CHAPTER 9
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Summary, Findings of the Study and Suggestions

9.1 Summary

The basis of this study is that a well-developed financial system is necessary to facilitate the growth of the economy, and that Ethiopia need to strengthen her financial sector. The market based economic policy adopted since 1992, the privatization programs and the desire to enhance the role of the private sector in the economy makes the role of the competitive financial system even more crucially important. The level of investment required to strengthen the muscle of Ethiopia's economy demand saving to be mobilised and channelled to various avenues in a more efficient way. So far, in Ethiopia, the gap between investment and saving is widening as the country is committed to rapid modernization programs.

To reduce substantially or even cover this yawning gap between saving and investment, domestic saving should be tapped primarily. Searching for foreign capital before properly using the resource at the door is not a good practice if permanent base for growth is to be created. Yes, Ethiopia is a low per capita income country. Even so savings exist but are scattered among millions of pockets in small amount. In fact this is the very reason as to why the need for an efficient institutional mechanism, which connects these millions of pockets and creates a stable pool of fund, handle and invest conveniently is so great. Financial intermediaries are appropriate vehicles to fulfill this task and it is this task which makes them engines of economic development.

The survey of literature attests to the crucial role of the financial institutions, in the process of economic development. A developed financial system has a positive impact on saving, investment and growth. Financial system persuades people to save and savings to be expressed in financial assets through liquidity, safety, convenience and better return embedded in financial assets. A developed
financial system promotes investment by placing finance in the hand of those who are willing to venture into productive avenues. It enhances the efficiency of resource allocation by enabling investors to diversify risk, better liquidity management and better evaluation of projects. Financial institutions can undertake such task more easily and efficiently since they have potential that is not available to an individual of small means. The interaction between the financial and real development is such that the development of real sector enhances financial development and for a financial sector to induce growth it has to precede the real development, and financial underdevelopment in any case is a constraint to growth.

The survey of the state of financial sector in developing sub-Saharan African countries (The region to which Ethiopia belongs) presented that in less developed Sub-Saharan African countries financial markets are not well developed, and it seems that this situation is the weak point of the content itself. Most of these countries (e.g. Ethiopia) do not even have the embryo of stock market, which rendered the scope of direct finance narrow. The populace is not aware of the trade in financial instruments, be it short term or long-term. Majority of the people live in rural areas. In such milieu, indirect finance through the financial institutions is the best way by which savings can be mobilised and transferred to investors. However, the need for securities market should not be overlooked because these countries need stock market that serve the need of enterprises, financial institutions and private individuals with adequate financial resources and skill to play in the market so as to facilitate their activities.

Also the review of literature presented about interest rate: Interest rate differential, the role of interest rate in developing countries. It is noted that in a market oriented economy the rate of interest is one of the important means by which people are persuaded to save in a form of financial assets and to allocate savings efficiently. Interest rate ceiling weaken the intermediary role of financial institutions. Savings get discouraged, particularly financial savings. Financial institutions resort to credit rationing, yet credit rationing does not guarantee
efficient allocation of resource. Further, it may lead to choice of technology not appropriate to the reality in developing countries.

Interest rate ceiling is a kind of financial repression. Moreover, all policies, which inhibit financial institutions from operating in accordance with their technological potential, are a recipe for financial repression. It can be a system of directed credit programme, excessive reserve requirement, tax policy that is biased against the financial sector and the like. Financial repression inhibits financial deepening and financial innovation. A financially repressed economy suffers from the loss of the positive impact of financial sector on economic development. For a financially repressed economy the alternative is to remove all the structural impediments which inhibit financial development. That is a healthy and conducive macroeconomic environment should be installed. Then only it is possible to revamp the financial sector.

Government has important role to play in a financial sector. Financial system cannot be left to complete laissez-faire policy. Prudential regulations and efficient supervisory mechanism are absolutely essential. To this end the government has to provide the necessary legal infrastructure which financial system require to function in a smooth way. Nevertheless, regulation of the financial system should not blunt the edge of competition. Financial institutions should not be put in a straight-jacket of legislation's that would destroy responsiveness, flexibility, and dynamism. Moreover, there has to be a fiscal discipline. The government should not use financial sector as a source of cheap credit but rather should stand on an equal footing with private borrowers.

