

RURAL CREDIT IN ETHIOPIA

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I. INTRODUCTION

Ethiopia has a population of about 52.8 million (1991) of which 87 per cent is rural depending on agriculture for its livelihood. Statistical data of the World Bank in its World Development Report 1993 has revealed that the country ranks the third least income earning in the world with GNP per capita of US\$120. GNP per capita has been declining by an annual average rate of (1.6 per cent) over the period [1980-1991]. The agricultural production is growing only at an annual average rate of (0.3 per cent) far behind the population growth rate of about 3 per cent. Added to this, the growth rate of agricultural production is declining from 0.7 per cent (1970-80) to 0.3 per cent (1980-1991). Similarly, the contribution of agriculture to GNP has declined from 56 per cent (1970) to 47 per cent (1991) (World Bank 1993:238-240). This decline is mainly due to traditional farming system and the resultant low productivity. Thus, peasants are subjected to live at a bare subsistence level. As a result, they remain in a vicious circle of poverty (low productivity, low income, low saving and consequently low productivity). In order to break this poverty cycle injection of capital could be one of the determinant factors for raising productivity and income levels of the rural people. The sources of capital could be from own savings, borrowing (credit) or grants from domestic or foreign sources. In a subsistence economy, saving is almost nil. Therefore, credit is the only mechanism to acquire the desired capital goods for production and to create employment opportunities. This can break the vicious circle and raise productivity and level of income.

Similar to other developing countries, Ethiopia always gives priority to the peasant agriculture in its national development plan. This is due to the fact that development cannot take place without giving special considerations to the majority of the rural population.

Against this background, the need to identify the existing problems hindering the use of credit in the rural areas of Ethiopia has attracted the attention of lenders, borrowers, policy makers, development agents and researchers.

Thus, the purpose of this paper is:

To highlight the role of rural credit in the course of development and to create awareness of its importance to policy makers, financial institutions, government and non-government development agencies.

To review the existing rural credit policies and its operational performances and effectiveness.

To identify constraints in the use of rural credit and to develop appropriate strategies and policies to be adopted to reach out the rural population in order to increase production and income level.

The study is based on literature review mainly using AIDB as a major source. The paper is organized in three parts. The first part tries to indicate the need for the study of rural credit in the development process. The second part focuses on the policies and performances of rural credit and identifying certain factors affecting its operation. The third part tries to draw lessons from past operational experiences and suggests strategies and policies to be considered in expanding an efficient use of rural credit in Ethiopia.

II. AN ASSESSMENT OF AIDB's RURAL CREDIT OPERATIONS

The sources of rural credit could be categorized into formal and informal. The formal sources are financial institutions that are set up legally and engaged in the provision of credit and mobilizing of savings. These institutions are regulated and controlled by the National Bank of Ethiopia (NBE).

The second and most important in the rural areas is the informal sources which are categorized as commercial (those who lend money on short term basis to obtain profit) and non-commercial (lenders that generally include friends, relatives and neighbours). Informal sources also include the mutual help associations (such as iddir, church, mehaber, ikub, etc.); modern cooperatives, and non-government organizations (NGOs). The informal sources of credit operate outside the banking system and control of NBE.

2.1 Policy and Procedure of Lending

a) General

AIDB extends development credits to projects that are considered to be financially, economically and socially viable. It provides short-term credit (1 year), medium-term (2-5 years) and long-term (over 5 years) credits. CBE on the other hand, provides short-term and medium-term credits. Defaulting borrowers would not be considered for fresh loans unless due loans are fully settled.

b) Loan Security

Banks require a collateral for individual and private loans. AIDB & CBE each require between 100-125 per cent of their loan amount. In rural areas the collateral requirement may be requested outside the project. The mortgage could be fixed assets for investment loans, merchandise or grain stock could also be considered by CBE for short-term loans. Both Banks do not seek any such collateral for cooperatives' loan other than their certificate of legal entity and management strength.

