. No plan for orientation of new and old members. Boards also fail because they have no plan for orientation of new and old members. Deliberate thought is rarely given to the matter of blending new and old board members into a well-functioning team. Related to this, is the lack of a formal plan of board training and education to continually upgrade the level of board skills and knowledge.

Some of these problems will be painfully familiar. All are preventable. This article will explore basic tools and techniques that have proven helpful to corporate governance in addressing the barriers discussed above.

7. PRINCIPLES OF SOUND CORPORATE GOVERNANCE

In most jurisdictions corporate governance rules exist for general-purpose corporations; these likely also apply to financial institutions. Key elements of good corporate governance principles include honesty, trust and integrity, openness, performance orientation, responsibility and accountability, mutual respect, and commitment to the organization.

Of importance is how directors and management develop a model of governance that aligns the values of the corporate participants and then evaluate this model periodically for its effectiveness. In particular, senior executives should conduct themselves honestly and ethically, especially concerning actual or apparent conflicts of interest, and disclosure in financial reports. Herein below are commonly accepted principles of corporate governance include:

7.1. Board Oversight

Every company should be headed by an effective Board to lead and control the company. The Board is collectively responsible for the success of the company. The Board works with Management to achieve this and management remains accountable to the Board.

It is difficult to conduct the activities of an organization when there are no strategic objectives or guiding corporate values.

Therefore, the board should establish the strategies that will direct the ongoing activities of the institution. It should also take the lead in establishing the "tone at the top" and approving corporate values for itself, senior management and other employees.

The board of directors should also ensure that senior management implements policies that prohibit (or strictly limit) activities and relationships that diminish the quality of corporate governance, such as conflicts of interest and providing preferential treatment to related parties and other favored entities

In general the board of directors has, but not limited to, the following roles:

- Establish policies and strategies, the means of attaining them, and procedures for monitoring and evaluating the progress toward them. Adherence to the policies and strategies are reviewed regularly, an at least annually.
- Have in place and monitors independent risk management functions that monitor the risks related to the type of business undertaken.
- The board of directors establishes audit functions, actuarial functions, strong internal controls and applicable checks and balances.
- Appoints and dismisses external auditors, actuaries, and senior management.
- Review management performance; and
- Set the company's values and standards and ensure that obligations to shareholders and others are understood and met.

7.2. Board Size, Composition and Appointment

The board needs a range of skills and understanding to be able to deal with various business issues and have the ability to review and challenge management performance. It needs to be of sufficient size and have an appropriate level of commitment to fulfill its responsibilities and duties.

The mix of directors should consists of Executive directors, Non –executive directors and Independent Director. The executive director is a staff of a financial institution that is on the institution's payroll and employed under a service contract, and is involved in the institution's day-to-day management responsibilities

A non-executive director is not a staff of the institution's and not under the institution's payroll. He/she is not involved in the daily management of the institution. Including on the board qualified directors that are not members of the institution's management, or having a supervisory board or board of auditors separate from a management board can enhance independence and objectivity.

Moreover, such members can bring new perspectives from other businesses that may improve the strategic direction given to management, such as insight into local conditions. Qualified external directors can also become significant sources of management expertise in times of corporate stress.

On the other hand independent directors are directors who are independent of management and free from any business or other relationship, which could interfere with the exercise of independent judgment or the ability to act in the best interest of company.

Hence there should have the appropriate mix of executive and non-executive directors. International best practitioners in the financial sector recommended that the minimum number of directors should be five and the number of non-executive directors should not be less than one third of the board. It is desirable of course that almost, if not all, the non-executive directors be independent directors.

There should also be a formal and transparent process for the appointment of new Directors and CEO to the Board. The board of directors is ultimately responsible for the operations and financial soundness of the financial institution. It must receive on timely basis sufficient information to judge the performance of management. An effective number of board members should be capable of exercising judgments, independent of the views of management, large shareholders or governments.

7.3. Board Committees and Performance

The board of directors should periodically assess its own performance, determine where weaknesses exist and, where possible, take appropriate corrective actions. Processes should be established that allow the board to monitor compliance with these policies and ensure that deviations are reported to an appropriate level of management.

The Board should establish committees to assist in the discharge of its duties.