Besides, government can encourage banks and other financial institutions to commit their funds to risky but productive activities. This can be done by means of the facility of deposit insurance. But whether the government should provide deposit insurance facility to banks is contested because of the shortcomings of the instrument of deposit insurance. However, it can be used with care to meet the genuine need of financial institutions.
9.1.1 Towards the Economy of Ethiopia

The survey of Ethiopia’s economy presented a picture of the agriculture dependent economy with low industrial base, which suffered under the vagaries of weather, unconducive policy environment and man made problems. The geographic location and climate condition of Ethiopia are basically awesome. There is a big potential of unutilized natural resources. Ethiopia is like a tower of water in East Africa - rivers run in all direction from central plateau of the country. Nevertheless, weather gets angry with Ethiopians so frequently which affect most part of the country which sometimes include the Central Plateau; mostly drought occasionally El’neo. It is so surprising that often a few years of good harvest is followed by unfavourable climatic condition which largely affect the economy and down play with the plans laid for the future, because when something goes wrong with rain the economy hobbles. It is a paradox that Ethiopia often faces such problem amidst of abundant fresh water on which even other African countries depend.

The review of the policy environment presented the fact that the economy also suffered under the economic policy of past regime. From small prospect in early 1970s to total despair by the end of 1990. A group of pro Soviet military leaders led the country to the verge of total crisis. In as much as military rule continued, militancy prevailed for nearly two decades reaching climax by the end of 1980s. Ethiopia paid so much financially and in terms of human lives. During this period all the macroeconomic indicators deteriorated. The level of per capita income, saving, BOP worsened. The fiscal deficit escalated year after year. Debt burden mounted high. In sum the economy passed through unprecedented regression. The socialist regime was a period of missed opportunities of development. Since 1992 the economy have shown sign of recovery because of the new economic policy pursued by the government.

Nevertheless, Ethiopia’s economy is still the least developed in the world by any standard and has a long way to go on the path of growth. It still depends on
rain fed subsistence agriculture. In spite of past regimes ambitious plans to develop the industrial sector, its share in GDP, its contribution to employment generation, foreign exchange has not been impressive. This situation is unchallenged as the country moves ahead to the new millennium.

However, today, Ethiopia recognizes the crucially important role of well-developed industrial sector more than ever before. Agricultural Development Led Industrialization (ADLI) is the policy of the government. Because, rapid industrialization will continue to be the engine of growth in developing countries and economies in transition as well into twenty first century, the key to social and economic change as well as essential tool against unemployment, poverty and social tension and in the resolution of political conflict (UNIDO, 1997). The implication is then the need for a dynamic financial sector, which facilitates this process.

9.1.2 Towards the Financial Sector

The review of the Ethiopia’s financial sector presented the structure and evolution of modern financial institutions in Ethiopia. Banking institutions existed in Ethiopia since early twenty century, to be more specific since 1906. However, it was after 1963 i.e. when the Commercial Bank of Ethiopia (CBE) and the National Bank of Ethiopia (NBE) were established that modern banking made rapid progress in the country. By early 1970 various financial institutions (banks and insurance companies, and specialized financial institutions) together with the local share market began to flourish in Ethiopia.

Before 1975 the Ethiopian financial sector was fairly liberalized with good prospects of development. Nevertheless, the whole scenario changed after 1974, when the government chose to follow socialist economic policy. From the outset the socialist government considered competition among financial institutions as a duplication of work and waste of resource. Accordingly private financial institutions were all nationalized and merged with the public financial institutions. The number of commercial banks decreased from four to just one. The CBE
together with the two specialized banks AIDB and HSB operated in the economy with strict compartmentalization of activities. Also the number of insurance companies decreased from thirteen to just one. The financial sector was entirely controlled by the government, and functioned under the directives of the monetary authorities. The strait-jacket imposed on the financial sector was removed after nearly two decades, in 1992. Since 1994 private banks and insurance companies are functioning along with the fully government owned banks and insurance companies.

The semi-formal institutions like saving and credit associations existed since early 1960s. However, the SCAs are popular among salaried employees and are concentrated in cities, mainly in Addis Ababa. They serve as a source of personal loan to their members. They spread the virtue of thrift and benefit of modern banks. Given support and encouragement the SCAs can easily be converted to formal banks. The informal institutions like Idir and Iqub are the means devised by Ethiopians to put together their resources so as to face the realities in the country. They are the result of the growing demand for financial services and social securities by the Ethiopians. Like SCAs Idirs and Iqubs are also more active in urban areas.

