

FINANCIAL REFORMS, DOMESTIC RESOURCE MOBILIZATION AND CREDIT POLICY IN ETHIOPIA

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1. INTRODUCTION

Financial resource is a very important, if not the most important, factor in economic development. A variety of economic growth theories, ranging from Harrod-Domar's "Growth Model", and Rostow's "Take-off" (1960) have one thing in common: that the availability of savings is a precondition for continuing growth. In his work, *The Theory of Economic Growth*, Schumpeter (1934) has noted the need to develop domestic financial institutions and patterns of behaviour necessary to generate and mobilize scarce domestic capital funds as key conditions for economic growth. These theories and models show that mobilization of financial resources is crucial in achieving rapid economic growth.

If, for example, an economy wants to increase real capital formation, it has to provide a climate that encourages domestic savings and importation of foreign capital. Since, however, resource mobilization is very closely tied to savings, encouraging the former requires an institutional arrangement to encourage and mobilize savings, on the one hand, and to channel the savings so mobilized into productive investment, on the other. A greater dependence on domestic sources of capital, therefore, requires a wide range of independent and well-organized financial institutions, which have the ability to mobilize internal resources freely for the purpose of capital formation, and allow capital to be invested conveniently and freely into the desired development sectors.

Developing countries are generally characterized by low rate of domestic savings. However, the inadequacy of domestic savings rate seems exaggerated. Except in the very poor countries, the gross domestic savings rate has been found to be fairly high in a large number of developing countries. What is lacking is the efficiency in the process by which the savings being accumulated in the economy are translated into savings usable for productive purposes (Mauri, 1977). These developing countries are further characterized by government intervention in financial markets, directly or through specialized monetary and credit institutions. For instance, fixing interest rates is nearly a universal policy in many developing countries including Ethiopia.

A fundamental goal set by the literature on financial sector reform is, therefore, how to design policies and institutional arrangements conducive to financial sector liberalization, which are consistent with a liberalized economic policy. Such exercise has to result in the elimination of financial repression, i.e., the increase in interest rate towards an efficient market clearing level, the promotion of optimal financial savings within a framework that avoids misallocation of financial and real resources.

The objective of this paper is to review the performance of the formal financial sector in Ethiopia. It investigates domestic resource mobilization, institutional arrangements, credit policy and resource allocation issues, to identify the basic reasons that justify reforms within the sector. A short review of the informal (traditional) financial sector is also made to illuminate its importance in the economy and the need to link it with the formal sector.

The paper is organized as follows: the next section deals with the informal financial sector to be followed by the analysis of the formal sector. Section 4 looks at savings and resource mobilization in the country. Next comes the analysis on government financing. Before concluding the paper a section dealing with credit and credit policy is presented.

2. THE INFORMAL FINANCIAL SECTOR

In Ethiopia, a variety of traditional resource mobilization and saving mechanisms exist in both urban and rural communities. The details and the names of these traditional resource mobilization institutions vary from one community to the other, but, the practice of saving is widespread in the country. However, in the non-monetized part of the peasant economy, saving is made in kind, usually in the form of cattle and other physical assets. But, in the more monetized sectors, resource mobilization is in cash. There does not exist sex discrimination in the formation of groups. Nor are individuals confined to one group or system. The level of saving varies considerably between individuals and groups. Examples of these traditional savings mechanisms include: (a) *Ekub*: a group of people form an *equb* by contributing specific sums on daily, weekly or monthly basis and at each due date one of the contributors is given the collected sum on lottery basis. This continues until all contributors get a turn. Then the *equb* ends. In this arrangement savings circulate. (b) *Idir*: a much larger community group formed to pool resources usually to bury the dead. But, some *idirs* have a wider role. (c) *Mahber*: a small group like the *ekub*, but, with social objectives similar to the *idir*. These traditional social institutions play a crucial role in the economy, but, they are neglected as far as research is concerned. For instance, it is not known how much resource is mobilized by these traditional institutions annually and what is the pattern of their expenditure, i.e., whether the funds mobilized are invested productively or are spent on consumption.

