FINANCE AND DEVELOPMENT IN ETHIOPIA

Neway Gebre Ab*

Translated by: Yonas Admassu

It is very likely that there may be some among you with some experience and with research output to their credit in the field of finance. So, I would like to apologize from the outset for any oversight on my part in addressing the issues involved. While, in keeping with the running theme of this forum, I shall attempt, towards the conclusion of my presentation, to answer the question of what my vision of Ethiopia in the year 2020 would be, a good part of my endeavor shall focus on addressing the issue of finance and economic development in the context of Ethiopia. The topic, needless to say, is very broad. The question, therefore, of how best to broach the core theme of the topic has its own problems. A better way to deal with the problem perhaps would be to introduce, by degrees, the concepts involved. Accordingly, I have found it proper to point out what components are incorporated in what we call the financial sector. The financial sector, as is commonly understood, can be considered under two headings: the formal market and the informal market. The main institutions subsumed under the formal financial market sector are banks and insurance companies. However, we can also think of those enterprises known as micro-finance institutions, though largely different in the orientation of their activities hat provide financial services to the community; they could transform themselves into rural banks if their capacity strengthen. There are also those institutions we call cooperatives. Finally, I shall dwell upon, in some detail, those forms of the financial market known as securities.

What do we mean when we speak of the financial sector as being formal? The financial sector is said to be formal if it is run according to a set of rules and regulations, operates on the basis of consistent and visible interest rates across the board or has a predictable profit margin. On the other hand, a securities market is the type that operates on the basis of supply and demand. What we call the informal market consists of local financial services operating on the basis of locally accepted customs or agreements. The people mainly involved in this sector are private loaners. This informal market serves as the main source of loans, particularly in rural areas of those countries where banking services have not proliferated. To cite but one example, in Ethiopia during the reign of the late Emperor, but particularly in the coffee producing areas of the country, there were lots of private loaners actively involved in the money-lending business. The loan is conducted in such a way that the lender hands over a determined amount of money, say 100 Birr, to the borrower, for which the lender would receive 200 Birr, including interest, at the end of a period of one year. There are also instances where the lender becomes a purchaser of grains and redeems his money in the form of grains purchased. This scheme helps the lender ensure the payment of the loan. Although in talking about the financial market sector we need to keep in mind these two types of institution, my talk tonight has as its focus the formal component of financial sector.

What is the nature of the formal financial market? What role(s) do these banks and other institutions in the sector play? Let us first consider these two questions, for beginners.

The main function of a bank is to accumulate money in the form of savings entrusted to it by various individuals. The bank collects savings at the individual, family or company levels. The bank then loans out the savings so collected to people interested in borrowing money. In effect, the bank serves as an intermediary between those who save and those who borrow money. Seen from one angle the banks play an important role or accomplish a big task. For, if there were no banks, it would mean that each borrower would have to rove about in search of individuals with enough

* Ato Neway Gebre Ab is Economic Advisor with the rank of Minister in the Office of the Prime Minister. He is also the Director of the Ethiopian Development Research Institute.

savings to lend him the money he needs. What this means, then, is that, with the banks as intermediaries, it is possible to borrow directly from the stock of finance collected and accumulated from different individuals and invest the loan so procured. We can thus see that financial institutions play an intermediary role in many respects. Their role, in short is, bringing together the savers and the borrowers. This is the main role of banks.

The fundamental role of insurance companies is to provide coverage for possible risks. People face all sorts of risks: there are car accidents; and there are risks involving death. So, there are different types of insurance against different types of risks. Though the idea and practice may be alien to Ethiopia, it is also possible to take out insurance against the loss of one's harvest, since there are such risks as the caprices of climatic changes. We can therefore think of the insurance business as playing the role of sniffing out risks and problems and providing protection against them—just in case!

To consider the matter from yet another angle, if a given insurance company must operate in a sustainable manner, and if, in particular, it must expand, the company must be in a position to be able to invest the money collected from clients in the form of premiums. When it comes to banks this investment is undertaken through money loaned out to borrowers. But how can an insurance company invest the money it collects from its clients? The practice in the developed countries is for insurance companies to get involved in the securities market. Since I have earlier used the word 'securities', let me explain what the term means.

'Securities' basically refers to a kind of document bearing a promissory note in the form of 'I-owe-you'*. The practice is common here in Ethiopia, whereby the government periodically sells security bonds endorsed by the treasury. It just happens to be the case that enterprises, not individuals, engage in the buying of such securities. The nature of the transaction is such that a determined amount of money in the form of profit accrues to those who do the lending i.e. to those who buy the securities. Securities are loan instruments or mechanisms. This being the case, if a country's economy is strong, the government will engage in selling not only treasury bills but also long-term bonds. The bonds so sold have the benefit of having a secondary market outlet. And this scheme has its benefits. What this means is that an individual or enterprise that has bought a bond can sell it to a third party for less than its actual value (when in need of cash, for example). Consequently, bonds serve as a kind of financial instrument with secondary market- or market-system capabilities.

Another securities market is the share-market. Investors need not be limited to banks to get the loan services they need. If a given investor is reputable enough and so desires, that investor can collect the money he or she needs by selling shares to the public. So, when we speak of the securities market, we mainly mean these two branches. Finally, I would like to talk about micro-financial institutions, a topic I simply cannot skip with Dr. Wolday sitting here by me.