9.2 Summary of the Main Study

In order to examine the operation of the main financial institutions CBE, AIDB (later DBE) and EIC, and evaluate the role these institutions played, study is made on some of the channels through which financial institutions affect the growth of the economy. Some of these channels are: the trend of total liabilities of banks relative to GNP, the trend of banks deposits relative to money stock (\(M_1\)) and gross national income, the spread of bank branches, credit disbursement and the growth of insurance companies. Comparison of the performance of financial institutions during the three periods pre 1975, 1975 - 1991, and post 1991 period is made. The summary is given below.

9.2.1 Growth of Deposit Money Banks (DMBs)
The momentum of growth of deposit money banks gathered during the pre-1974 period received a setback during the post-1974 period. This is noted from the trend of banking ratio. The banking ratio increased from 16.2% in 1974 to 32.5% in 1991, and then increased to 51.2% in 1996. The banking ratio increased by 16.3% during the seventeen years between 1974 and 1991 and by about 19% during the five years between 1991 and 1996, which shows the stagnation of the growth of deposit money banks during 1975-1991. Moreover, the banking ratio of Ethiopia (less than 60% in 1996) is low when compared with similar ratios for countries like Japan (156% in 1995). The low banking ratio is a sign of low level of development of deposit money banks. This is corroborated by the low ratio of demand deposits (less than 50% in 1996) and saving and time deposits (less than 75% in 1996) to money supply ($M_1$).

9.2.2 Deposit Mobilization

Banking institutions did not fare well with respect to deposit mobilization. Total banks deposits, as a percentage of GDP, for all banks, was about 32% in 1996. Over 90% of the total deposits mobilized by the banking institutions were due to CBE. The total deposits mobilized by banks is low when seen in the light of the fact that banking system account almost for all financial savings in modern financial institutions.

CBE is the main bank involved in deposit mobilization. Total deposits mobilized by CBE more than doubled between 1992 and 1996. However, evidences reveals that CBE mobilized deposits mainly from limited private and individuals in urban and semi-urban areas. Whereas DBE’s role in deposit mobilization is minimal. Deposits mobilized by DBE as a percentage of its total liabilities are abysmally low.

The structure of deposits mobilized is such that long-term deposits are just a small fraction of total deposits mobilized. For instance in 1991/92 time deposits of all banks were only 12.6% of total deposits, whereas time deposits of CBE were just 3.04% of its total deposits. In 1996 time deposits were 7.4% of total deposits.
mobilized by all banks. While the time deposits of CBE were 4.6% of its total deposits. Not less than 50% of the total deposits mobilized by banks is of demand deposit type, followed by saving deposits which accounts for large amount of the remaining, which shows the dearth of long-term deposits which banks could lend for long-term investment.

9.2.3 Spread of Bank Branches

The bank density in Ethiopia is very low, about 280,000 people per bank branch as of 1996. The branches of banks are confined in urban and semi-urban areas, as a result of which large proportion of the population is out of the reach of the services of modern banking institutions. Consequently deposit mobilized outside urban areas is small. In fact Addis Ababa and a few other cities together account for large proportion of total deposits mobilized by the banking institutions (i.e. not less than 75%). Deposit mobilized is largely from the non-agricultural activities. However, during the post 1992 deposit mobilized from the agricultural sector have also increased which is not because of the increased facilities of banks in rural areas but rather because of the increased demand for the financial services in such areas.

9.2.4 Interest Rate and Deposit Mobilization

Deposit Mobilization has also been adversely affected by the interest rate policies followed by the past regimes. During the 1975-1991 period the interest rate earned by deposits was fixed and unattractive to depositors as it was negative in real terms for most of the period. Whereas during the 1992-1996 deposit rates were altered in response to change in price. To this deposits responded positively. However, during 1992-1996 authorities fixed the minimum deposit rates and maximum lending rates. In the absence of restriction on the margin or the spread, banks would have been able to bid-up deposit rate and make deposit instruments more attractive thereby increasing financial savings. Moreover, inadequate bank branches in the country limited the response of deposits to the adjustment made to the level of interest rate.
9.2.5 Credit Disbursement

Before 1975, banks distributed credit to various economic sectors based on their own discretion as they had autonomy over loan transactions. Interest rate charged on loans and advances was slightly lower for export trade. Otherwise all other sectors were treated at par. Whereas during the socialist regime discriminatory credit policy, which favored the socialized sector was followed. Banks loans and advances earned negative interest rate in real terms, in most cases. The socialized sector was the main beneficiary of the low level of interest rate charged on loans and advances. Financial resources flowed to the socialized sector with little consideration of efficiency while the private sector suffered from shortage of credit. For instance the large proportion of loans and advances of AIDB was allocated to public enterprises which were loss making ones. Whereas the loans and advances of CBE in its total assets portfolio reduced so much as the bank's resource was channeled to NBE in the form of deposits or invested in government bills, which was ultimately used to finance government deficit or channelled to AIDB.