On the resource allocation side or credit, there are also several traditional sources or institutions which meet the credit needs of the society. Before the Land Reform of 1975, for instance, local money-lenders which were often urban residents, small businessmen or landlords advanced money to those who needed credit at very exploitative and exorbitant rates of interest, on average, ranging between 100 and 300 per cent per annum. Studies in this area are also very limited. But, two studies after the Land Form (MOA, 1983/84 and Dessalegn, 1984) have shown that the traditional sources of credit as well as the interest charged have changed after the reform. While the study by MOA indicated that 80% of peasants' credit was from friends, relatives and merchants, the study by Dessalegn indicated that the Land Reform has done away with local money-lenders and that peasants at present borrow money from other peasants, relatives, etc. and virtually no interest is involved.

Money-lending continued in the informal sector, because, it satisfied a demand. But, the question is whether the funds involved are used for investment and consequently contribute to development. A feature of money-lending in the informal sector is that over 80% of the proceeds are used for consumption purposes. Borrowing from money-lenders, friends, and relatives is widespread among small farmers. It is known that most small farmers hardly use purchased inputs. For instance, the proportion of farmers using fertilizers does not exceed 15%. It therefore follows that borrowing is usually not for investment purposes, but, largely for consumption. Because of the high interest rate, borrowing is usually for a short term not exceeding 12 months. The high interest rate in the informal sector usually encourages the flow of funds away from the banking system, thus distorting resource allocation.

3. THE FORMAL FINANCIAL SECTOR

Over the last five decades, the formal financial sector in Ethiopia included an array of banking and non-banking institutions. Since its inception in 1942, the financial system comprised commercial banks, a development bank, specialised housing and tourism institutions, cooperatives, a share market, the insurance industry and pension fund. The organizational structure, management and ownership of these financial institutions have changed since the nationalization of the financial sector institutions in 1976.

3.1 The Formal Financial Sector Before 1976

The history of the formal financial sector development in the country can only be traced back to 1942, when the State Bank of Ethiopia was created by Imperial Charter. Until 1963, the Bank had the dual functions of a central bank and a commercial bank. However, *Proclamation No. 206 of 1963*, promulgated to regulate the banking and monetary system in Ethiopia, created two institutions: the National Bank of Ethiopia (NBE) as the central bank of the country, and the Commercial Bank of Ethiopia (CBE), to take overall banking business with the public, including mobilization of savings for short-term purposes.

In addition, there were also other financial institutions that mobilized resources for medium- and long-term purposes. These included: (a) the Development Bank of Ethiopia (DBE), a state-owned institution, established by the Imperial Charter of 1951, with a paid-up capital of Birr 11 million; (b) the Ethiopian Investment Corporation (EIC) established as a fully government-owned company in 1963, with a paid-up capital of Birr 29 million; (c) the Addis Ababa Bank, established as a private share company in 1964, with a paid-up capital of Birr 5 million; and (d) the Banco Di Roma established in 1967 as an Ethiopian share company with a share capital of Birr 4 million.

Other financial institutions, insufficiently developed, but, involved in the mobilization of financial resources during the period, were: the Agricultural and Industrial Development Bank (AIDB), which was formed by merging of DBE and EIC in 1970; the Ethiopian Tourism and Hotel Investment Corporation (established in 1970); the Savings and Mortgage Corporation (1965); the Imperial Savings and Home Ownership Public Association (1962);

the Insurance Industry (1971); the Addis Ababa Share Market (1965); Cooperatives (1966); and the Pension Fund (1961).

The period before 1976 was characterized by a rapid growth rate of savings and time deposits, 21% on average, and a steady rise of these deposits as a percentage of GDP from 4.02% in 1961 to 6.39% in 1969 (IBRD, 1972). On the other hand, the Commercial Bank, as well as the other financial intermediaries had unsatisfied demand for funds. However, the shortage of funds was not, as might be expected, reflected in the level of interest rate within the financial system, because the rates tended to be administered rather than market determined. The deposit rates were prescribed by the National Bank of Ethiopia, while lending rates were left to institutions with a maximum rate of 12%. The continued shortage of domestic resources at the then existing interest rates, the movement of funds from the banking system into money-lending and the availability of a market for funds at rates which, on average, were 20 times as high as the Commercial Bank rate, all indicated that the interest rates offered by the banking system were too low. Table 1 shows the interest rate structure during the period (1964-71).