Micro-financial institutions are institutions operating like banks. But they do not constitute banks. Why are they not banks? The loans banks provide are drawn upon the money they collect from people in the form of savings, whereas the micro-financial institutions provide loans—at least until such a time as they increase their capacity—from their own savings or equity. If these micro-financial institutions start accepting people's money for purposes of saving and continue to do so on a sustainable basis, the amount of money entrusted to them for safekeeping will increase. And when larger share of their loan out proves to be saving, then a situation is created whereby they begin to act more and more in the manner of the banks with regard to the services they provide. So, then, when we ask what role micro-financial institutions play in a country's economic development, we are more or less asking the same question about how much of a source they could serve by way of providing the financial input necessary for investment.

An investor normally has two sources of financing, particularly if the investor is a big one. One source is the securities market from where the investor could secure the money needed for investment, while banks serve the second source.

Given the scenario so far described, we might as well limit our question to the role banks play in investment, since the status of the securities market in Ethiopia is rather precarious as things stand now. Regarding the banks, I have not come across any study that throws light on the role they play as sources of finance for investment. I would venture an estimate, however, and say that their contribution in this respect could not be anything less than 15 per cent. But what does this mean? Suppose, for example, that the

* The promissory note is commonly abbreviated as IOU [Trans.]

private sector makes an annual investment of about 7-8 per cent to the country's GDP. Suppose, also, that 2 per cent of this resource is secured through bank loans. This is enough of an indicator for me to mark the contribution form this sector is substantial. The question, however, of whether my estimate, as well as judgment, is correct or not is something to be borne out or disproved by future research. Still, I will stick to the opinion that the role of banks in respect of contributing to investment is significant.

Where banks play a minimal role is the area of financial transaction that in the main involves what we call small-scale borrowers. Small-scale borrowers normally do no have sufficient collateral to count on. Our country's banks always provide loans after making sure that borrowers have sufficient collateral. It is appropriate at this point to ask how much share these small-scale investors have in the country's overall investment undertaking. It may come as a shot in the dark on my part, but my estimate is that their share might hit the 50 per cent mark. The figure might vary from year to year. But if we surmise that at least one third of the share in the country's overall investment undertaking is contributed by small-scale investors, the inevitable conclusion would be that the country's banks have virtually no role to play in this respect. When it comes to medium-scale investment projects with greater volume than that of the small-scale investors, their usual financial sources happen to be the banks. It is in this area that the country's banks play a significant role.

What of the question of the capacity of those investors that function and operate on their own financial resources? Our answer to this question could be nothing more than a matter of conjecture. Because those investors with well-organized businesses have savings marked as depreciation fund and also count on their profit margins, the likelihood is that they may not seek, or need, much help from the banks. As for the other categories of investors, but more particularly those that come into the sector as beginners with none but a few years of experience, your guess is only as good as mine; that their financial resource could be none other than the loans provided to them by the banks.

So far, I have attempted to describe the roles banks play in the financial market and the benefits they provide with regard to investment. The next issue I would like to consider concerns the problems confronting the country's banking system.

The most important input that financial institutions—be they banks or insurance companies—need for the efficiency and effectiveness of their work is information. To the same degree that the information these institutions get is meager or insufficient, their operations and functioning, too, will be inefficient. Conversely, to the same degree that the information they get adequate or sufficient, the operations of the institutions, too, improve a great deal. The discrepancy [or the gap] between the volume of information and the performative capacity and efficacy of the institutions is what economists call "information asymmetry."

Let us say that the borrower has all the needed information about the lender, whereas the lender does not have all the necessary information about the borrower. This gap in information opens the door for problems affecting the relationship of the two parties. The problems are varied in their nature and type. At one extreme, we have those who borrow money but fail to pay their debts. On the other hand, we have those types of borrowers who default on payment of their debts and keep asking for deferment or extension of the due date. Such and more are the problems faced by banks as lending institutions. While this can be considered the main problem the banks face, there also are other issues that compound the already existing problems. The other problem is the limited capacity of banks to lend money without asking for collateral. This is not something determined and settled by law. On what grounds, then, do they allow themselves such latitude to authorize loans on the basis alone of feasibility studies, without, that is, considering all necessary information about the borrowers or, for that matter, about the projects, accepting insufficient collateral or none at all? Such questions point to the magnitude of the problem in our particular situation.

It would be unfair, indeed impossible, to expect or require banking institutions to be in possession of all the information they need and require about the state, say, of the industrial sector in the country. But the banks should be able to procure such information from different source. Information sources include research institutions, government documents, or data garnered from consultative reports supplied by the private sector. Let us assume that such capacious information sources are available for use by the banks. Let us, then, assume that some investor would approach the banks for loans with the building of a shoe factory for a project. In this situation, the banks, which may not have all the detailed information about the particular market, could garner enough of the necessary information to warrant consideration of the request of the investor for loans. The only task left for the bank to do would be assessment and evaluation of the project, which is but minimal. But because, first, the banks have problems of getting the necessary information, second, because they will be forced to get the information needed with regard to the particular market situation, the details of the proposed project and the kind of technology needed to implement the project, and all this on their own, the chances for erring on the prospects and feasibility of the venture would be great. It is in consideration of such risk, I think, why the banks are forced to introduce the question of collateral as a prerequisite for securing loans. As long as banks continue to engage in such practices, it would eventually mean that they could not play the role expected of them in development.

