

THE NEED TO ENSURE FAIR COMPETITION IN THE ETHIOPIAN BANKING BUSINESS: AN APPRAISAL OF LEGAL FRAMEWORK AND PRACTICE

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Abstract

The Banking sector can be the main source of financial innovation and efficiency in economies where financial sector reforms are prudently designed to enhance competition among the private and state-owned banks alike. The domestic private investment in the banking industry in Ethiopia was re-introduced in addition to the restructuring of state owned banks since 1994. Under the supervisor mandate of the National Bank of Ethiopia (NBE), various banking and monetary legislations were adopted to regulate the effective functioning of the banking sector. However, the current banking sector lacks regulatory neutrality due to government's involvement in the business of banking. The purpose of this article was to analyze the legal frameworks governing competition among the commercial banks in Ethiopia. The finding of this article reveals that despite the need to ensure fair competition in the banking industry, the "subsidy measures" provided for state-owned commercial bank of Ethiopia adversely impacts the competitiveness of privately owned banking investments. This article specifically identified that the government deliberately designed a legal framework that favors state-owned commercial bank of Ethiopia by imposing limitation pertaining to certain financial activities of private banks including but not limited to: (a) the mandatory obligation of private banks to buy National Bank of Ethiopia treasury bills, (b) limitation on share of long term portfolio investment, (c) limitation on share of revolving credit facilities, and (d) limitation on private commercial banks pertaining to the opening letter of credit by government institutions regarding the importation of goods and services. It was argued that on top of the gaps in Ethiopian competition law capable of ensuring fair competition in the banking sector, the legal and practical acts of the government to subsidize state-owned commercial bank negatively impacts the growth of private banking investments. It is concluded that the government of Ethiopia should ensure regulatory neutrality to ensure fair playing field in the banking sector.

Keywords: banking sector, Ethiopia, market failure, regulatory neutrality, subsidy, unfair-competition

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INTRODUCTION

Competitive Banking industry plays a vital role for a nation's financial stability and economic prosperity mainly by saving mobilization at household level and efficient credit allocation to the different sectors of the economy leading to capital accumulation and investment expansion. The role of having strong competition law which regulates the unfair competitive behavior of both private and state owned banks as competitors is so crucial to strike the competitive balance of the banking sector in view of the regulatory role of the government in the area. Currently, the Ethiopian government is subsidizing the Commercial Bank of Ethiopia while at the same time setting the regulatory standards for the banking sector in general. This unlike treatment of private and state owned commercial banks would affect the competitiveness in the banking sector thereby adverse impacting the development of private banks in particular and the financial sector in general.

Though the Ethiopia government has taken many reforms for the development of the banking sector including the re-introduction of domestic private investment in the banking industry, restructuring of state owned banks, and granting power of foreclosure to banks, it has failed to ensure regulatory neutrality in regulating by unfairly treating private banks as compared to the state-owned Commercial Bank of Ethiopia by subsidizing the latter through deliberately designed legal and practical techniques. The purpose of this article is, thus, to moderately analyze Ethiopian competition law framework and practice to demonstrate the challenges posed to ensure fair trade competition in the Ethiopian banking sector. More specifically, the extent to which Ethiopian trade competition law ensures regulatory and competitive neutrality by controlled government subsidy would be evaluated. In this article, the general principles and standards applicable to private - public banking business competition, the legal regimes governing competition in the Ethiopian banking business, major unfair competitive practices in the Ethiopian banking business and the impacts of government's discriminatory subsidy measures on private commercial banks will be discussed to finally provide a concluding remarks.