The other feature of the financial sector institutions before 1976 was that they were autonomous and operated on profit-and-loss basis. The NBE exercised powers for licensing and inspection of commercial banks. It imposed requirements for maintenance of reserve balances and liquidity ratios and ceilings on deposits accepted by the Bank. However, each bank or financial institution had its own credit policy, although, the general regulations of the NBE limited the maximum lending of any bank to 10% of its capital and reserves. While commercial banks looked for adequate security and sound financial business standing of borrowers, the development bank favoured projects that contributed to the country's economic growth consistent with the development plan of the country. Furthermore, projects were selected for financing on the basis of their managerial competence and viability in terms of financial and economic returns. While commercial banks mostly provided short-term loans, the development bank extended medium- and long-term development credit.

Table 1: The Structure of Interest Rates 1964 - 1971 (per cent per annum)

	Jan. 1964	Feb. 1965	Sept. 1966	Feb. 1967	April 1969	August 1970	Dec. 1971
1. National Bank Discounts, Rediscounts and Advances							
Eligible Paper (Exports)	4.5	4.5	5.0	5.0	5.0	5.0	5.0
Eligible Paper (Others)	5.0	5.0	5.5	5.5	5.5	6.5	6.5
Treasury Bills	4.5	4.5	5.5	5.5	5.5	6.0	6.0
2. Commercial Banks Deposits							
Savings	4.5	4.5	4.5	5.0	5.0	6.0	6.0
Time:							
30 days - 6 months	3.0	3.0	3.0	3.0	3.0	4.0	4.0
6 - 12 months	3.5	3.5	3.5	4.0	4.0	5.0	5.0
Over 12 months	4.5	4.5	4.5	5.0	5.0	6.0	6.0
Lending:							
Exports	6-9.0	6-9.0	7-9.90	7-9.0	7.5-9.5	7.5-9.5	7.5-9.5
Others	7-9.0	7-9.5	7-10.0	7-10.0	8-10.0	8-10.0	8.5-11.0
3. Other Financial Institutions Including Subsidiaries							
Deposits							
Savings	-	-	5.0	5.0	5.0	6.0	6.0
Time:							
30 days 6 months	-	-	3.0	3.0	3.0	4.0	4.0
6 - 12 months	-	-		5.5	6.0	6.0	6.0
Over 12 months	-	-	5.5 - 6.75	5.5 - 6.75	5.5 - 6.75	6.20 - 6.8	6.20 - 7.0
Lending	-	-	6.0 - 10.0	6.0 - 10.0	6.5 - 10.0	6.5 - 10.0	6.5 - 13.0

Source: National Bank of Ethiopia.

3.2 The Restructuring of the Formal Financial Sector

Consequent to the 1976 revolution, the financial system in Ethiopia was nationalized and restructured on the basis of the 1976 Banking Law. As a result, the sector now comprises only five institutions each with a specific and differentiated area of responsibility based on function. Thus, the sector includes: (a) the NBE, the central bank with overall responsibility for monetary policy and financial sector supervision; (b) the CBE, the sole commercial bank undertaking both retail and wholesale banking, short-term commercial credit and savings mobilization; (c) the AIDB, which concentrates on seasonal production credit, medium- and long-term credit for agriculture, industry and other sectors; (d) the Housing and Savings Bank (HSB), the main source of long-term credit for building and housing; and (e) the Ethiopian Insurance Corporation (EIC), which provides a full range of insurance and assurance cover. There is also one pension authority, but, with a separate legal entity and management. The NBE, through its Credit Cooperatives Development Department has promoted about 450 formal savings and credit cooperatives.