I realize time is running out on me. To make the best of what little time is left, I shall now examine, as briefly as possible, the state of the activities of Ethiopia's banks. One of the criteria or indicators for measuring the activities of banks in Ethiopia is the rate of interest they demand, particularly from borrowers. This is important because the second most important role of the banks, next, of course, to accumulating capital through savings, is encouraging and promoting investment. With respect to this dimension of the banks' activities or transactions, what we can say for sure from the outset is that it would be virtually impossible for an investor to make any profit at all on a loan for which that investor is required to pay a 30% interest hanging over his head for the Sword of Damocles. If, however, the rate of interest is reasonably low, a prospective investor can borrow money from a bank and go into a profitable business. Considering all this, the rate and terms of the interest our banks charge for loans becomes an important question in need of addressing. As things stand now, the minimum rate of interest charged by the banks is 7.5 per cent, while the maximum goes as high as 14 per cent. The 14 per cent ceiling, I believe is practiced occasionally, as Ato Leukun, who is here with us tonight could possibly corroborate, among the private banks. The average interest rate as set forth by the National Bank is 10.5 per cent. The question now is how this rate of interest compares with those of other countries, which we must do in order to determine whether or not we are faring well in this respect. If we look at the situation in other African countries—and there are about 50 countries in Africa—there are about seven countries—including Namibia, South Africa, Egypt and Tunisia among the continents northern states—the rate of interest which their banks charge stands at about 10 per cent. The interest rate in such neighboring countries as Kenya goes as high as 20 and more, in some cases, as high even as 30 to 40 per cent. Considered in terms of interest rates charged by banks from borrowers, we can safely conclude that the financial sector in Ethiopia is propitious. In other words, we are doing fine.

The second criterion has to do with the difference between the interests banks pay out on savings accounts and those they charge borrowers when extending loans. When it comes to this point, I think, in the majority of cases, the difference stands at 6 per cent only. The minimum interest paid on savings is 3 per cent. If we take the interest paid on loans to stand at 10.5 per cent on the average, the difference between the two rates is 7.5 per cent. This is not considered really exorbitant. For purposes of comparison, for instance, the spread between the two rates in the developed countries could be 3 and 4 per cent. The interest charged on loans, depending on the rate of inflation, is 5, 6, or 7 per cent. Compared to this, I would not consider the interest rate in our country to be unusual. So that, considered over all, I think the situation of interest rates charged by banks in Ethiopia is reasonable.

The other criterion takes into account the state of what we call Non-Performing Loans (NPLs). These are what we may understand in Amharic as loans that are not paid back or sick loan. According to the Basil agreement the money allowed as write-off should be below 10 per cent of the loan. If we allow, as a reasonable limit, a high of 15 per cent in non-performing loans for developing countries, the rate in Ethiopia is exorbitantly high, which we can consider as really bad. In Ethiopia at present, while some of the private banks are far better in this respect, the Commercial Bank of Ethiopia—which is the biggest and most important financial institution, registers about 33 per cent in non-performing loans. This means that, of the total amount of loans in default, 33 per cent are non-performing or "sick" loans [to speak of the situation in an Amharic idiom]. This does not bode well with the sector. This percentage, in other words, has to come down. The rate has started declining, and we hope it would continue to do so in the future. There are some private banks that have better control of the situation. This is perhaps something we need to dwell upon during the discussions session.

Another issue worth considering regarding the sector is the extent of competition among financial institutions. The question of competition is one that has been raised very often. It is true that it has only been a very short time since the country's private banks started participating in the financial sector. Awash bank is the first of such banks, and even then it has been only ten years since its started its operations. It is difficult to assume that these fresh private banks could stand up to the challenges posed by such a veteran of the financial market as the Commercial Bank. I would, however, like to relate to you something about the achievements of the banks as of Sene 1996.* Considered in terms of the volume of savings, the Commercial Bank of Ethiopia accounted for 73.6 per cent while the private banks accounted for 22.1 per cent. The remaining share of 5.3 per cent was distributed among the development bank and civic associations' savings. In respect, therefore, of savings, the private banks find themselves on the lowest rungs.

And yet, when we look at the matter in terms of loan transactions, we see a somewhat different scenario. We are here talking about overall loans and outstanding loans. Again, when we look at the Sene 1996 report, we see that the private banks had registered 23.8 per cent, and the Commercial Bank 76.8 per cent in total loans. Of this total, if we subtract money loaned out to the government—since the Commercial Bank loans out a lot of money to the government—that is, if we bracket off government loans from the computation, the share of the private banks would increase to 40.1 per cent, while that of the Commercial Bank would come down to as low as 59.9 per cent. Again, if we exclude, on top of the already mentioned, direct government loans, loans paid out to individual government institutions and also those loans disbursed to civic associations (which are very small in number but must be included because they are in the accounts) and consider the amount of loans extended to the private sector, what does the picture look like? While the share of the private banks accounts for 50.2 per cent, that of the Commercial Bank is 49.8 per cent. In my estimate, then, we can speak of the sector as competitive enough considering that it took the private banks a journey of a mere ten years in the business to get where they did at the time under consideration.