1. GENERAL PRINCIPLES APPLICABLE TO BANKING BUSINESS COMPETITION

1.1. The Principle of Competitive Neutrality

When state owned and private business compete on a level playing field, resources are used more effectively with in the economy in the interest of growth and development. For this reason, the principle of competitive neutrality between state owned and private businesses is gaining

wide support around the world.¹ According to this principle, public enterprises should compete with their private counterparts on the same level playing field—any arbitrary distinction in any form and in favor of public enterprises is prohibited as the presence of state-owned enterprises in the market place should not thwart entrepreneurship, fair competition or lead to other inefficiency.² Thus, public enterprises are expected to compete in the market neutrally without any favor that places them at the potential advantage when compared to private businesses. The pertinent question is, therefore, what is the parameter to ensure the existence of competitive neutrality in certain banking sector that pledges itself to enhance equal playing field. It is generally agreed that competitive neutrality occurs where no entity operating in an economic market is subject to undue competitive advantages or disadvantages.³

The most common mechanism to ensure competitive neutrality in the banking sector is to ensure regulatory neutrality. According to this principle, the legal frameworks that provide for the regulation of the banking sector should be non-discriminatory in the sense that there should not be differences in coverage, applicability, transparency or implementation of regulatory norms between public and private businesses (...).⁴ The government must not create a regulatory environment that recognizes the disproportionate impact of regulation on private banks. In other words, government should work to neutralize any competitive advantage or disadvantage that may accrue due to government ownership of the banking businesses by also firmly establishing the transparent regulatory legal environment that equally ensures competitiveness of the private banking businesses.⁵

According to the Organization for Economic Co-operation and Development (OECD) guidance, regulatory neutrality relates to the need to ensure equal regulatory treatment between private and public businesses.⁶ In addition to regulatory measures, a multidisciplinary approach is needed to level the playing field. Thus, a combination of regulatory and non-regulatory measures may be necessary to neutralize any advantage or disadvantage that may accrue due to ownership status of the banking businesses in what so ever form. For instance, government should refrain from taking any practical or legally established arbitrary discriminatory measures that favor public enterprises in such a way to affect the conditions of competition in the banking sector. But,

¹ See ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), COMPETITIVE NEUTRALITY: MAINTAINING A LEVEL PLAYING FIELD BETWEEN PUBLIC AND PRIVATE BUSINESSES 3 (OECD Publishing, 2012).

² *Id.*

³ *Id.* at 17.

⁴ *Id.* at 83.

⁵ *Id.*

⁶ *Id.* at 86.

this does not mean that there are no situations which necessitate government's intervention to give preferential treatment for a selected enterprise.

1.2. The Prohibition of Subsidy

As indicated before, it is a common national and international trade practice that states provide subsidy to support their domestic industries to ensure their competitive capacity in the form of preferential treatment, often through the provisions of subsidy schemes. However, the issue worth noting is whether preferential treatment should be allowed in the banking sector and if it is the case, the standard used to determine their nature as non-arbitrary and tolerable in the context of free market system. In this regard, Hailegabriel Gedecho has noted the following:

State intervention in subsidizing enterprises has been necessitated, for markets do not always work perfect. Put in other words, market failure provides the very typical rationale for government intervention in regulation of the market. At least within the context of antitrust regulation, market is said to have failed when competition is eliminated from a certain market.⁷

Thus, only in case of market failure that government can take discriminatory regulation or measures to a certain public enterprise to remedy such market failures generally acceptable in economic terms. In such a case, the purpose of government's intervention should be limited only to return secure and healthy functioning of competition since subsidies are very sensitive issues in trade relations. Though subsidies are evidently used by governments to pursue and promote their objectives and social policies, they also may have adverse effects on the interests of trade competitors in the market. However, although there is a common consensus regarding the adverse effects of subsidy on trade competition, there are no common standards to judge a certain preferential treatment as government subsidy. In some jurisdictions, certain measures are granted in a certain prescribed form to become a subsidy. But, in others, attention is given to its effect on trade competition irrespective of its form. Under the World Trade Organization (WTO) regimes, for instance, all government measures that confer some sort of benefit are not considered as a subsidy and are not prohibited.⁸ A measure becomes a subsidy under the Subsidies and Countervailing Measures (SCM) Agreement where.⁹

⁷ Hailegabriel Gedecho, *European Influence on Ethiopian Antitrust Regime: A Comparative and Functional Analysis of Some Problems*, 3 MIZAN LAW REVIEW n. 2, 271, 277(2009).