Individual borrowers are required to contribute certain share of equity in the project. In reality cooperatives do not contribute any fund to their project. To reduce risk, loans for the purchase of machinery and equipment, draft animals are covered by insurance against accidental damage and loss. This practice has to some extent helped farmers in relieving them from debt burden.

c) Interest Rate

The interest rates charged to borrowers are fixed by NBE. The rates have been changed from time to time. However, the current lending interest rate structure issued by NBE in September 1994 is 14-15 per cent on all types of loans. The minimum lending interest rate has been raised by about 180 per cent over the rate prior to 1992 and by 27 per cent as compared to the rate issued in 1992. The interest rate before October 1992 didn't have much relationship with the opportunity cost of capital or the rate of inflation rather its approach was a concessionary basis favouring the socialized sectors (cooperatives and state enterprises) to encourage the socialist way of development. The revised rate of interest on October 1, 1992 was fixed on a discriminatory basis of economic sectors and terms of lending in favour of the agricultural sector so as to give priority for agricultural development. Lastly, the present rate didn't take into account differences in economic or social sectors. The issue remains on whether the rise in lending interest rates bring about any effect on the demand for rural credit and on the rural development process.

Similarly, whether a subsidized rate or a market interest rate is to be charged to peasant farmer borrowers is a matter of principle. Subsidy could be viewed in terms of lowering interest rates, lowering prices of inputs at below market levels and subsidizing services such as extension education. The degree to which they would be subsidized depends on various factors.

- The availability of loans from external donors at concessional interest rates.
- The availability of budgetary resources.
- The type and importance of services to be provided to credit beneficiaries.

Subsidies could be used as incentives to promote production, to induce adoption of new technology and so on. However, it should be justified by economic or social benefits. The benefits to be obtained should outweigh costs involved in.

Prior to 1992, the interest rate charged to farmers cooperatives was 5 per cent below the rate of savings deposit (6 per cent). Financial institutions were obliged to pay interest margin on deposits from their own. The more expanded the volume of credit in the rural areas was the more the financial institutions would face financial difficulties due to failure to cover, costs and incurring loss. This would adversely affect rural credit expansion. Moreover, several studies have also indicated that subsidizing interest rates and prices of inputs would tempt farmers to sell at black market prices to traders or large farmers instead of using them in their own farms. Thus, it doesn't bring any change to peasant farmers' crop production. The sales proceed would be used for non-productive purposes or to pay off money lenders debit.

One can also visualize that credit at a subsidized interest rate might induce farmers to accept the credit as a gift and to use it for consumption purposes not to make the technology available. Such loan would never be paid back. Subsidized credit may also tend to generate a demand greater than the supply of lending institutions. Thus, rationing of credit becomes necessary to allocate loans among farmers.

In general, the decision whether to subsidize interest rates, prices of goods and services, exchange rates below official rates would depend upon the economic justification and objectives of the government policy.

2.2 Target Beneficiaries and Credit Delivery Mechanism

Classification on the basis of asset level is not so far practised in order to make the poor credit worthy. This is may be due to the assumption that all peasant farmers are of equal status or no one has given attention to the poor farmer. AIDB lending approach to target beneficiaries are both a direct type and a two tier system. The direct type is in which the Bank extends credit directly to the end user. This could be an individual person or organization such

Credit delivery mechanism has been insufficient to serve the rural people. Peasant farmers have access to credit only through their service cooperatives. They have no other alternative to obtain small size of loans individually for they are not capable of producing tangible collateral. The existing cooperative organizations are getting weaker from time to time and access to credit through other organizations such as groups or peasant associations is minimal. Such organizations are not legally recognized by banks. They were temporarily allowed to borrow only farm input loans.

Loans would not be provided to defaulters until they settle their due loans, thus, potential clients would be denied for subsequent credit. Thus, the volume of credit has been declining from year to year.