Since most of the enterprises in the socialized sector were inefficient the resource allocated to this sector was used inefficiently, as a result of which the non-performing loans of banks increased. For instance the AIDB terribly suffered from huge non-performing loans to the extent even its financial viability was threatened. Whereas CBE's role as financial intermediary reduced as its credit to the private sector as a proportion of deposits mobilized decreased. Such a massive crowding out of the private sector was at the cost of economic growth.

Banks' experience with the legal system with respect to debt recovery was unsatisfactory. The slow court system unfairly penalized creditors. During the socialist regime the legal procedures were more applicable to the private borrowers, while public enterprises which were at the root of problems to the financial institutions were not subject to strict legal treatment. This made the debt recovery system slow. Whereas during the post 1992 some measures have been
taken to improve the legal and judicial procedures so as to establish expedite debt recovery procedures. Further recently in February, 1998 a foreclosure law was promulgated so as to enable banks to collect loans from defaulting debtors in a situation where it has been difficult to obtain timely judgement from courts law.

After 1992, banks have regained their autonomy in loan transactions. There is no discrimination in credit allocation. Once more the private sector has become important in banks’ loan portfolio. However, the study of the distribution of domestic credit shows that domestic trade and services, and international trade together have the largest share in loan portfolio of CBE. While the share of industrial and agricultural sector in CBE’s loan portfolio is low. Whereas the DBE (Former AIDB) allocated the largest proportion of its loan to the agricultural and industrial sector.

9.2.6 Non-Banking Financial Institution (NBFIs)

The non-banking financial institutions in Ethiopia are mainly the Insurance’s companies and the pension fund. The non-banking sector is yet to develop. Their role as a direct source of credit is minimal. They keep large proportion of their fund in a form of deposit with banks or invest in government bonds. During the socialist regime they were the cheapest source of finance to the government and government owned specialized banks. The absence of securities market inhibits these institutions from playing active role as a source of direct finance to the various sectors. Even so the Ethiopian Insurance Corporation have made an attempt to hold stake in some companies within and without the country.

9.2.7 The Current State of the Financial Sector

When the post 1992 period is compared to the previous periods the Ethiopian financial sector have made some improvements. However, it remains least developed in many aspects. The inter-bank money market is still at the rudimentary stage, which is perhaps because of the quasi-monopoly position of CBE. Financial saving is mainly in the form of deposits in commercial banks. Apart from traditional instruments like cash and bank deposits savers in Ethiopia have a
few options to invest in financial assets. Higher yielding and riskier assets and long-term assets are almost non-existent. There are no short-term papers other than government bills, which are traded in a highly institutionalized market beyond the reach of the general public.

The range of lending instruments used by the banking sector is limited. The available forms of credit are overdraft account, trade advance and straight loans. The assets eligible for collateral are limited to buildings and vehicles, which limit many borrowers from making themselves, avail of bank loans. Other fee-based services largely comprise of letters of credit, safe deposit boxes and remittance facilities. The remittance service of banks outside cities like Addis Ababa is rather slow.

9.2.8 Financial Institutions and Long-term Investment Fund—Looking Ahead

In connection to the current state of the financial sector in Ethiopia there is something, which need to be considered seriously. That is though not as voracious as in many advanced developing countries, the appetite of Ethiopians for financial services has increased. The traditional aversion of debt is slowly waning away. Debt is becoming good, as more people like to borrow to achieve their objectives. This is mainly because of the new economic policy, which removed restrictions on the role of the private sector in the economy. Private investors are given free rein to invest any amount in any avenue, which means higher demand for external fund (direct or indirect) by private investors and others as they contemplate on expansion, modernization of the existing enterprises, and buying the enterprises ready for privatization.

On the other hand the capacity of the financial institutions to meet all the demand for funds is so limited.

First, neither insurance companies, nor pension funds are significant sources of funds to industrial enterprises, to other sectors and new investments. The absence of securities market continues to pose constraint. Second, it is not easy for CBE, to give adequate fund particularly long-term fund to all viable projects. The reason is the smallness of the banks long-term deposit, which does not allow the
bank to indulge more in medium and long-term lending. Third, the DBE (and also CBB) which are the main sources of long-term finance are also constrained by the shortage of fund. For instance during 1992-1996 the EIA approved projects with an estimated value of Birr 16.6 billion. Whereas the loan approved by DBE during the same period for investment as a percentage of the cost of the projects approved was not more than 10%. If all banks are to finance just a third of the total projects approved by EIA (i.e. the value of the projects approved till 1998 was Birr 36.5 billion) it would require liquidity which banks do not have, which means that bulk of resource to finance investment should come from sources other than banks.