⁸ See PETER VAN DEN BOSSCHE, *THE LAW AND POLICY OF THE WORLD TRADE ORGANIZATION: TEXT, CASES AND MATERIALS* 564 (2nd ed. Cambridge University Press, 2008).

⁹ Agreement on Subsidies and Countervailing Measures (SCM Agreement, 1994), Art.1. Available at: <http://worldtradelaw.net/uragreements/scmagreement.pdf>. (Last accessed on April 10, 2014).

There is a financial contribution by a government or any public body within the territory of a member (...): A government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees): Government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits): A Government makes payment to a funding mechanism or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, different from practices normally followed by governments or there is any form of income and price support in the sense of Article XVI of GATT 1994 and a benefit is thereby conferred (...).

However, the standards provided under the SCM agreement is criticized since it failed to sufficiently regulate issues of subsidies given the different ways subsidies could be granted either directly in less open ways or indirectly in the form of sheltering from the full force of competition. This scenario could happen by excluding competitors from market access and by imposing different restrictions and obligations. Wilcoxon has noted the following points on this matter:

Some subsidies are direct and visible; others are indirect and hidden. In the former cases, government has made outright gifts, grants of public lands or payment from the treasury. More often, it has given aid in less open ways by rendering services for less than they are worth, by buying goods and services for more than they are worth and by exempting some enterprises from taxes that others must pay. Acting indirectly, government has subsidized a certain enterprise by sheltering it from the full force of competition mainly by exclusion of competitors from market access.¹⁰

Unlike the World Trade Organization SCM standard, the European Union competition law focuses on the effect of the subsidy of whatever form on the competition rather than the benefit that may accrue to become a subsidy.¹¹ Accordingly, Article 87(1) of the treaty establishing European Union provides:

Any aid granted by a member state or through state resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the

¹⁰ CLAIR WILCOX, PUBLIC POLICIES TOWARDS BUSINESS 786 (4th ed. Richard Darwin Inc., 1971).

¹¹ See ARNULL A., DASHWOOD A., ROSS, M & D. WYATT, EUROPEAN UNION LAW 681 (Sweet and Maxwell 4th ed., 2000). [Hereinafter ARNULL A *et al.*]

production of certain goods shall, in so far as it affects trade competition, be incompatible with the common market.¹²

State aid is thus to be understood in terms of its effects (than forms) involving the provision of some kind of tangible benefit in any form for specific undertakings which imposes negative effects on other undertakings competitiveness in the same sector.

2. COMPETITION IN THE ETHIOPIAN BANKING BUSINESS

2.1. Banking Business Competition Regimes: An Overview

In the preceding discussion, it is noted how the existence of competitive neutrality in regulating public and private enterprises promises to be fruitful by guaranteeing fair competition.¹³ This is achieved mainly by enacting strong competition laws and by ensuring their implementation. In Ethiopia, there is a trade competition and consumers' protection proclamation¹⁴ which regulates the manner of competition between traders in general. The scope of this legislation extends to public enterprises—they are also required to observe the provisions of the proclamation during competition with other private enterprises in the same sector. However, this proclamation fails to regulate the government's subsidy or preferential treatment issues that usually aim to favour public enterprises in general and the banking sector in particular.

The relative strength and weakness of competition laws in a certain country is measured in terms of the existence of four common core variables:¹⁵

(a) Scope of application to governmental entities and to government—encouraged or sanctioned conduct of state enterprises and private firms; (b) substantive rules governing specific business practices and arrangements; (c) scope of sectoral coverage; and (d) enforcement over public enterprises.

In this regard, it could be argued that Ethiopian competition law belongs to the very weak competition laws category. The application of competition law to government's encouraged or sanctioned acts towards certain private firms or state owned enterprises is very relevant to market access issue.¹⁶ For instance, the European Union law imposes obligation on its member states to

¹² *Id.*

¹³ See also W. FRIED MANN, *THE STATE AND THE RULE OF LAW IN A MIXED ECONOMY* 86 (Stevens and Sons, 1971).

¹⁴ Trade Competition and Consumers' Protection Proclamation, FED. NEG. GAZETTA (No. 813/2013).