Although, each of the five institutions is a separate legal entity, the financial sector as a whole is led by the NBE. They share the common Board of the NBE in which the overall responsibility for financial sector supervision and monetary policy implementation is vested. The financial sector was reorganized along the lines of a socialist financial system, while nevertheless, preserving the important distinction between the central and commercial banking functions. Policies in the sector have been geared towards supporting a planned economy and all major aspects of borrowing and lending were fully regulated. Individual financial institutions operate in specific business segments allocated to them. Competition is virtually non-existent, and financial institutions have very little autonomy.

3.3 Interest Rate Policy

Interest rate policy is set by the NBE, which prescribes in detail which instruments are available to which depositors and borrowers in which sectors and at what rate of interest. The rate structure bears little relationship with the opportunity cost of capital or the rate of inflation, but, rather, form part of the overall approach to central planning and control of the economy. Concessionary lending rates were specified for public enterprises and cooperatives over private borrowers and for agriculture over industry and trade. Saving rates were equal to or above these concessionary rates and only provide an acceptable margin to the banks with respect to lending to private organizations and individuals. Thus, lending rates were largely negative with respect to domestically mobilized resources. Saving accounts are only available for a limited classification of savers, namely, individuals, and private organizations, saving and credit cooperatives, *ekub* and *idir*. Thus, for the majority of institutions a return on saving would only be achieved for deposits of over one year. Withdrawal of such deposits before full year (term) resulted in penalty, with savings earning only the lower rate for shorter-term deposits. For instance, time deposit withdrawn before full year earned no interest rate at all.

The interest rate policy had far reaching effects on financial sector development in the country. The structure of deposit rates, discriminating against institutional deposits acted as a disincentive to effective management of surplus short-term liquidity and inhibited the careful use of credit. On the lending side, the lower interest rates to public enterprises and cooperatives are forms of subsidy which should have been provided if deemed necessary through government budgetary allocations. At the level of financial institutions, the fixed schedule of lending and borrowing options stifled product innovations and severely impeded the development of core banking skills such as credit evaluation and associated pricing of credit.

In Tables 2 and 3, interest rates on deposits and on long- and short-term loans and advances are presented.

Table 2: Interest Rates on Deposits (per cent per annum)

	Demand Deposits Current	Time Deposits				Saving Accounts	
	A/C	1yr.	2yrs.	3yrs.	5yrs.	up to 100,000	over 100,000
1. Financial Institutions	Nil	1.0	-	-	-	-	-
2. Government-owned Undertakings	Nil	1.0	-	-	-	-	-
3. Private Organizations, Coops. (except S & CC)							
4. Urban Dwellers Associations, Peasant Associations, Other Mass Organizations & Professional Associations	Nil	4.0	4.5	5.0	5.5	-	-
5. Individual Savings & Credit Cooperatives <i>Idir, Ekub</i>	Nil	6.0	6.5	7.0	7.5	6.0	2.0

- Notes:** 1. If amounts were withdrawn from time deposits before the full term, only the rate for number of years completed was paid. Thus, time deposits withdrawn in less than a year received no interest.
2. Only individuals, *idir, ekub*, savings and credit cooperatives and private organizations were allowed to maintain savings accounts (i.e., for less than one year).

Source: National Bank of Ethiopia

Table 2: Interest Rates on Long- and Short-term Loans and Advances (per cent per annum)

Sector	Coops.	Government-owned Undertakings	Individuals & Private Organizations	Financial Institutions
1. Agriculture	5.0	6.0	7.0	-
2. Industry, Mining, Power & Water Resolver	6.0	8.0	9.0	-
3. Domestic Trade	6.0	8.0	9.5	-
4. Transport & Communication	6.0	8.0	8.0	-
5. Export Trade	6.0	6.0	6.0	-
6. Import Trade Fertilizers, Seed & Pesticides-All Other Imports	5.0	6.0	7.0	-
7. Hotel and Tourism	6.0	8.0	9.0	-
8. Construction	6.0	8.0	9.0	-
9. Housing - Construction - Purchase	4.5 6.0	4.5 6.0	7.0 8.0	- -
10. Central Govt. - Short-term - Long-term	- -	3.0 5.0	- -	- -
11. National Bank of Ethiopia	-	-	-	2.5-4.0
12. Personal	-	-	-	-
13. Others	to be determined by the Bank			
14. Penalty	2.0-5.0	2.0-5.0	2.0-5.0	-

Source: National Bank of Ethiopia.