**Table 1: Number of Loans, Volume of Credit and Proportion of Rural Credit
(1981/82 - 1991/92) (in million Birr)**

Year	R U R A L C R E D I T						O V E R A L L			Per cent Share of Rural Credit to Total Loan Disbrs.
	A I D B				C B E*	Total Annual Disburse- ment	T O T A L C R E D I T			
	Number of Loans	Invest- ment	Working Capital	Total			AIDB	CBE	Total	
1	2	3	4	5=3+4	6	7=5+6	8	9	10=8+9	11=7÷10
1981/82	226	0.9	50.5	51.4	1.0	52.4	336.7	704.4	1041.1	5
1982/83	303	0.4	50.9	51.3	1.0	52.3	255.6	1338.1	1593.7	3
1983/84	325	0.1	54.0	54.1	1.1	55.2	275.4	758.6	1034.0	5
1984/85	387	4.3	32.6	36.9	1.3	38.2	306.6	404.4	711.0	5
1985/86	636	8.5	57.3	65.8	2.7	68.5	374.8	353.7	728.5	9
1986/87	1013	16.9	38.2	55.1	29.8	84.9	289.9	411.3	701.2	12
1987/88	1321	29.7	49.2	78.9	45.2	124.1	382.9	438.8	821.7	15
1988/89	1478	26.5	61.2	87.7	33.1	120.8	307.6	423.5	731.1	17
1989/90	1346	11.7	7.70	84.4	5.3	89.76	308.5	337.9	646.4	14
1990/91	205	10.7	56.1	66.8	3.2	70.0	256.6	339.9	496.5	14
1991/92	260	1.7	34.0	35.7	0.5	36.2	167.7	364.3	532.0	7
Total	7500	111.4	556.7	668.1	124.1	792.3	3162.3	5874.9	9037.2	9
Average	602	10.1	50.6	60.7	11.3	72.0	287.5	534.1	821.6	9

Source: AIDB Annual Reports, 1982 - 1992.

CBE Annual Reports, 1982 - 1992.

* No. of loans and type of credit couldn't be obtained.

As shown in table 2 the major components of rural credit lending throughout the years was mainly short-term loans accounted for more than 80 per cent. This credit has been extended in the form of working capital particularly for purchase of farm inputs. Less than 20 per cent of the credit went to investments such as draft oxen, grain mills, coffee washing stations, oil mills and other small scale industrial and services sector. The industrial loans have been drastically grown in 1994 due to authorization of branch offices to approve a certain loan limit to private enterprises and individuals residing in the rural towns.

The major investment credits extended to the rural peasant farmers during the five year period (1990-1994) were grain mills and draft oxen loans comprising 7 per cent and 3 per cent of total loans respectively. The small size and limited items of investment credit were not due to constraints of availability of loanable fund or lenders deliberately divert their fund to short-term loans but the technology used by the peasant farmers is traditional and labour intensive which doesn't require much fund for acquiring investment items. The plots of land owned by each farmer is fragmented and it doesn't warrant to purchase modern machinery and equipment for a single person. Thus, the credit absorption capacity for purchase of investment items in the rural areas has been very low. On the other hand, the application of farm inputs in farm operation has been widely adopted thus the demand for short-term credit suppressed over investment credits.

The previous attempt to mechanize peasant farms through producers' cooperative has failed. This has been proved by the utilization of ADF line of credit for purchase of farm machinery and implements, farm tools etc. The credit program was launched in 1983 to help increase crop production of peasant farms. A total of Birr 23 million was allocated, however, only Birr 11 million or about 48 per cent was utilized by cooperatives until June 1991. The implementation of the credit scheme took more than ten years. This showed that, there existed low investment credit absorption capacity by the peasant farmers. Moreover, those purchased and distributed machinery and equipment were dismantled and the whereabouts of some of them were not even known.

In light of this, new kind of technology must be developed or specially designed that suits and assist the peasant farmers in order to increase agricultural production and their level of income. Such technology could be water management techniques for storing and using water, small scale irrigation projects, water wells, horticultural crop development, new animal-powered farm implements, mechanical tillers and so on. The introduction of output increasing technology must be accompanied by technical assistance.