¹⁵ ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), *ANTITRUST AND MARKET ACCESS: THE SCOPE AND COVERAGE OF COMPETITION LAWS AND IMPLICATION FOR TRADE* 11 (OECD Publishing, 1996).

¹⁶ *Id.*

promote competition between undertakings. Accordingly, article 87 of the treaty establishing the European Union Law puts a basic prohibition of state aid to undertakings.¹⁷ Under Article 86(1) of the same treaty, in the case of public undertakings (...), member states shall neither enact nor maintain in force any measure contrary to the rules contained in the treaty in particular to those rules provided from (...) Articles 81—89.¹⁸ From these provisions, Article 87 is related to state aid which states that member states cannot provide aid to their own public enterprises unless exceptionally approved by the European commission. In this regard, it is better to assess the prerequisites to approve state aid to a certain public enterprise by the commission. In order to avoid arbitrary state aid, the commission puts forward the use of a general balancing test. In essence, this test asks whether: (1) the state aid addresses a market failure or other objectives of common interest; (2) the state aid is well targeted (...); and (3) the distortions of competition are sufficiently limited so that the overall balance is positive.¹⁹

However, Ethiopian competition law does not include such mechanisms to control arbitrary state aid to certain enterprises as indicated above. Hence, in light of this fact, government's subsidy measures to Commercial Bank of Ethiopia and its sanctioned measures against private commercial banks could not be legally justified since it lacks legislative backing under the Ethiopian competition law. Therefore, in this context, the fairness the government ought to deliver to the state-owned banking sector could not be deciphered under the general principles of competition law²⁰ though fairness might relate to the creation of equal conditions among the competitors that compete in the supposedly free market.²¹

In general, ensuring fair trade competition between public and private businesses is very difficult in situations where a government is a stakeholder in trade on the one hand and a regulator on the other unless state subsidy to its enterprise is sufficiently regulated under the law. As such, a strong institutional framework and competition law which incorporate provisions to control state aid or subsidy to a certain public or private enterprise along with the means of granting subsidy in case of market failure without distorting competition in the market is of paramount importance to enhance competition in the Ethiopian banking sector.

¹⁷ *Id.* at 189.

¹⁸ ARNULL A *et al.*, *supra* note 11 at 712.

¹⁹ JOSEF DREXL, LURENCE IDOT & JOEL MONGER (eds.), *ECONOMIC THEORY AND COMPETITION LAW* 17 (Edward Elgar Publishing Limited, 2009).

²⁰ *Id.*, at 184.

²¹ *Id.*

2.2. Major Unfair-competitive Practices in the Ethiopian Banking Business

In this section, the author tries to identify major unfair-competitive practices in the Ethiopian banking business sourced either from the law or the practice. While some of the government measures could draw their authority from clearly enacted legal sources others are generally practiced arbitrarily despite the criticisms from the business community. Yet, whatever the sources of the measures be, they are generally believed to favor the Commercial Bank of Ethiopia while capable of affecting the competitiveness of private banks.

2.2.1. *Obligation to Buy Government Treasury Bonds to Finance Development Projects*

The National Bank of Ethiopia has issued a Directive²² compelling private commercial banks to buy bonds issued using 27 percent of their annual loans and advances²³ from the state-owned Development Bank of Ethiopia with a very low interest rate of three percent per annum²⁴ for five years.²⁵ However, the Directive excludes Commercial Bank of Ethiopia from such obligation.²⁶ In this regard, two contending arguments could be pinpointed from the general public debate on such obligations of private commercial banks to buy the Treasury bond issued by the NBE. The first argument against this measure contends that the government is required to keep its hands-off the private commercial banks which are the largest source of finance for the private sector.²⁷ It is argued that imposition of such type of obligation on private commercial banks creates liquidity constraint and thereby reducing the lending capacity of private banks which ultimately affects their competitiveness in the financial market.²⁸ The second argument, which favor the measures of the NBE, contend that private commercial banks as a corporate citizens have corporate social responsibility to participate in the development of their country in the same manner individual citizens managed to contribute so far as financing these development projects doesn't have much strain.²⁹ The proponents of this later argument, however, complain issues regarding the

²² National Bank of Ethiopia (NBE) Bill Purchase Directive, (No. MFA/NBE bills/002/2013), (hereinafter, referred as, NBE Bill Purchase Directive).