Thus it is quite understandable that the long-term fund from financial institutions is not adequate when compared to investment projects approved, and are in a pipeline for implementation. Under such circumstance projects face shortage of external fund they require for quick implementation. Without adequate capital it is very difficult for economic agents to be able to respond to incentives offered by new policies.

### 9.3 Findings of the Study

1. The study reveals that the role of financial institutions (hereafter FIs) was influenced by the policies of the governments. Before 1975 FIs played active role in the process of economic development. Whereas during 1975-1991 the repressive policy of the socialist government inhibited FIs from playing active role in the economy. During this period the whole process of financial intermediation and the development of the financial sector was severely affected. During the post 1991 period the role of FIs in the economy have improved, though much remains to be achieved, because of the installation of better policy environment.

2. In spite of improvements made in financial intermediation, the Ethiopian financial system is underdeveloped. The density and volume of financial services vis-a-vis the population is inadequate. Banks are confined in urban and semi-urban areas as a result of which the populace is outside the orbit of their services.
3. In spite of low per capita income, in Ethiopia there is a saving culture even among individuals of small means, which can be developed. And there is a widespread demand for a variety of financial services in rural and urban areas.

4. The study reveals that insurance industry in Ethiopia is not well developed. The economic significance of insurance industry is low. The per capita expenditure on insurance in Ethiopia is low. The benefit of life insurance is not yet popularized in the country.

5. i. Deposits mobilized by the banking institutions are low, when seen in the light of the fact that bank deposits are the main financial instrument in Ethiopia by which financial savings could be made. Because of inadequate bank branch offices, banks are not able to garner savings scattered among millions within the country. Moreover, deposits mobilized are largely of short-term nature.

ii. The position of DBE with respect to deposit mobilization is far below satisfactory. DBE faces serious funding mismatch. While substantial amount of its loans have long-term maturity. The long-term deposits mobilized by the bank are low. Still DBE depends on the support of the government and government owned institutions such as CBE, EIC and Pension Fund. The danger is that as the government owned institutions seek more profitable investment, DBE may lose access to their resources, which means that DBE may run into liquidity constraint, which may force it to seek government help. To make the matter more serious there is no market from which the bank could borrow. This means that the status of DBE is risky and unsustained one, which is not good for the healthy development of financial sector.

iii. The low volume and short-term maturity dominated deposits in the hand of banks have limited their capacity to expedite investment in the country.

6. i. The study reveals that the largest proportion of domestic credit flowed to the trade (domestic and international) sector. Whereas the industrial and agricultural sector together received less than credit allocated to the trade sector. This trend will continue so long as commercial banks dominate the financial sector or
until banks manage to mobilize sufficient long-term fund, which they could lend for long-term investment.

ii. In spite of the important role of rural farmers in the economy and the strategy chosen in Ethiopia since 1992, which gave central place to agricultural and rural development, the rural Ethiopia is poorly served with bank credit facilities.

iii. Similarly the small-scale industries and micro-enterprises which are involved in different kinds of manufacturing activities face shortage of credit facilities.

7. During 1975-1991 the low, static and discriminatory deposit rates regime did not encourage savings in Ethiopia. Whereas, during the 1992-1996 period the low spread between deposit and lending rates did not give flexibility to banks so that they could bid up deposit rates and mobilize more savings. Further because of inadequate bank branches the catchment area of banks was narrow as a result of which banks were not able to mobilize more savings though deposit rates were positive in real terms.

8. In spite of policy changes and liberalization of the financial sector competition is conspicuous by its absence. The state monopoly over the financial sector is unchallenged. Both the banking and insurance business are dominated by the long established government owned institutions. Because of the absence of effective competition among financial institutions there is lack of innovation in the financial sector. For instance banks render more or less the same traditional financial services for only narrowly defined collateral. The restriction of collateral to a limited assets such as vehicles and buildings hamper sound lending and reduce access to credit for many groups.

9. In Ethiopia where accelerated rate of development is an urgent need, what is required is not merely the provision of loans by financial institutions, but also risk capital which would enable investors to take risk inherent in investments;
particularly investments in avenues which are risky but productive and useful to the economy.