In a number of countries, financial institutions' boards have found it beneficial to establish certain specialized committees including:

- a Risk management committee - providing oversight of the senior management's activities in managing credit, market, liquidity, operational, legal and other risks.
- an Audit committee - providing oversight of the company's internal and external auditors, approving their appointment and dismissal, reviewing and approving audit scope and frequency, receiving their reports and ensuring that management is taking appropriate corrective actions in a timely manner to address control weaknesses, on-compliance with policies, laws and regulations, and other problems identified by auditors. The independence of this committee can be enhanced when it is comprised of external board members that have financial expertise.
- a Compensation Committee – providing oversight of remuneration of senior management and other key personnel and ensuring that compensation is consistent with the company's culture, objectives, strategy and control environment.
- a Nominations Committee – providing important assessment of board effectiveness and directing the process of renewing and replacing board members.

A financial institution may have an Executive Committee (EXCO) of the Board, to deliberate on matters requiring Board review that arise between full Board meetings.

7.4. Senior Management Oversight

Senior management is a key component of corporate governance. Senior management consists of a core group of officers responsible for the day to day activities of the financial institution. This group should include such individuals as the chief financial officer, division heads and the chief auditor. These individuals must have the necessary skills to manage the business under their supervision as well as have appropriate control over the key individuals in these areas.

While the board of directors provides checks and balances to senior managers, similarly, senior managers should assume that oversight role with respect to line managers in specific business areas and activities. Management situations to be avoided include:

- senior managers who are overly involved in business line decision-making;
- Senior managers who are assigned in an area to manage without the necessary prerequisite skills or knowledge; and
- Senior managers who are unwilling to exercise control over successful, key employees for fear of losing them.

7.5. Separation of Power

The board chairman and chief executive officer "CEO" should in principle be separate persons, to ensure an appropriate balance of power, increased accountability and greater capacity of the board for independent decision making. The division of responsibilities between the Chairman and CEO should be clearly established, set out in writing and agreed by the Board. In addition, companies should disclose the relationship between the Chairman and CEO where they are related to each other.

The Board Chairman should:

- lead the board to ensure its effectiveness on all aspects of its role and set its agenda;
- ensure that the directors receive accurate, timely and clear information;
- ensure effective communication with shareholders;
- encourage constructive relations between the board and management;
- facilitate the effective contribution of non-executive directors in particular;

The CEO is responsible for:

- Overseeing the operations of the financial institutions' and providing direction to it on a day-to-day basis, subject to the objectives and policies set out by the board of directors, as well as to legislation.
- Providing the board of directors with recommendations, for its review and approval, on objectives, strategy, business plans and major policies that govern the operation of the financial institution.
- Providing the board with comprehensive, relevant and timely information that will enable it to review business objectives, business strategy and policies, and to hold senior management accountable for its performance.
- Appoints senior executive officers for different tasks.

7.6. Accountability, Internal Control and Audit

The role of auditors is vital to the corporate governance process. The effectiveness of the board and senior management can be enhanced by:

- Recognizing the importance of the audit process and communicating this importance throughout the financial institutions;
- Taking measures that enhance the independence and stature of auditors;
- Utilizing, in a timely and effective manner, the findings of auditors;
- Ensuring the independence of the head auditor through his reporting to the board or the board's audit committee;
- Engaging external auditors to judge the effectiveness of internal controls;
- Requiring timely correction by management of problems identified by auditors.

The board should recognize and acknowledge that the internal and external auditors are their critically important agents. In particular, the board should utilize the work of the auditors as an independent check on the information received from management on the operations and performance of the institution.

7.7. Remuneration Policy

Failure to link incentive compensations to the business strategy can cause or encourage managers to book business based upon volume and/or short-term profitability to the financial institution with little regard to short or long-term risk consequences. The board of directors should approve the compensation of members of senior management and other key personnel and ensure that such compensation is consistent with the Institution's culture, objectives, strategy and control environment. This will help to ensure that senior managers and other key personnel will be motivated to act in the best interests of the institution. In order to avoid incentives being created for excessive risk-taking, the salary scales should be set, within the scope of general business policy, in such a way that they do not overly depend on short-term performance.

7.8. Communications with Shareholders and Public Disclosure

Organizations should respect the rights of shareholders and help shareholders to exercise those rights. They can help shareholders exercise their rights by effectively communicating information that is understandable and accessible and encouraging shareholders to participate in general meetings. Board should meet regularly and as warranted by particular circumstances, as deemed appropriate by the board members and are duly furnished with complete and timely information.