²³ *Id.* Art. 3(1) and Article 4(2).

²⁴ *Id.* Art. 9(2).

²⁵ *Id.* Art.9(1)

²⁶ *Id.* Art.2(3)

²⁷ Melkeam Aschalew, "IMF Warns Depriving Private Sector Unbalances Development", ADDIS FORTUNE News Paper Published On Feb 17, 2013 [Vol 13, No 668. Available at: <<http://addisfortune.net/articles/imf-warns-depriving-private-sector-unbalances-development/>>.

²⁸ *Id.*

²⁹ Binyam Alemayehu, "Banking Boom: A Veteran's Disagreement with Liberalization", ADDIS FORTUNE News Paper, Published on Nov 17, 2013 [Vol 14, No 707]. Available at: <<http://addisfortune.net/interviews/banking-booma-veterans-disagreement-with-liberalisation/>>.

percentage and maturity date, the amount of annual interest, the basis of the calculation to determine the bills to be purchased and the exclusion of Commercial Bank of Ethiopia from such obligation. Thus, they propose a flexible approach by claiming the amount of 27 percent and the maturity date of five years to be reduced; the annual interest rate to be increased since minimum deposit interest rate is five percent under the law; lending interest rate on bills purchased shall be above five percent; the basis of calculation to determine the bills to be purchased shall be the net deposit or net loan instead of using the disbursement amount.³⁰

The hot issue among others, however, is the exclusion of CBE from obligation to buy NBE bills since it creates more favorable competitive ground for the former in the financial market. As indicated before, this situation adversely affects private commercial banks competitiveness in the financial market as it drains their liquidity position. In this regard, Melkeam Aschalew has noted the following:

Until December 2012, the 14 Private Commercial Banks operating in the country mobilized 66.2 billion birr whilst disbursing 40.7 billion Birr in loans to the public. In the same period, banks purchased 15.3 billion Birr worth of NBE bills which is 15.5 percent of the total assets held and 23 percent of the deposit mobilized by the banks. By any standard, this is a huge amount of money and it could dry the liquidity of the banks. Whereas it creates favorable grounds for state owned banks to easily win the competition in the financial market.³¹

The pertinent legal issue is to what extent could government oblige private commercial banks to deliver their corporate social responsibility? It is obvious that business organizations are established with the primary motive of profit maximization. Hence, in the absence of clearly articulated corporate social responsibility rules that equally apply to every business, the state should refrain from such acts since it undermines their primary objective for which their establishment is specifically justified.

2.2.2. Exclusion of Private Banks in the Mobilization of Savings for Grand Housing Programs

One of the major changes observed since the 2013 is related to the new housing project that requires Ethiopian urban residents to deposit predetermined amount of money in the state owned

³⁰ *Id.*

³¹ Melkeam Aschalew, "Temporary Banking Fixes, No Long Term Solution", ADDIS FORTUNE News Paper, February 24, 2013, at.10, Col.2.

Commercial Bank of Ethiopia before registration to acquire housing services. Though the Housing Scheme Registration Directive³² under Article 2(9) states that saving account could be opened in CBE, Addis Credit and Saving Institution or *in any other banks (...)*, the registration forms annexed to the Directive excluded the validity of saving accounts opened in other private banks and financial institutions other than accounts opened in the Commercial Bank of Ethiopia.³³

The current government housing project undoubtedly boosted the power of the CBE by helping different branches to mobilize financial resources under the guise of saving requirements to own a house. Conversely, it diminishes the prospect of private banks to attract deposits from savers.³⁴ This restriction affects saving mobilization of private banks and it reduces their liquidity position thereby reducing their lending capacity.³⁵ Particularly, the deposit transfer of customers from private banks to the CBE caused the former to lose their customers and bar them from attracting new customers while it helps the latter to attract many customers with zero cost.³⁶ The most noticeable effect of this measure is that it is capable of destructing customers' confidence on private banks³⁷ thereby affecting the stability of the banking sector in the long run.