Be that as it may, outsiders have many times been critical about our banking system. They keep telling us that what we have in Ethiopia is a mono-bank system, or that we have a system whereby one bank sits dominant over the other banks. In a situation where the power of one bank exceeds those of the others taken together, they seem to conclude, there cannot exist a healthy financial sector. A look into the details of the matter, however, gives us a somewhat different picture. When we speak of outstanding loans—a point I forgot to mention—we mean the stock of loans in default accumulated over a number of years, even loans extended three or four years ago. If we ask about the flow of loans extended in a year, we find that the private banks hold over 50 per cent of the total share, bettering, in no uncertain terms the Commercial Bank. Thus, if we considered the state of the sector in terms of performance, our ruling would be that, if there had been no non-performing loans, the sector definitely would be rated as healthy. Yet, with the existence of non-performing loans, worse yet, given the high rate of their proliferation, our conclusion cannot be that the sector is healthy as a whole. And as I have pointed out earlier on in my presentation, what this situation indicates is that the relationship between borrowers and lenders is not good. If we go back, way back, in time and examine the lore, we used to hear, as by word-of-mouth, almost legend-like one could say, such quips as: "Either the borrower or the lender will die." And very recently we have heard another version of this attitude, namely: "How worse could the consequences of not paying back one's loans be? At the most one would be taken to a court of law, and receive 10 or 15 years in jail, at worst." Since at present, however, banks have been empowered to dispose of the property signed out by the borrower as collateral and redeem their losses, the problem has been somewhat on the wane. This is not a problem of banks alone. This points in the direction also of how much the level of confidence and trust within the wider community has been enriched or impoverished. But I think things will change for the better in the course of time.

Finally, to wrap up the issues so far raised, let me tackle one more issue that you might all be eager to hear about. Let me formulate the issue as a question: Is the financial market free or controlled? This question had earlier been raised by Wolday. What I am up to is the question of liberalization as it relates to the financial market. Broadly seen this market assumes two forms. There is, on the one hand, what we call the money (capital) market, while, on the other hand we have what is known as the foreign exchange market.

* June-July 2004 [Trans.].

The nature of the financial market is determined by interest rates. This market has two dimensions or components. The first is what those in the business call 'Credit Market'. Banks have financial stocks that they loan out. Then there are people who would like to borrow money from the banks. In the transaction between the borrower and the lender, the rate of interest is determined, as in all other types of market, by the relationship between [or the law of] supply and demand. This is one aspect or dimension of the market in question.

Alongside this market is the Money Market. There is a general supply of money and a corresponding demand for money. This is directed and controlled by a central bank. How much leadership and/or control the National Bank provides in this respect is something we can talk about later. The rate of interest operating in the financial market is the combined result of the two markets, not that of the credit market alone. The central bank can discharge the money in the economy and collect it from the public. In doing so, the central bank be able to influence the interest rate. It is, therefore, by taking these two markets, we can talk about liberalization within the market with respect to the financial market.

As has been already mentioned, there is, on the other hand, the foreign exchange market. This market, too, has two dimensions or aspects. But let me take a pause and first address the question of why the need for a foreign exchange market. We need foreign exchange for the purpose of buying the goods and services we need from abroad. What constitutes services? If I want to send my kid abroad for education, or if I need medical treatment in some foreign country, the money I pay for the expenses incurred must be in foreign currency. Or, if I happen to be rich enough and I want to go to some foreign land as a tourist, to relax or for some sightseeing, my expenses must be covered in foreign currency. Such are what we classify under services. Consequently, foreign exchange market refers to the kind of market that deals with the purchase or sale of goods and services between countries.

For purposes of illustration, let us assume that a person goes to a bank with the local currency of Ethiopian Birr. He tells the bank what he wants to do. Based on his needs, he asks the bank to give him the money he needs in foreign currency, let us say Dollar or Euro, or any other currency relevant to his needs. The bank gives (sells) the person the amount he needs in foreign currency [which corresponds to the amount he has in Birr]. If, as in all other types of market, there is a disparity between the available supply and the demand, the exchange rate will vary. On any given day [and hour], the value of the Dollar in Ethiopian Birr can go up to nine Birr instead of the 8.60 or 8.70 that it was the previous day. This is one type of the foreign exchange market.

There is also another reason why foreign exchange is needed. What is this reason, which we may consider as a second reason? One may simply want to have ready cash on hand, or buy property in the form of real estate in a foreign country, for both of which foreign currency is needed. So, the person would demand that the foreign exchange market be made available to him whereby he will dispose off the Birr in his hand and get the foreign currency he needs—say, in dollars. As far as this person is concerned there is no problem in this arrangement, since, for such person, there is no difference whether he puts the dollar so secured into his local account or in an account he opens up in America or any other country. But there is a catch involved here. When a given amount of money is taken out of the country and is transferred into an account in a foreign bank, it means that capital is escaped from or drains out of the country. The question, consequently, become one of capital-drain rather than that of money-exchange. The fundamental question is in what type of currency the person wants to save his money: local currency or foreign? A corollary to this question is: In what form does this person want to own the resources or assets he desires to have? Is it in the form of property, or cash? If property, is the property locally obtained, or is it to be procured from abroad? And if cash, is it needed in local currency or in foreign currency? We have to take account of all these factors before we determine whether the foreign exchange market should or should not be liberalized. Well, since time seems to be really running out I will try to wrap up as quickly as possible.