4. SAVINGS AND DOMESTIC RESOURCES MOBILIZATION

4.1 Private Sector Savings

In general, there has been a high level of liquidity in the financial system over the last decade. There are several reasons for this. Among these, the private sector households and enterprises combined had a significant financial surplus that was in excess of savings over investment, which had been mobilized through financial intermediaries. Among the situations which favoured savings mobilization were: the expansion of commercial bank branches which increased from 114 in 1979 to 157 in 1989, the positive real interest rates in the 1980s, and the limited opportunities for investment and consumption expenditure by the private sector. Private investment, in manufacturing or service industries had been tightly regulated and subject to fixed asset ceilings and case-by-case licensing. The main commercial outlet for private investment was trade only, but, even here opportunities had been reduced through strict licensing which reduced the number of traders very significantly.

Financial records indicate that net deposits (demand, savings and time deposits) by the commercial banks and other specialized institutions increased from Birr 185.6 million in 1981 to Birr 499.8 million showing an increase of 269%. On average, net deposits increased by 23% per annum during the period. Table 4 indicates these developments.

Table 4: Net Deposits Mobilized by the Commercial Bank and Specialized Banks

Year	Amount (Million Birr)	Percentage Change
1981	185.6	
1982	180.5	- 3
1983	314.7	74
1984	261.9	-72
1985	372.8	42
1986	375.7	-
1987	385.2	2
1988	364.8	6
1989	272.9	24
1990	499.8	83

Source: National Bank of Ethiopia, *Annual Reports*, (various years).

4.2 Aggregate Domestic Savings

A high level of liquidity in the financial system is not necessarily a reflection of high level of domestic savings. In fact, the overall domestic savings ratio in Ethiopia has been low. According the review made by the World Bank (1990), aggregate gross domestic savings as measured in the national accounts, have lagged far behind fixed investment. The resource gap, the gap between savings and investment, increased from under 5% of GDP in 1980/81 to over 10% in 1987/88. The review further revealed a significant dissaving by the Government

averaging 2.5% of GDP over the period between 1982/83 and 1987/88. The dissaving or low level of saving might be explained by the war and relief assistance directly financing higher levels of consumptions than the economy would otherwise afford. In general, therefore, there have been persistent low levels of domestic resource mobilization as depicted in Table 5.

Table 5: Real Domestic Savings and Investment

Year	Investment	% of GDP	Savings (Million Birr)	% of GDP
1974/75	814.3	10.4	583.6	7.5
1777/78	676.1	7.5	174.0	1.9
1980/81	913.6	10.4	275.9	3.1
1983/84	1193.0	12.4	232.6	2.4
1985/86	1267.4	12.7	222.0	2.2
1987/88	1503.5	15.6	429.6	4.5
1988/89	1411.6	14.4	452.0	4.6

Source: World Bank.

5. GOVERNMENT FINANCING

As the result of excess liquidity in the banking system and lack of expenditure opportunities which has dampened the private sectors' demand for loanable funds, the Government had been able to enjoy cheap financing of its fiscal deficits. The interest rate policy of 1986, which discouraged public enterprises from holding their liquid assets in the interest-bearing accounts at CBE had also created a favourable situation for the government deficit financing.

According to the analysis by the Specific Identification Mission Report (IFAD, 1990), the aggregate liquidity expansion in the face of low growth had been limited by monetary deepening. The best indicator of this is the "velocity of circulation" of broad money, i.e., the ratio of GDP at market prices to average money supply. The inverse of this ratio, the ratio of money to GDP has increased from 25% in 1980/81 to 44% in 1988/89. The Government has been able to finance that part of its deficit not covered by net foreign borrowings because individuals and enterprises had been willing to hold more money in cash and on deposit. The government's net borrowing between 1984/85 and 1987/88 is shown in Table 6.