Organizations should clarify and make publicly known the roles and responsibilities of board and management to provide shareholders with a level of accountability. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Disclosure of material matters concerning the organization should be timely and balanced to ensure that all investors have access to clear, factual information.

As set out in the Basel Committee's paper and in the Organization for Economic Cooperation and Development paper, it is difficult to hold the board of directors and senior management properly accountable for their actions and performance when there is a lack of transparency. This happens in situations where the stakeholders, market participants and general public do not receive sufficient information on the structure and objectives of the financial institution with which to judge the effectiveness of the board and senior management in governing the institution.

Transparency can reinforce sound corporate governance. Therefore, public disclosure is desirable in the following areas:

- Board structure (size, membership, qualifications and committees);
- Senior management structure (responsibilities, reporting lines, qualifications and experience);
- Basic organizational structure (line of business structure, legal entity structure);

7.9. Board Rotation

A director shall not serve on a board of financial institutions for more than a specific period of consecutive years; however, he/she may be re-elected after a lapse of a certain number of years. The Board of an institution must have in place a formal policy on Board renewal. This policy must provide details of how the Board intends to renew itself in order to ensure it remains open to new ideas and independent.

7.10. Related Party Transactions

Financial institutions should establish policies and procedures on related party transactions, which include the definitions of relatedness, limits applied, terms of transactions, and the authorities and procedures for approving, monitoring, and, where necessary, writing off of these transactions.

The Board should ensure that established control processes are not overridden to accommodate the company's related parties and individuals. The AC should review all material related party transactions and keep the Board informed of such transactions.

Related party transactions should be monitored with particular care, and appropriate steps taken to control or mitigate the risks of related party lending. The terms and conditions of such credits should not be more favorable than credit granted to non-related obligors under similar circumstances.

8. The Role of Regulators

Supervisors of financial institutions should be aware of the importance of corporate governance and its impact on corporate performance. They should expect financial institutions to implement organizational structures that include the appropriate checks and balances. Regulatory safeguards must emphasize accountability and transparency. Supervisors should determine that the boards and senior management of individual institutions have in place processes that ensure they are fulfilling all of their duties and responsibilities.

A financial institution's board of directors and senior management are ultimately responsible for the performance of the financial institutions. As such, regulators typically check to ensure that an institution is being properly governed and bring to management's attention any problems that they detect through their supervisory efforts.

When the institution takes risks that it cannot measure or control, regulators must hold the board of directors accountable and require that corrective measures be taken in a timely manner. Supervisors should be attentive to any warning signs of deterioration in the management of the institution's activities. They should consider issuing guidance to financial institutions on sound corporate governance and the pro-active practices that need to be in place. They should also take account of corporate governance issues in issuing guidance on other topics.

Against these backgrounds, most regulators outline a three-fold role in the supervision of financial institutions in their jurisdictions:

- Promoting understanding of what is required for good corporate governance in their jurisdictions;
- Researching and maintaining data on how financial institutions report and disclose their particular governance practices; and
- Using their enforcement powers where non compliance with laws issued by them occurs, which is often as a result of corporate governance failings.

Therefore, it is necessary for supervisors to determine that individual financial institutions are conducting their business in such a way as not to harm consumers of financial services particularly depositors and insurance claimants.

9. Concluding Remarks

The recent emphasis on effective corporate governance has underscored the importance of robust risk management oversight at the board level and the need for the board to set appropriate corporate policies and strategies to prevent excessive risk taking.

From financial industry perspective, corporate governance is about how companies set corporate objectives; run the day-to-day operations of the business; consider the interests of recognized stakeholders; align corporate activities and behaviors; and protect the interests of beneficiaries of their services.

The Board is the focal point of the corporate governance system. It is ultimately accountable and responsible for the performance and conduct of the company. Delegating authority to Board committees or management does not in any way mitigate or dissipate the discharge by the board of directors of its duties and responsibilities.

Good Corporate Governance is something we have to live with and in the financial sector the imperatives are even stronger than the rest of the corporate sector. Financial sectors must continue the journey on the path of sound practices, and start with a modest beginning in spite of the fact that the challenges ahead are still quite daunting.

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