In short, the requirement to deposit the down payments on monthly basis for many years will have a multiplied impact on private banks.³⁸ This in turn helps CBE to consolidate its market share.³⁹ Not only the deposits are affected but also the foreign exchange earnings also impacted as the Diaspora community, who are willing to benefit from the new government housing schemes, are also required to make a deposit payable in foreign currencies only to the Commercial Bank of Ethiopia.⁴⁰ Therefore, the exclusion of private commercial banks in saving mobilization for grand housing program is incompatible with the principles of free market economy since it blocks private banks a free market access while granting pure monopoly right to the Commercial Bank of Ethiopia in the domestic banking industry.

³² Addis Ababa City Administration Housing Scheme Registration Directive (No.2/2013). Amharic: translation mine.

³³ *Id.* Forms 001, 002, and 003.

³⁴ Ebisa Derbie, *Impacts of the Grand Housing Program of the Government of Ethiopia on Private Banks*, vol. 4, No.1, 4 JOURNAL OF BUSINESS ADMINISTRATION, n.1, 22, 26 (2014).

³⁵ Alemayehu Anbessia, "Yegil Bankoch Adega Lay Nachew" [literally mean "Private Banks are on Danger"] ADDIS ADMASS News Paper, June 22, 2005 EC. at.1 (Amharic: translation mine).

³⁶ *Id.*

³⁷ *Id.*

³⁸ Ebisa, *supra* note 34, at 28.

³⁹ *Id.*

⁴⁰ *Id.* at 32.

2.2.3. *Limitation on Share of Long-term Loan Portfolio*

According to the Directive issued by the NBE, the total outstanding balances of short term loans of private banks shall not be less than 40 percent of total outstanding loans and advances of the bank excluding NBE bills outstanding balance at any given time.⁴¹ This measure was introduced to minimize private banks liquidity constraint which faced due to the NBE bills purchase obligation, and to enable them to collect their 40% loan within one year from the date of disbursement.⁴² However, the [Banking] industry observers fear that the little space created for private banks, by lowering legal reserve to five from ten percent⁴³, may be overshadowed by the requirement to ensure that loan portfolios shall be made up of 40 percent short-term loans that will mature within one year. In this regard, Melkeam Aschalew noted the following:

The impact of this loan restructuring depends on the composition of the loan books of individual banks. The majority of private banks loan requests are for at least an 18 month repayment period. Therefore, pushing a considerable number of loans in to a one year maturity period so as to comply with the directive would further drain the liquid resource of banks.⁴⁴

In addition, “this limit on maturity of loans will force private banks to purchase more of the five year NBE bills at a very low interest rate since private banks are expected to purchase from each disbursement made repeatedly for a short period than disbursement for a long period”.⁴⁵ This will further reduce private banks capacity to extend loans to customers. Since “lending interest rate is better in case of long term loans than short term loans” limiting the share of long term loans of private commercial banks to 60 percent may affect their profitability.⁴⁶ The loan restructuring may also create customers dissatisfaction since customers usually prefer middle and long term loans thereby forcing them to decide to borrow from the Commercial Bank of Ethiopia as it has no limitation on its share of loan portfolio of long term loans unlike the private banks.

⁴¹ See NBE Bill Purchase Directive, *supra* note 22, Art.5.

⁴² Interview with Gebisa Teressa, Attorney at the Debt Recovery Division of Wogagen Bank Share Company (Addis Ababa, Ethiopia, 8 May, 2014).

⁴³ National Bank of Ethiopia Reserve Requirement Directive (6th replacement), Art. 3 (No. SSB/55/2013).

⁴⁴ Melkeam Aschalew, *supra* note 31.

⁴⁵ Gebisa, *supra* note 42.