What exactly would it mean if we were to conclude, from all that has been said so far, that the financial market should be liberalized? With respect to both types of market, what we mean is that we should all be allowed to avail ourselves of foreign currency for the corresponding amount of Ethiopian Birr, whether to buy goods and services or procure property with varying values in some foreign country. The situation in Ethiopia allows such transaction to the extent that the transaction specifically involves trade. All the banks need is the necessary documents. It is possible to buy a determined amount of foreign currency for importing goods and getting the services one needs. If, on the other hand, one insists that he wants to have cash, but only in dollars instead of Birr, or wants to buy a house, but in America or India rather than in Ethiopia, at this point the market becomes off-limits to such a person. In other words, the market, in such instances is regulated or controlled.

When all has been said and done, therefore, our answer to the question of the nature of the foreign exchange market in Ethiopia is, as I have already pointed out in respect of the financial and foreign exchange markets, that it is partly open or liberalized and partly regulated or controlled.

Allow me now, at last, to use the little time left to express my wishes for or my vision of Ethiopia as it would [or should] appear the year 2020.

I cannot be certain that I would be able to answer all the questions that could possibly be raised in this regard. One important question has to do with the kind of world that Ethiopia will find itself in the year 2020. I am, of course, referring to the outside world, the global situation. This, I think, is a crucial question. What this in turn means is that some of the constraints the country faces today will be removed. The question that logically follows from this first one is whether the country would be in a position to overcome what limitations it has today and be able to function as a developing economy. In my opinion, this country will have to fulfill certain fundamental requirements or demands. I have the East Asian experience in mind when presenting this point as a matter of recommendation or suggestion. The first requisite is that there must be an export-oriented development plan put in place. What this means, in more mundane terms, is that the country's economy must compete with other economies elsewhere in the world, such as to come out a winner and be able to sell its goods on the international market. There are, to be sure, many prerequisites that must be met for this to be realized, but that must be the country's goal. When this is achieved, a liberalized financial market will become a reality. This is the first point.

The second point is that we must be able to create a country where good governance, transparency and accountability will have prevailed and, along with these principles, the capacity for their enforcement and our duty to comply with them a reality. Short of this, even when we find it possible to have an export-oriented development, all the foreign exchange we need, and a relatively liberalized financial market, in a situation where corruption, bribery, and fraudulence still prove to be the *modus operandi* our day-to-day lives, the country's economic development will still run the risk of being undermined and subverted. Such a way of doing things will certainly not do for a country that has not as yet been fully developed. It may be important to make adjustments in the country's taxation system, as Ato Leukun has pointed out earlier. But the question of taxation is a different matter. Even if the rate of taxation in Ethiopia were brought down to 10 per cent, there are lots of people around us who want to engage in fraud. So the question really is not that of the system of taxation alone. There is the bigger problem of non-compliance when it comes to laws, rules and regulations. This problem still prevails when it comes to paying taxes, in banking, in governance, in such practices as penetrating a few centimeters into a neighboring plot of land when we build our houses and illegally claim it as our own. These practices pervade most every area of our life, including commercial transactions. Business people in the market sector very well know what they do to one another in this respect. My vision of Ethiopia in the year 2020 is one where we will have extricated ourselves from such a way of thinking and functioning and in which we will have created the kind of economy that would enable us to compete with foreign countries and live a life worthy of the demands of the time. This is the kind of Ethiopia I envision for the year 2020. To me this to be sure is the greatest of our challenges.

Thank you.

FINANCE AND DEVELOPMENT IN ETHIOPIA

Leukun Berhanu*

The Role of Finance in National Development

It is not necessary to explain to this forum the fact that development involves several inputs. It is common knowledge that development is the result of a unified and coordinated interaction of many inputs.

It is difficult to think of healthy human organs and a healthy person without blood and its healthy circulation throughout the human body. It is also extremely hard to think of any meaningful socio-economic development and poverty reduction without finance and its healthy flow throughout an economy. Viewed from this angle, it is clear that finance is a key instrument for development. Finance can indeed be viewed as the blood of an economy.

However, one must realize the fact that finance does not possess any divine power to bring about development. From religious point of view, the human blood is created and directed by the creator who possesses divine powers. Consequently, unless human intervention militates against its smooth functioning, the human blood traverses each and every fabric of the human body -- non-stop, day and night and for years on end -- in absolute obedience to the order of its divine creator.

Of course, mobilization and management of financial resources is not handled by infallible divine power but by fallible human beings. Consequently, the process of mobilization and management of financial resources can not be free from faults. Obviously, the comparison we made between blood and finance is not to equate the nature of the two but to underline the crucial role of finance in socio economic development.

Though human deeds are by no means faultless, the consolation is that human beings have the capacity to realize and correct their mistakes. It is encouraging for all poor countries to note that many developing countries, despite the ups and downs, have effectively utilized finance to pull themselves out of the quagmire of poverty to the comforts of prosperity. Therefore, it is necessary to find ways and means of enhancing the crucial role of finance in our country's development.