**Table 2: AIDB, Rural Lending by Category of Items
(1990 - 1994)**

Items	Y E A R						Share of Total
	1990	1991	1992	1993	1994	Total	
A. Investment							
1. Ag. machinery & Eqt.	208	112	56	28	422	826	0.3
2. Draft oxen	5132	3477	24	1799	88	1050	3.4
3. Livestock*	1424	2519	782	628	3722	9075	3
4. Coffee processing	3723	744	340	58	52	4917	1.6
5. Irrigation	50	1	-	94	42	187	0.1
6. Grain mills	1025	3458	50	2101	13869	20503	6.7
7. Oil mills	16	88	270	1287	2698	4359	1.4
8. Small scale industrial & service projects**	59	254	79	1830	13465	15687	5.1
9. Others	108	1	126	-	946	1181	0.4
Sub-Total	11745	10654	1727	7825	35304	67255	22.0
B. Short-Term Loan							
1. Farm inputs	72476	55877	34045	5559	14819	232812	76
2. Crop advance	200	15	-	5	1190	1609	0.6
3. Micro-enterprises	-	-	-	204	1835	1835	0.7
4. Others	26	244	-	-	1448	1747	0.7
Sub-Total	72702	56136	34045	5582 8	19292	238003	
Total	84447	66790	35772	6365 3	54596	305258	78
Short-term Loan as per cent of total	86	84	95	88	35	78	100

Source: AIDB, Rural Credit Performance Reports, (1990-1994)

* Fattening, dairy, fishery

** Cement product, pastry, shoe, woodwork, hotels, etc.

With regard to some credit schemes such as oxen lending and grain mills the performance evaluation studies have proved their success and encouraged the Bank towards expanding provision of similar services. These lending schemes have components of IFAD line of credit which was launched in 1983 and completed in 1988. The major objective was to promote agricultural production and to increase income level of farmers. The credit scheme was initially earmarked at Birr 2.9 million for the purchase of 8000 draft oxen and Birr 7.6 million for the purchase of 275 grain mills. However, the demand for both were

drastically increased from time to time showing that there was a need for such credit and gaining acceptance by farmers. During the implementation period it was managed to purchase about 52,000 draft oxen and distributed on credit to farmers owning one ox or without ox at a cost of Birr 17 million. Similarly, about 585 grain mills were purchased at Birr 10.9 million and distributed to agricultural service cooperatives. The demand is still growing, thus the bank continued lending to such schemes using its own funds. The impact of these lendings have been assessed and found to be successful in their contribution to increase agricultural production. The effectiveness of these credit services will be discussed in the latter section.

On the demand side, even though it is not easy to determine the credit need of the rural sector, one can at least make an estimate of the annual quantity of fertilizer needed by the peasant sector to arrive at the total financial need. Similarly, financial requirement of coffee growing farmers for crop advance payment could also be estimated from annual production and export of washed clean coffee.

**Table 3: Peasant Sector Short-term Credit Demand Estimate
(Fertilizer and Red Cherry Coffee Advance Payment)**

a. Fertilizer	Quantity Distributed (Qt) (1985/86)	Current Unit Price/qt	Total Value '000' Birr
Dap	813,000	143.5	116,544
Urea	83,200	131.15	10,912
Total	893,200	-	127,456

Source: National Fertilizer and Input Unit, Profile of Fertilizer Supply Distribution and Credit in Ethiopia, Oct. 1987.

b. Coffee Harvesting and Processing	Average (1989-1992)
Total export of washed coffee (MT)*	60,750
Less: Share of state farms**	3,039
Washed coffee produced by peasant sector	57,711
Converted to red cherry (MT)	360,694
Crop advance payment Birr/1.10kg('000 Birr)	396,763
Credit requirement (50 per cent of total) ('000 Birr)	198,381

Source: Computed from NBE Annual Reports 1988/89,89/90,90/91,91/92

** Ministry of Coffee and Tea Development.

In light of this, the actual fertilizer distribution of 1985/86 and the annual average export of washed clean coffee for the period 1989 to 1992 have been considered as shown in table 3. Based on this, the total annual credit needed for fertilizer acquisition and for red

cherry coffee advance payment is estimated at Birr 326 million of which Birr 128 million would be for fertilizer and the balance Birr 198 million for red cherry coffee advance payment. This sum is more than four times the annual average rural credit extended by banks for the past eleven years.