⁴⁶ *Id.*

2.2.4. *Limitation on Share of Revolving Credit Facilities*

The Directive issued by the National Bank of Ethiopia limits the share of revolving credit facility of private commercial banks. Private commercial banks are required to limit the amount of their total revolving credit facility within the ten percent of their total outstanding loans and advances at any given time.⁴⁷ This restriction limits the banks' lending capacity, market access and customer attraction capacity since revolving credit helps the bank to lend money continuously and collect the interest that accrues from it.⁴⁸ Ultimately, it may affect private commercial banks competitiveness with state owned CBE since the later has no limitation on its share of revolving credit facility.

2.2.5. *Limitation on the Opening of Letter of Credit for the Import of Goods and Services*

The Ministry of Finance and Economic Development (MoFED) has enacted a Directive which obliges all civil service institutions of the government to open Letter of Credit (LC) either in CBE or Construction and Business Bank of Ethiopia (another state owned bank) when they want to import goods and services.⁴⁹ Accordingly, all private banks are excluded from processing Letter of Credit for such Civil Service institutions which represent the bulk of government procurement in the country. Due to this fact, they lose service and commission payments that could ripe from the processing of the opening of Letter of Credit. In addition, the deposit in the letter of credit account will circulate for months in CBE until payment is effected to the seller. This affects private commercial banks market access and source of income.

2.2.6. *Restriction on Civil Servants' Salary Payment only through the CBE*

In 2011, the MoFED has enacted Cash Management Directive which obliges all Civil Service Institutions in the country to pay the salary of their employees through banks unless otherwise provided in the directive.⁵⁰ The Directive says that the bank will be selected through agreement between the bank and the concerned civil service institution⁵¹ implicating the legal right of the private banks to participate in the agreement. However, the writer of this paper learned that "there is no civil service institution which has entered in to agreement with any of the private banks though these private banks have proposed the question for many civil service institutions."⁵²

⁴⁷ NBE Bill Purchase Directive, *supra* note22, Art.6.

⁴⁸ Gebisa, *supra* note 42.

⁴⁹ Democratic Republic of Ethiopia Federal Government Cash Management Directive, Art. 23 (3) (No.4/2011). (Amharic: translation mine).

⁵⁰ *Id.* Art.12 (2).

⁵¹ *Id.* Art.12 (4).

⁵² Interview with Solomon Moges, Legal Department Attorney at the Abyssinia Bank (Addis Ababa, Ethiopia, 8 May 2014).

Accordingly, “all civil service institutions have bank account in the CBE since they are required to transfer one year salary of their employees to Commercial Bank of Ethiopia at the beginning of the budget year.”⁵³ It goes without saying that such act of the government absolutely destructs fair competition in the financial market as it becomes difficult for the private banks to compete with the CBE.⁵⁴ It is noted that such activities of the government are anomalous with the spirit of free market economy—consumers are free to choose the goods and services they want to purchase since all civil service institutions had opened bank account to their employee in CBE without the consent of the former.⁵⁵

Another similar restriction that relates to employee’s salary payment through bank account deposit is the practical imposition on the public enterprises not to deposit their employee’s salary in private banks unless written order is given from the management board of the concerned public enterprise.⁵⁶ As such, given the domination of the management boards of all public enterprises by political dignitaries such as ministers and directors, it could become difficult to expect the passing of an order that favors private commercial banks—no public enterprise has opened its account in private commercial banks so far.⁵⁷ It should be noted that unlike ordinary depositors who deposit their money in saving account bearing five percent minimum interest rate, public enterprises deposit their money in current account—a deposit with zero interest rate. This condition is more favorable to the CBE even if the balance in current account is too volatile in nature.

This situation could force private banks to lose service and commission payments and help CBE to mobilize deposit with a free interest rate and to obtain more service and commission payments in unfair competitive situation. This adversely affects private commercial banks’ market access in general and deposit mobilization in particular which ultimately may affect their liquidity position and lending capacity thereby reducing their competitiveness in the financial market. On the other hand, it helps CBE to consolidate its market share since it circulates the money until the concerned public enterprise withdrawn it. The issue is whether such *de facto* subsidizing act of public enterprises to the CBE could be attributable to the inactivity of the government. Under the World Trade Organization rules, subsidy made by a government or a public body, including regional and local authorities as well as state owned enterprises, is prohibited in order to effectively control the negative effects of subsidy on fair and free

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Id.*

competition in the market.⁵⁸ Thus, it could be argued that the subsidizing acts of public enterprises to another public enterprise in a manner that disfavors private enterprises would amount government subsidy that negatively affects competitiveness of the Ethiopian banking sector.