The Link between Finance and Development

Finance is a key tool for accelerated socio-economic development and socio-economic development creates additional financial resources for further development. Therefore, there is a strong linkage and interdependence between finance and socio-economic development. However, it should be noted at this juncture that finance is not a panacea for solving development problems since development is the result of synchronized and coordinated interaction of several development tools and engagement of several teams of actors in the entire process of development. Furthermore, it should also be noted that the effectiveness of finance as a tool for accelerated economic development depends upon its effective utilization.

The existence of an effective tool is of no use unless it is supported by the capacity to utilize it effectively. In fact, an effective tool can easily do more harm than good if it falls into the hands of those incapable of using it properly.

For example, in the hope of resolving financial problems, if currency is printed and issued recklessly without due regard for conditions prevailing in an economy, money ceases to be a key tool for development by triggering uncontrollable inflation which recks an economy and impoverishes savers. That is why governments of all countries take, and must always take, due care to avoid the havock that reckless money creation does to their citizens and their economies. Therefore, when we refer to finance as a key tool for development it should be understood that we presume availability of capacity to utilize the tool appropriately and effectively.

The State of Finance and Development in Ethiopia

The fact that efforts were made to develop our country in the past is undeniable. Despite the efforts made, however, our country is at the lowest end in the list of poor countries of the world still struggling to come out of poverty. Therefore, finance and other tools of development combined could not yet pull her out of poverty. This is the glaring fact which does not require statistical measures of poverty to prove it. Nevertheless, making some general observations on the low level of our country's development might be in order.

Illiteracy is very high. Potable water is more of a luxury in many parts of the country than a basic necessity. Modern health care services cover only a small fraction of a large population which lives in areas mostly inaccessible by all weather roads. Though some progress is being made in all of these and other measures, our country's level of development remains very low even by African standards which is itself very low by world standards. I raise these points neither to condemn the past, which does not serve much purpose, nor to belittle the efforts made in the past to change the dismal scene I briefly described. I raise them in order to underline the formidable challenges facing the present and future generations of this country to pull Ethiopia out of the deep waters of underdevelopment and poverty to the high platforms of development and prosperity.

It is possible to present several reasons for the dismal socio-economic conditions of our country. It is also possible to ascribe responsibilities for our country's poverty to past systems of government, to past leadership, to external factors, etc., which might be appealing to historians and other intellectuals but not of much use in changing the plight of today's poor.

If Ethiopia's economic history offers any good lessons for the present and the future, the most important thing to do in the context of our discussion is to pick the good lessons and move forward to change the country's present and future economic conditions positively. Therefore, the direction of our attention should be to explore what must be done in the present and in the future in order to accelerate socio-economic development and pull our country out of poverty.
Following this line of thinking, I would like to raise a few points focusing upon what I think should be done to enhance our country's sources of finance and strengthen effective circulation and utilization of financial resources in support of the country's development.

Creation and Enhancement of Financial Resources

Money becomes a key tool for development only when it is accumulated. Saving money means preparing one of the provisions necessary for development. When small streams are harnessed through the natural or man made processes they are transformed into a sources of electric power for homes and industries of all kinds and into a source of irrigation to transform arid deserts into irrigated fertile lands. The benefits of a pool of water is generally higher than trickles of it. Similarly, in the development process the positive power of money lies in its accumulation. Creating the necessary conditions for expansion and growth of financial institutions to harness savings is like building adequate stores for storing grains ahead of harvest periods or like building dams to harness water for electricity generation or for irrigation.

At the end of March, 2006 the number of bank branches in Ethiopia was 379 out of which 147 were branches of private banks which were established during the last ten years. It is gratifying to note that 39% of the bank branches were owned by the young private banks which are making notable contributions to the economy. Nevertheless, the number of bank branches in our country is very low considering the country's area and population.

According to quarterly report of the National Bank of Ethiopia, total deposits in the banking system stood at Birr 34.6 billion as at 31/12/04. Out of these total deposits the share of private banks was Birr 8.3 billion or about 24%. There is a high volume of cash in circulation in Ethiopia. Channeling more and more of these funds to the banks will increase the volume of funds which could be utilized through the banking system in support of the country's development.

The role of urban and rural micro financing institutions and traditional savings institutions in savings mobilization and provision of credit specially to micro enterprises is also considered significant. Similarly, insurance companies also play important roles in mobilizing financial resources. Therefore, it is necessary to focus upon creating and developing appropriate conditions for growth and expansion of banks and other financial institutions to harness growing volume of financial resources to meet financial requirements of a growing economy.

The establishment of financial institutions which are necessary but are not yet established also requires due consideration. Some of these financial institutions which are desirable but are not currently available in a formal and well organized manner are venture capital institutions, investment banks, mortgage companies, stock exchanges, etc., all of which play significant roles in mobilization of financial resources for investment purposes. Therefore, ways and means of establishing these institutions, encouraging their growth and expansion, and creating appropriate incentive structures to attract investors to the fields of investment should be explored and implemented.