2.4 Loan Repayment

Collection of loans from borrowers is normally through deposits in accounts held with the nearest CBE branches. The other alternative is direct settlement of due loans at the main branch offices of AID Bank. The Bank doesn't operate savings or demand accounts thus clients are not provided with other banking services other than the normal credit facility. They can neither open a saving account with the Bank nor transfer money from one place to another. The Bank could not have the chance to control over the deposits and withdrawals of clients accounts other than making follow-up visits and supervisions to confirm whether the borrowed loan is utilized for the intended purposes or not.

The eight years (1986-1993) loan recovery performance of the Bank shown in table 4 depicts some improvements during the period 1986-1989. However, this recovery rate started declining since 1990 and showed a deteriorating trend. As at June 30, 1993 the total loan balance in arrears was Birr 177 million or 89 per cent of total outstanding loans. Even though, there is no set of standards to categorize this rate of default. Review of 1973 and 1985 evaluation study on rural credit projects around the world indicated that successful projects had delinquency rates of 2 per cent-3 per cent. The unsuccessful projects had delinquency rates ranging from 10 to 75 per cent with most falling between 25 and 50 per cent (Pamanadham 1988:66). This indication classifies AIDB's recovery performance in the unsuccessful category.

Default may arise from three major factors. First, the inability of borrowers to repay the loan as a result of crop failure for various reasons. Second, due to unwillingness of borrowers to repay the loan viewing the loan as a grant or as political patronage. From a close observation of borrowers' attitude one can conclude that the latter is the major factor for failure of loan repayment apart from the dissolution of cooperatives which would be discussed in the latter section. The third factor could be institutional and policy problems. The system of credit delivery and collection mechanisms of the Bank have contributed to poor loan recovery performances. Loans have been delivered to beneficiaries through cooperatives. Cooperatives lack cohesion, strength and capability of managing the loan entrusted to them and thus fail to repay loans. Credit has not been tied up with savings. There was no joint savings and borrowing practice that would enable the bank to control over the movement of cash in their accounts. There was no sufficient security for the loan, either in the form of collateral of tangible asset or sufficient paid up capital contributed by members initially to claim for in case of default. The absence of any valuable tangible asset owned by cooperatives tempted them to become defaulters.

This problem could only be alleviated through improvement in the credit delivery and collection mechanisms with close cooperation and coordination of the local authorities,

and development agents, re-organization and strengthening of the existing cooperatives to attain a standard that qualifies them for credit.

Table 4: Rural Credit Loan Recovery Performance of AIDB (1986 - 1993)

Year	Recovery* Rate (Per cent)	Loan Portfolio**		
		Out- Standing	Loan In Arrears	Per cent of Arrears Against o/s
1985/86	39	85,000	11,000	13
1987	55	81,000	29,000	36
1988	68	98,000	41,000	42
1989	63	114,800	46,300	40
1990	31	126,000	67,300	53
1991	47	123,263	120,762	98
1992	15	151,558	121,116	80
1993	11	198,711	176,900	89

Source: * AIDB, A review on AIDB's Loan Recovery Performance 1985/86 - 1992

* AIDB, IBRD Reports June 1991 & 1993.

** AIDB, Annual Reports.

2.5 Mobilization of Financial Resources for Rural Credit

Funds for rural credit are usually mobilized from foreign and domestic sources. The Bank has been relying on NBE's borrowing as a domestic source for it has not been involved in the mobilization of savings. Apart from this, the large sum of fund for rural credit about Birr 402 million came from foreign sources such as IFAD, IDA, OPEC, ADF, EEC, CIDA and FINNIDA during the period 1984 to 1992.