2.2.7. *The Exclusion of Private Banks from Processing Export Trade to China*

Since 2006, the National Bank of Ethiopia has ordered that all private banks which process export trade to China shall cease and should be undertaken and overseen by the CBE though there is no clear Directive to that effect.⁵⁹ Accordingly, the order states that the process of all exports to China shall be handled by CBE alone and that no other private bank can take part in this transaction.⁶⁰ In this regard, media reports have noted the following:

The reason for the decision was simply based on the fact that after some time spent with Ethiopia and China negotiating on a possible loan: the Chinese agreed to grant the amount if Ethiopia would in turn make the payments in exports—the process of which can only take place through state banks selected by both governments.⁶¹

By doing so, the government creates *de facto* monopoly that benefits CBE while excluding private banking competitors in the foreign export trade. This exclusion reduces significant market access of private commercial banks and may result in foreign currency problem since Private Banks make more from the letter of credit commissions they open for exporters than they do from the general banking business.⁶² Conversely, it increases market access of the CBE by granting *de facto* monopoly in the sector. Therefore, while the granting of monopoly to the CBE on certain transactions and projects could amount to direct discriminatory subsidy measures, the exclusionary measures, discriminatory imposition of obligations, and restrictions against private banks are acts of indirect subsidy capable of negatively affecting the banking industry.

⁵⁸ BOSSCHE, *supra* note 8, at 564.

⁵⁹ Interview With (Anonymous), Corporate Planning and Market Department at the Oromia International Bank (Addis Ababa, Ethiopia, 19 April 2014).

⁶⁰ *Id.*

⁶¹ Issayas Mekuria, “*Commercial Bank of Ethiopia Monopolizes China Export Banking*”, ADDIS FORTUNE News Paper, November 26, 2006, at 1, Col.2.

⁶² *Id.*

CONCLUDING REMARKS

This paper has moderately attempted to demonstrate how the Ethiopian government has been providing legal backing that encourages the state-owned Commercial Bank on the one hand while discouraging private commercial banks on the other. It is argued that the discriminatory subsidy measures that are granted to the state owned Commercial Bank are not in conformity with the generally accepted principles of regulatory neutrality in the banking sector. Thus, to avoid measures that negatively affect the competitiveness of the banking industry, the existing practice of government measures that amounts to subsidy should be revisited in a bid to create an enabling environment to ignite genuine competitiveness of the Ethiopian banking sector. Accordingly, the government should refrain from taking any arbitrary discriminatory measures in favor of state owned Commercial Bank of Ethiopia negating the free market system capable of sustaining competitiveness. Thus, the act of providing undue competitive advantage to the Commercial Bank of Ethiopia while imposing undue competitive disadvantage on private commercial banks should be remedied since these measures restricts the later from accessing opportunities in the market with their full capacity.⁶³

It is also remarked that the government both as a regulator and trader in the banking business is required to impartially set standards that neutralize any competitive advantages that accrue due to the state ownership of the banking business. In this regard, it is indicated that owing to the legal gaps that clearly regulate subsidy issues in the domestic banking sector, the government is engaged unboundedly in acts that encourage state owned banks but discourage the competitiveness of privately owned banking business. In view of the best practice and international imperativeness of the need to ensure fair competition in the banking sector as indicated in this paper, it is necessary to also ensure fair competition in the Ethiopian banking sector. Though it is up to the Ethiopian government policy to decide whether its economic activities should, in any particular sector, be monopolistic or competitive with private enterprises, the nature of the banking sector as a sensitive cord of the financial system should not be arbitrarily regulated in such a way that distorts the capacity of private banking businesses to compete with their state owned counterparts.

⁶³ Solomon, *supra* note 52.