There is a saying to the following effect: "He who shuns eating cabbages for a day will end up eating nothing but cabbages for the rest of his life." Traditionally, cabbage is considered a low quality food and the message is that one should save even by eating low quality foods for some time. Therefore, the saying is an aphorism which aptly describes the importance of savings in order to come out of poverty and ample studies have ascertained beyond any doubt that the poor can and do save. Therefore, cultivating and disseminating the culture of savings as well as creating appropriate incentives to encourage savings in a sustainable manner system wide cannot be overemphasized. Incidentally, in order to drive home this point I would like to point out the fact that any person who keeps his money in a bank, no matter how small, enhances the pool of financial resources available for development and becomes a direct participant in the process of his country's development which is an honourable deed and a source of pride.

The government requires sustainable sources and growing volume of revenue particularly for expanding and maintaining infrastructure required for socio-economic development. Therefore, in addition to a host of other subjects to be addressed in this regard, it is also necessary to focus upon the following:

- Broaden the tax base and strengthen tax collection
- Ensure that the system of taxation is fair and equitable, taking into account the tax payer's capacity to pay, and does not discourage investment and encourage tax evasion
- Continuously educate the tax payers that meeting their tax obligations is critical for covering the costs of the country's development
- Strengthen the culture of openness and transparency, credibility and accountability by periodically communicating to the general public statements of Government income and expenditure.

It is obviously impossible to raise the entire volume of funds required for accelerated development in a developing country. Therefore, it is necessary to conduct studies and develop strategies for tapping external resources in support of the country's development. In this regard, the following points deserve appropriate attention:

- Fulfill the required criteria and utilize debt cancellation and grant opportunities available to poor countries
- Unfailingly recognize that borrowed funds are repayable and borrow mainly for development purposes, in line with capacity to pay, at low interest rates and payable over a long period.
- Create appropriate conditions which encourage domestic and foreign investment.

In particular, continued attention should be given to taking the following measures in order to encourage domestic and foreign investors:

- Publicize widely and repeatedly the investment opportunities and incentives the country offers
- In order to build the capacity of domestic investors, who are the foundation of the country's economic development, encourage partnerships between domestic and foreign investors
- Encourage Ethiopian investors in the diaspora to be engaged in various investment activities in their country.

- Strengthen dialogue between the government and investors
- Continue making all the necessary efforts to ensure the rule of law
- Make relentless efforts to ensure sustainable peace and stability

Strengthening Financial Management Capacity

Mobilizing financial resources required for development is an important task. But the role of finance as a tool for development lies in its effective utilization. Therefore, it is absolutely necessary to ensure effective utilization of financial resources by aiming our efforts in the directions presented hereunder:

a) Continue focusing on maintaining price stability--a rather traditional area of focus in Ethiopia --. Rampant inflation destroys the value of savings and investment suffers seriously if there is no sustainable price stability. The need to refrain from taking policy or other measures which make inflation out of control is so obvious to require any justification.

b) Ensure viability of projects through appropriate studies and continue building capacity in projects studies. Otherwise, hard earned financial resources can easily be squandered.

c) Avoid diverting funds allocated for development purposes for consumption purposes, even if the nature of the consumption appears to be urgent.

d) Pursue a policy direction which encourages ploughing back profits to expand existing investment or going into new investments. For example, the recently adopted policy of waiving taxes on dividends for shareholders who plough back their dividends is an encouraging move in this regard. Conducting further studies to provide similar incentives will help expansion and growth of private sector investment.

e) Lack of adequate project implementation capacity, both in the public and private sectors, leads to costly time overruns and budget overshooting thus leading to wastage of scarce financial resources. Therefore, the need for continuously building capacity in the entire spectrum of project formulation, analysis, implementation and monitoring cannot be overemphasized.

f) Fight corruption resolutely and work on developing cultures which value honesty and integrity in order to avoid deliberate misuse and embezzlement of both public and private financial resources. Take expeditious and sufficiently punitive legal measures against convicted offenders and publicize the offences made and punishments delivered as part of an educational campaign to discourage such criminal offences.

g) It is impossible to ascertain proper utilization of financial resources in a development project or any other economic activity without appropriate accounting systems and audited financial statements. Reliable, timely and audited financial statements are key instruments which portray the financial status of any activity which involves finance. They also provide opportunity for taking appropriate corrective measures in time where wastage or misuse of financial resources are observed. An organization which does not have a reliable, timely and audited financial statements is like a person who does not see his face in a mirror and does not know what he actually looks like.

In our country, the number of organizations which have appropriate accounting systems and timely and audited financial statements is limited. Despite the fact that there are several organizations which are much larger than share companies, the law requires only share companies to produce audited financial statements. Therefore, in the absence of audited financial statements which show the true picture of their financial status, it will not be surprising if many organizations suddenly collapse without realizing that they have actually been heading to their inevitable collapse.

In order to change this faulty state of affair, I believe the law should require all sizable economic entities, in addition to share companies, to prepare audited financial statements. Such a move helps tax authorities to make tax assessments based on reliable financial statements and establish a more transparent relationships between the tax assessors and the tax payers. It helps owners of the economic entities themselves to see the financial status of their organizations regularly, to know where their firms are and where they are heading, and take timely actions. It enhances financial transparency and allows lending banks to have a reliable picture of financial status of borrowing firms. It also creates employment opportunities for accountants and auditors. In my view, the sooner the law is amended the better for all stakeholders.