The utilization of funds particularly for investment items are shown in table 5. This fund has assisted in the provision of modern technologies to some extent which would have not been possible to acquire in the local market due to shortage of foreign exchange. The sum indicated in the table doesn't include funds utilized for the acquisition of short-term fertilizer loans under the PADEP lines of credit.

**Table 5: Utilization of Foreign Loans by Purpose
(1984 - 1992)**

Purpose	No. of Items	Value(Birr)
Flour mills & spare parts	785	18,719,015
Draft Oxen	112,139	36,712,314
Coffee processing stations	136	37,089,212
Dairy	735	918,196
Fattening	5,334	3,325,930
Machinery implements and attachments		
Stores	Various	17,086,469
Oil mills	8,296m ²	1,027,234
Feed processing mills	17	2,000,844
Farm tools	1	89,351
Sacks	Bulk	970,496
	34,574	95,078
Total		118,034,129

Source: AIDB, Annual Report, 1992

2.6 The Effectiveness of Rural Credit Service

In a capital deficient system like Ethiopia, the provision of rural credit has assisted in raising agricultural production and creating employment opportunities which as a result increase in the level of rural income.

The economic and social impact of this credit in the development process could be evaluated not only in terms of the volume of credit disbursed and physical input distributed but, could also be measured in terms of increase in productivity, output and ultimate improvement of the income level and well being of the rural people. As an example, impact of the draft oxen and grain mill loans are analyzed here under.

a) Productivity: It might be difficult to relate the impact of credit to improvement in the production of crops. However, this could be taken as one factor and could be ascertained by comparison of yield "with" and "without" credit. The two draft oxen evaluation studies have revealed that farmers who were provided credit and own oxen have expanded their cultivated areas. The studies have revealed a yield margin of 2.67qt/ha between farmers who own one ox compared with those having no ox of their own and a margin of yield of 1.86qt/ha between those owing one ox and two oxen [AIDB 1987, pp. 1-6]. The raise in productivity (yield) and the increase in cultivated area had positive effect in increasing total output and thus raising the level of rural income.

b) Savings: There could be many different definition of savings. Savings could be viewed as deposits in money terms or in the form of capital formation. Beneficiaries of credit may not have savings deposit with a bank but the credit given to them for acquisition of capital assets such as draft oxen and farm tools have contributed to channel farm income

into capital formation. The impact study on grain mill users [AIDB 1988, pp. 42-52] revealed that the credit has benefitted the rural people in various ways.

. Time saved - About 373 hours per household/year has been saved by replacing the traditional stone-grinder method with modern grinding mills. The time gained has been used for productive activities.

. Money saved - An average of Birr 21 per household/year has been saved using cooperative grain mills acquired by credit as compared to private traders mills users.

c) Quality improvement: This in turn increased income earnings through better market price. Such improvement could clearly be seen in the processing of washed coffee.

d) Employment: The credit in one or the other has contributed towards employment in the rural areas. Employees working in the coffee washing stations, flour milling stations and the tractor operators could be cited as examples.

2.7 Major Operational Problems and Constraints in Rural Credit

a) Credit Policy and Delivery System

The intermediaries through which credit could be channelled to the rural people is limited. The present system of rural lending is only through registered cooperatives. Individuals who are not members of any registered cooperatives or organized under any informal groups could not obtain any credit. Few individual middle farmers possessing some savings and fixed assets in town are capable of providing collateral and equity contribution have access to the banks. But a peasant farmer who could not offer a collateral is not considered to be credit worthy.

In view of this, rural credit operations had a limited coverage in terms of both number of borrowers and credit diversification.

b) Dissolution of Borrowing Cooperatives

Cooperatives were not initially organized on economic grounds but rather on the basis of ideology. Their objectives were broad. Their membership size was as large as about 2000. The country's average membership size of an agricultural service cooperative was 1105 [MOA 1991].