Table 6: Government Net Borrowing from the Banking System 1984/85-1987/88
(In Millions of Birr at Current Prices)

Year	Net Government Borrowing	As % of GDP
1984/85	326.4	3.3
1985/86	148.5	1.4
1986/87	434.5	3.9
1987/88	292.5	3.5

Source: World Bank.

6. CREDIT AND CREDIT POLICY

Both the institutional set-up and credit policy after 1976 were geared towards the overall policy of the country's centralized economic management. The financial institutions organized under the 1976 Banking Law are hence simple instruments of the state to channel resources mobilized by the financial sector towards state enterprises and cooperatives. Credit to the private sector is based on strict collateral requirements. Loans and advances by borrowing institutions over the ten-year period between 1981 and 1990 show that on average the government sector took 36.4% of the total, while 50.3% went to public enterprises. The private sector's share was only 8.3% of the total loans and advances made by the banking system during the period. This strongly confirmed that the policy favoured the Government and the public sector. Table 7 shows loans and advances by borrowing institutions for the period between 1981 and 1990.

6.1 Overall Lending Policy

Lending policies in the formal financial sector are set by the NBE, and were geared towards supporting the planned economy and hence all major aspects of borrowing and lending are fully regulated. Interest rates charged to borrowers and commitment fees and other charges on the loans are all dictated by NBE. Within the context of the planned economy, the state and public enterprises had been the major customers of the banking system as depositors, borrowers and users of its services. In many instances, banks have been directed by the National Bank to lend for non-viable investments in the public sector. As the result, most of the funds disbursed to the public enterprises, particularly state farms, have remained uncollected, leaving the banks with low rate of growth of capital and reserve of about 3%, on average. Among the financial institutions, the AIDB suffered serious capital depletion, with its net capital becoming negative by the end of the 1990 financial year. Table 8 gives the net capital position of the Bank between 1982 and 1991.

6.2 Sectoral Distribution of Credit

Table 9 summarizes loans and advances by economic sector. It is clearly indicated in the table that the lion's share of the resources mobilized by the banking system was allocated for government financing. Loans and advances to the government totalled Birr 3.7 billion in 1987, the highest between 1981 and 1990. It then took a declining trend and stood at 36.4% of the total outstanding loans and advances as of June 30, 1990.

Loans and advances to the agricultural sector took an increasing trend and stood at Birr 1.9 billion in 1990 and accounted to 30.6% of the total outstanding credit by the banking system. The largest portion of this outstanding credit is the loan disbursed to state farms upon the direct authorization of the central government. The industrial sector, which was also dominated by state-owned enterprises took 8.4%, while the share of hotels and tourism was 10.8%. One should be cautious in understanding what the outstanding loans and advances show with respect to the performance of the economic sectors. In most cases, they show poor performance and lack of capability to settle the outstanding loans which accumulated from year to year. Loans and advances to state farms were the best examples of such cases.

Table 7: Loans and Advances by Borrowing Institutions in Millions of Birr as at June 30

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	Share %
1. Central Government	1,261.5	1,594.9	2,431.4	2,794.4	2,961.2	3,314.0	3,716.7	1,497.8	1,868.5	2,239.3	36.4
2. Public Enterprises	1,539.8	1,751.5	1,566.9	1,685.6	1,806.5	2,050.1	2,317.3	2,802.6	3,021.6	3,100.2	50.3
3. Cooperatives	109.7	114.6	113.1	120.6	97.0	87.7	125.3	179.4	229.3	310.7	5.0
4. Private Enterprises & Individuals	500.4	518.9	510.4	490.8	497.7	490.3	514.7	578.6	491.2	508.7	8.3
Total	3,411.4	3,979.9	4,621.8	5,091.4	5,362.4	5,942.1	6,674.1	5,076.1	5,634.8	6,158.9	100

Note : Annual figures are outstanding balances.

Source: National Bank of Ethiopia, *Annual Reports*, 1980/1981 - 1989/90.