Obviously, the need for an appropriate accounting system and audited financial statements equally applies to the public sector as it applies to the private sector. That is the only way of ascertaining that financial resources allocated by the government for development purposes, or for any other purpose for that matter, are actually used for the intended purposes in time.

h) Using one's own financial resources fruitfully and carefully is essential. Utilization of borrowed funds requires much more care and caution because even if the borrowed funds were squandered the debt has to be repaid using financial resources which could have been utilized for development and other constructive purposes. Furthermore, failure to service debts hampers the flow of financial resources, the health of lending institutions and could eventually lead to absence of willing lenders thereby creating shortage of funds to support the entire development process. The dangers of borrowing for consumption purposes should also be noted. Therefore, the subject of utilizing borrowed funds with appropriate degree of caution for development or other productive purposes which enhance capacity to pay the debt requires full attention of both the public and private sectors.

Strengthening the Flow of Financial Resources

A unit of an economy deprived of financial resources is similar to a human organ deprived of blood and its circulation. They both become numb and dysfunctional. As human organs are interrelated and mutually supportive, the various units of an economy are also inter connected and mutually supportive. The numbness of a human organ negatively affects the well being of the entire human body. Similarly, the numbness of a unit of an economy negatively affects the functioning of the economy as a whole. Therefore, it is absolutely necessary to ensure that all sectors of the economy get adequate financial resources in time.

The volume of outstanding loans and advances granted by banks in Ethiopia to various sectors of the economy stood at Birr 26.4 billion as at 31/12/04. Out of this total sum Birr 7.2 billion or 27% was the share of the private banks while the remaining 73% was the share of the state-owned banks. These figures are indicative of the high magnitude of financial resources mobilized and channeled by the banks to various sectors of the economy. Nevertheless, the volume of financial resources required for the country's accelerated socio-economic development is obviously much higher than the figures indicated. Even though commercial banks provide long term investment finance to some extent, the lion's share of their loan portfolio is composed of short term working capital finance because of short term nature of their loanable funds. Of course, short term working capital is an essential component of financial requirements of economic entities. In order to ensure availability of adequate long-term funds for investment, growth and expansion of financial institutions engaged in long term financing should be encouraged. Therefore, the tasks of mobilizing financial resources to meet short and long-term financial requirements of the economy deserve continuous attention.

The government tries to expand social services and infrastructure required to accelerate growth and development using financial resources generated internally and externally through grants and loans. Nevertheless, the low stage of services and infrastructure development indicate the need for mobilizing increasingly high volume of financial resources in order to accelerate their growth and expansion. Therefore, efforts should continue to be made to expand the sources and volume of external grants and loans as well as to ensure effective utilization of the financial resources.

The large numbers of micro enterprises in urban and rural areas do not have direct access to bank loans. They obtain small loans from micro financing institutions or they resort to traditional savings institutions. Though the financial capacity of the micro financing institutions vary from institution to institution, their financial capacity is limited in general and the volume of savings they mobilize from their target groups does not fully cover the loan requirements of the micro enterprises and their geographical coverage is also limited. Therefore, side by side with expanding their geographical coverage, it is also necessary to focus upon strengthening linkages among micro-financing institutions. Strengthening linkages of the institutions provides opportunity for relatively developed micro financing institutions to support the relatively weaker ones in addition to allowing exchange of mutually beneficial experiences

In general, there is a strong need for strengthening linkages among banks and other financial institutions in order to allow healthy flow of financial resources among the financial institutions and optimize the contributions of the entire financial system to the development process as a whole. This point leads to one important conclusion. That is, even though financial institutions compete among themselves they should be able to operate as an integral whole to ensure effective utilization of scarce financial resources and establish an efficient and effective country-wide payment systems. A lot is yet to be done in this regard.

I have raised a number of points which help to increase the contributions of financial resources to development. The points raised indicate general directions to be pursued. In order to translate the points raised into implementable action plans, a lot more should be done including conducting studies in the areas discussed and organizing follow-up discussions on each of the subjects.

It is a common knowledge that the forces of development are many. The discussion we made emphasizes the role of finance in development simply to underline the crucial role it plays in unison with other critical factors required for bringing about a sustainable socio economic development. Of all factors however, the supreme factor of development is the human being. All other factors necessary for bringing about development are inanimate resources fully under the command of the human being, for whose benefit development is intended and the sole factor who can synchronize all the other factors to bring about development. Therefore, one can assert that the entire development package is the product of positive human intellect working together positively. Consequently, in order to bring about development it is absolutely necessary to create all the necessary conditions for cultivating healthy human minds and directing the focus of the human intellect towards growth and development.

The appropriate environment for healthy minds and development is an environment of sustainable peace and stability. Therefore, the efforts being made to establish sustainable peace and stability internally and with the country's neighbours should continue unabated. All citizens must be united to achieve this noble goal which is an indisputable pre-condition for achieving accelerated and sustainable growth and development and for relegating poverty to the annals of history. In the near future or in "2020 Ethiopia", we can see a developed Ethiopia only if we work together as a team in an environment of sustainable peace and stability. In my view, the cost of establishing and maintaining sustainable peace and stability is immensely lower than the cost of losing peace and stability