For this reason, cooperatives lack integrity and willingness to follow the day-to-day activities and development of their organizations. Ultimately, they lost cohesion and easily disintegrated when change of government took place. The cooperative law didn't provide share capital during the formation of a society, thus, each member didn't possess any tangible asset in the organization so that the lending institution could not claim any valuable

asset or liquid cash other than office and store constructions built in the remote areas that cannot be easily liquidated.

The recent agricultural cooperative society proclamation No. 85/1995 provides that amalgamation and division of the societies could only take place upon full agreement between the creditors and members. It also describes contribution of share capital by each member as a pre-condition for forming a society. However, recently some defaulting cooperatives are re-organizing themselves and changing their initial names without any share contribution. Some members of the peasant associations are separating from their service cooperatives and joining others without consulting the creditor banks. Thus there is fear that the banks would loose their money and borrower-lender relationships.

c) Default Problem

Default is progressively increasing and the Bank has been facing the prospect of incurring substantial losses. Apart from the dissolution of cooperatives, borrowers have developed wrong attitude of expecting debt rescheduling or write-off and of regarding loans as government grants.

There is no special enforcement procedures in case cooperatives fail to repay the borrowed loans. Due to defaulters, lenders would incur heavy loan administration, supervision and follow-up costs. On top of this, unrecoverable loans would be increasing from time to time. As a result of huge expenses the Bank would be forced to operate at a loss with ultimate erosion of start-up capital. This operational loss impairs the self-sustainability of the Bank and casts a heavy burden on the institution as well as on the government. If loans are not repaid according to schedule, funds would be tied-up as arrears and the Bank would face shortage of loanable fund.

From the borrowers' point of view, the increasing number of defaulters would not be entertained for subsequent loans. This would hamper borrowers access to Bank loan and ultimately affect the overall development process.

d) Accessibility

The limited branch net-work, proximity and geographic distances between the borrowers and the lender financial institutions, the loan processing procedure, the length of time taken to process loan applications and the formalities for sanctioning loans are some of the major impediments to credit access. Distant locations and unfamiliarity with Bank procedures made access to Banks difficult.

From the lenders' point of view the large number of scattered small size loan applications, the difficulty conducting follow-up visits to each borrower, and the expected cost of loan administration are the major constraints in reaching the rural people.

e) Backward Technology

Rural agricultural and non-agricultural production systems are traditional with stagnant technology and characterized by low productivity despite favourable natural conditions. This low productivity is due to lack of knowledge of modern techniques and improper applications of production practices. Thus, the major credit need in the rural area is not for acquiring new technology but for consumption.

f) Inadequate Infrastructure

A country with an area of approximately 1.2 million square kms has only 18,549kms road of which only 4,095 is asphalt and the remaining 14,454 kms is gravel [CSA 1990, p. 85]. Due to lack of transportation and communication facilities in the rural areas, branch offices of the banks have been established only in major towns.

g) Inadequate Provision of Complementary Services

The provision of extension services is inadequate not only due to shortage of skilled manpower to bring about changes in techniques of production and social attitudes but also due to difficult mobility and shortage of budget. Marketing service for the output is deficient to give the required services. Farmers do not have the bargaining power for lack of marketing facilities.

h) Lack of Coordination Among the Financial Government and Non-Government Institutions

Coordinations among the concerned ministries and non-government organizations involved in development programmes and the financial institutions have been weakened in several regions and even non-existent in some areas. In the absence of close coordination among these agencies proper utilization of credit and its contribution to development programmes would not be expected. As a result of conflict of interest among these institutions many borrowers have failed to meet their repayment obligations.

III. ALTERNATIVE APPROACHES AND POLICY RECOMMENDATIONS TO PROMOTE RURAL CREDIT

At present, rural credit activity is declining. Thus, an effective rural credit policy need to be designed to bring positive economic and social impact on the rural people. In view of this, the following alternative approaches and policy measures are suggested.