Table 8: Equity Capital of AID Bank (millions of birr)

Year	Paid-up Capital	Accumulated Deficit	Net Capital
1982	100.00	(15.90)	84.1
1983	100.00	(22.7)	72.3
1984	100.00	(28.5)	71.5
1985	100.00	(27.0)	73.0
1986	100.00	3.7	103.7
1987	100.00	(5.7)	94.3
1988	100.00	(16.5)	83.5
1989	100.00	(17.7)	82.3
1990	100.00	(84.2)	15.8
1991*	100.00	(106.1)	(6.1)

Unaudited account.

Source: AID Bank Annual Reports

Table 9: Loans and Advances by Economic Sector (millions of birr)

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	%
1. Government Deficit Financing	1,261.5	1,594.9	2,431.4	2,588.2	2,961.2	3,314.0	3,716.7	1,497.8	1,868.5	2,239.3	36.4
2. Agriculture	808.2	948.4	822.4	933.9	1,058.3	1,245.4	1,427.0	1,653.9	1,744.1	1,884.8	30.6
3. Industry	248.5	271.7	246.6	245.7	263.6	271.2	296.3	345.2	470.8	517.6	8.4
4. Domestic Trade	75.5	150.3	189.7	155.4	75.0	134.6	180.1	247.4	172.5	158.4	2.6
5. International Trade											
a) Export	(83.2)	(97.2)	(161.8)	(160.6)	(170.2)	(210.5)	(148.9)	(156.7)	(235.4)	(173.7)	-
b) Import	(386.6)	(386.9)	(233.7)	(212.9)	(219.4)	(131.3)	(249.8)	(329.3)	(278.4)	(296.1)	-
6. Hotels and Tourism	7.6	6.4	360.1	390.9	426.9	452.0	456.8	573.5	610.0	663.2	10.8
7. Transport and Communication	149.7	147.9	132.1	140.4	131.4	117.9	115.3	157.27	111.0	88.8	1.4
8. Mines Power and Water Res.	11.8	10.2	11.9	15.8	14.3	17.4	18.1	16.6	18.0	22.0	0.4
9. Housing and Construction	309.5	345.2	12.9	18.6	17.7	19.0	36.9	55.3	75.4	90.2	1.5
10. Personal Loans	12.0	10.7	9.8	9.1	10.9	10.1	10.6	11.0	10.8	10.6	0.2
11. Others	56.9	10.2	9.4	9.1	13.5	18.7	17.6	14.5	11.7	14.2	0.2
Total		3,979.9	4,621.8	4,850.6	5,362.4	5,942.1	6,674.1	5,058.4	5,610.6	6,158.9	100

Source: Figures are outstanding balances as of June 30, of the fiscal year.

6.3 Rural Credit Policy

The 1986 Rural Credit Policy introduced by the NBE was revised and re-introduced in August 1988. The revised rural credit policy formed a basis for all rural credit activity. Until 1986, however, no rural credit policy existed and each bank operated according to its own lending policy and procedures. The objectives and strategies of the revised credit policy included:

- a) expanding credit operations in the rural sector through:
 - i) short-term production, marketing and other credit;
 - ii) investment credits for agriculture and non-agricultural activities in the rural areas;
- b) identifying and developing economic ventures in rural areas; and
- c) popularizing the benefits of institutional borrowing.

In order to achieve the above stated objectives, expansion of credit outlets through branch expansion and other means such as mobile banks were selected as strategies. The policy specifically defined the roles of AIDB, CBE and EIC, designating each area of responsibility within the rural credit sector. While the institutions are required to collaborate in co-financing projects whenever possible, EIC is charged with the design and operation of appropriate insurance schemes and other specified lending.

6.3.1 Credit Planning

The strategy designed for implementation of the revised rural credit policy was through credit planning. A credit plan was to be prepared in each area by banks operating in the area taking into account its lending capacity, the need to expand credit to the rural sector, and the need to expand coverage of borrowers and areas. The plans will have to be approved by the NBE. To coordinate the activities of the three financial institutions, credit coordinating committees were established at the national, sectoral, and field levels. At the national level, the Rural Credit Coordinating Committee (RCCC) determined policy and procedural issues and reviewed the performance of the other committees. Members included Governor and Vice Governor of the NBE, Vice Ministers of MOA and MCTD and the General Managers of AIDB, EIC, CBE, and Handcrafts and Small-scale Industries Development Authority (HASIDA) and the Head of Credit Control Division of NBE.