1. Expanding Branch Net-Works or Creating New Rural or Village Banks

Expanding rural branch net-works of the existing banks or creating rural or village banks to bring banking facilities closer to the rural people so that they save money and time.

2. Devising Appropriate Credit Delivery Mechanism

The present delivery mechanism of rural credit through cooperatives to small farmers is found to be unsuccessful. In order to provide effective credit services appropriate mechanisms should be designed to reach the maximum number of the rural community. To this effect, the following mechanism could be adopted for credit channelling.

a) Cooperatives: The existing cooperatives should be re-organized and strengthened by reducing the number of members to a manageable size. They should be strong and fulfill their obligations.

b) Groups or Associations: Experience of developing countries like Bangladesh, Ghana and Malawi have shown that groups serve as channels of credits. They could be formed by people living in the same villages or locality, based on similar social and economic status, land holding size and activities. The group would consist of members of a manageable size. These groups could be involved in savings and provision of credit to their members. To this effect, the concerned government body may issue a policy towards the formation of such groups.

c) Multi-purpose Institutional Arrangements: Government and non-government organizations which are involved in development programmes such as extension, input distribution and marketing services could be channels of credit. They could make arrangements with financial institutions since they are in a better position with regard to the supervision of credit utilization and loan collection.

d) Integrated Development Schemes: Government agencies and NGOs initiated development schemes can serve as channels of credit to the rural people where applicable. Lesson can be drawn from the experiences of CADU, WADU and ADAP etc.

e) Individual borrowers: They can be treated in accordance with the lending policy as long as they are capable of producing collateral and fulfill the requirements.

3. Simplifying Lending Procedures and Formalities

Develop simple appraisal methodology of projects and shorten loan processing procedures and formalities.

4. Diversification of Credit Activities

The credit provided to the rural people in the past has been limited to few items. Lending to artisans almost nil. Rural credit should constitute a wide range of activities.

5. Improving Loan Recovery Systems

Even though financial institutions are catalysts of development programme, their primary responsibility is to safeguard the funds at their disposal and to make a margin for maintaining their viability and self-sustainability. If loans are not repaid, banks cannot carry out their tasks involved in serving small farmers.

The present default problem could be improved if support from regional and local authorities as well as from concerned development agencies are provided. Default could be minimized through provision of banking facilities such as saving & current accounts to get access to the financial transactions of the borrower.

Loans should be secured before disbursement. The security should be geared towards keeping the interest of both the lender and the borrower to safeguard and reduce risk. Bankers are concerned with the land tenure issue for it is usually taken as security for loans. However, under the Ethiopian condition, rural land cannot be taken as collateral for it cannot be sold or transferred in any way. Therefore, under this conditions, the following forms of security would be possible and effective in extending rural credit.

a) Collective Security: This type of security would be more suitable to the country's condition particularly for cooperatives and group loans. The collective liability of all members should be taken as security in case of default by a member. However, loans should not be given to a cooperative in excess of a certain limit of their capital or asset. In the case of group loans, loans could be secured by issuing a joint bond in which all members are jointly responsible for repayment.

b) Establish Special Risk Fund: This could be kept by the government to safeguard the lending institutions and borrowers against abnormal risk.

Group Security Fund: This would be compulsory savings of group members to be used as insurance coverage against default, death, disability and other accidents.

Group Savings: These savings could help to mobilize funds and provide credit to members for cover their incidental expenses for which they could have diverted Banks' loans. The savings accounts held with the bank could also serve as a guarantee for the Bank's loan.

Insurance Schemes: In this approach, premium could be paid to insurance companies to cover against risk related to crops, animals, machinery etc.

6. A Coordinated Rural Development Approach

Credit alone doesn't always bring about an adequate development progress. It should be accompanied by adequate infrastructure and a coordinated complementary services to make credit more productive. The availability of technology, extension services, markets, price policy, storage, transport facility, input supply along with rural credit is indispensable.

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