The second credit coordination committee was the General Managers' Coordinating Committee (GMCC) consisting of the General Managers of the three institutions, namely AIDB,

CBE and EIC. The main function of the committee was to oversee smooth implementation of the credit plan and the operation of the lower level committees. At the field level, the Rural Credit Planning and Implementation Committee (RCPIC) was organized including branch managers of each financial institution in the area, and representatives of MOA, MCTD and HASIDA wherever applicable and the Awraja Administrator as the chairperson. Among the major roles of the RCPIC were, assessing credit demand in the area, reviewing the draft annual plans of CBE/AIDB branches, regularly reviewing implementation of their plans, assisting in loan recovery of the banks through pressure on borrowing cooperatives and recombining measures for consideration by the RCCC and GMCC at the higher levels.

The efficiencies of these committees had never been evaluated since their establishment, but it seems that they had not been effective as anticipated. The absence of a Regional Committee which should have coordinated the whole activities in the region was one factor limiting the activities of the committee. Misinterpretation of the policy by both banks created difficulties at the field level and complicated credit delivery. As a result, AIDB had a dramatic drop in its loan activities in the coffee growing areas, with extremely reduced loan recovery rate of the previous credits.

6.4 Credit Intermediation

Since the reorganization of financial institutions in 1976, banks became wholesalers while credit was retailed by cooperatives in both the industrial and agricultural sectors. In the industrial sector credit was provided to registered service or producer cooperatives, mostly engaged in handicraft activities. In the agricultural sector, registered service and producer cooperatives were eligible for bank credit except for agricultural input loans. Lack of registration of these cooperatives in both sectors was, therefore, the main impediment to the expansion of credit. For instance, as of May 1990, the percentage of SCs registered was only 48, while that of PCs was only 14. Even though registration was required, taking legal action against cooperatives was thought as having profound social and political consequences. Thus, the legal character of these borrowers had no impact on loan recoveries nor on the quality of the portfolio. Hence, the process has simply served to markedly reduce the number of cooperative borrowers to leave an adequate liquidity for the state-owned sectors. Linkage with informal sector for credit delivery was absent, and the chance of getting credit by small producers was very low.

7. CONCLUDING REMARKS

Financial institutions in Ethiopia, both state- and private-owned ones, first emerged with management autonomy, and liberal control of the Central Bank. But, after the structural reorganizations and nationalization of financial institutions in 1976, the sector is led by the National Bank. Under the current financial system, they lack institutional autonomy. The legal

framework presents numerous obstacles to real and financial sector liberalization. The lack of autonomy is an obstacle to the effective management of the institutions and serves to hamper competition.

The structure and behaviour of the financial system exhibits negative government savings and private sector positive savings-investment balance. It also shows the Government and state enterprises as dominant borrowers. Lack of autonomy by the banks to decide on credit to the public sector has eroded the capital of some financial institutions like the AIDB whose loan portfolio to state farms has exceeded Birr 2 billion. Private sector borrowing from the banking system continues to face numerous obstacles, despite the recent reforms to encourage the sector.

Interest rate policy is set out by the National Bank prescribing in detail each instrument available to both borrowers and depositors in all sectors. The structure of deposit rates, on the one hand, discriminates against institutional depositors and thus acts as a disincentive to effective management of savings. On the other hand, the lower interest rates charged to public enterprises and cooperatives act as a form of subsidy which could have been provided through budget allocation. With the escalating rate of inflation since the late 1980s, the interest rates on loans have remained negative. Therefore, the overall policy in the financial system does not encourage efficient and productive resource allocation. With more liberalized economic policy and market orientation, the financial sector with its present structure and behaviour will remain defunct. Therefore, financial sector reform is in order. The sector's reform shall be in the areas of the regulatory and legal framework, interest rate, institutional restructuring and capacity building.

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