10. The need to revamp the money and capital markets is imperative. The post 1992 economic environment makes these markets absolutely necessary. The investment code adopted by Ethiopia and the increased role of the private sector makes trade in securities necessary.

11. In sum, even though positive developments have taken place, the Ethiopian financial sector lacks depth and breadth in the services it provides and types of customers it serves, limited number of institutions and instruments for financial intermediation. The paucity of contractual saving institutions and the absence of organized stock and bond markets make banks the primary providers of financial intermediation.

9.4 Suggestions

9.4.1 Towards the Financial Institutions

   a. Banks should not take advantage of only favorable but rather circumscribed development episodes. Attention should be paid to small savers, especially in areas distant from cities. To this end banks have to expand their branch network so as to spread banking habit to the rural hinterland, expand the catchment area and to encourage savings with the formal institutions. Branch offices should take local conditions into consideration. Otherwise branch proliferation in itself may not necessarily be followed by increased deposit mobilisation.

   b. Banks should diversify their services. They should introduce new products and make all endeavours to make the public use facilities, which increase the efficiency of banking services. For instance a wider scale use of personal checks and the like.

   c. Increased integration of the formal and informal sectors is important, because there is substantial gain from making use of the advantages of both the sectors for the better. As a result of the link between the two, the size of the fund
outside the formal sector reduces which means efficiency in utilization of financial resources. Thus the formal institutions should persuade and woo the informal institutions in order to bring down financial services to the bulk of the population outside their reach. By working with the informal institutions, the formal institutions would be able to lend to groups, which are members of informal institutions. This would help financial institutions to get information about members of the group and the group also would serve as security.

d. The insurance companies (particularly the life business) and the pension fund scheme should put an effort through intensive information campaign, variety of services and other means so as to increase the number of policy holders.

e. The state monopoly over the financial sector should be slackened. Because it inhibits competition in the market. Because of the absence of competition banking institutions render more or less the same traditional financial services. Unless state monopoly is slackened such liberalization measures as those directed at interest rate may not workout based on market forces. This can be achieved by dividing banks like CBE into two or three separate banks. Whereas in insurance business the EIC may focus on reinsurance activities while leaving some of the activities to the private companies. This will help in curbing resource, which goes out of the country for the purpose of reinsurance.

f. Banks need to strengthen their link with borrowers. A successful productive lending to both old and new borrowers would require more attention than computation of the ability to repay and the existence of collateral. They have to involve themselves in preparation of projects, implementation, and even till maturity of the projects. Because the advisory role of banks is crucial for the assisted concern, apart from being helpful for their own business.

g. The involvement by lending institutions in productive activities such as agriculture and industry require special expertise which would enable them to appraise or discriminate among competing projects in a more rational way. Thus banks and other financial institutions should make endeavour to acquire the
necessary skill and expertise. This matter should be taken seriously because success in a dynamic business of today's world depends much on the caliber and competence of the staff of the financial institutions.

9.4.2 Towards Sources of Finance

a. In order to transform the subsistence farming in rural Ethiopia investment in agriculture and related activities is necessary. Hence the need to build up appropriate rural financial system. The source of finance to the rural sector should be holistic i.e. short-term credit because of the seasonality of agriculture and for the purchase of production inputs such as seeds, fertilizers. Pesticides and to meet cost of cultivation; medium/long-term for the development of agriculture, such as development of small irrigation, purchase of tractors and other agricultural implements and machinery, improvement of land etc; for consumption and for the payment of debt and the like. Otherwise there would be an inevitable substitution of one kind of loan for another which defeats the purpose of loan.

b. In Ethiopia there are a large number of medium and small scale manufacturing enterprises which could evolve into large manufacturing enterprises given adequate financial and technical support. In order to facilitate the metamorphosis of these enterprises, the government need to consider the establishment of well equipped specialised development bank which caters to the need of and pays close attention to medium and small scale enterprises. This may help enterprises to graduate from one stage to another and thereby contribute more to the country's economy.

c. The Micro-financing institutions (MFIs) which recently have started serving micro-enterprises should be strengthened. Such institutions have to be of good financial stand as they carry on their activities. They should put effort to mobilize savings rather than being mere retailers of credit, because experience have shown that institutions that mobilize savings as well as lend are more likely to be viable than intermediaries that only lend. MFIs should help borrowers understand that
their loans are not government grants. Otherwise wrong notions will create problem in recovering loans disbursed.

d. Short term money markets need to be developed. The short-term markets help enterprises as well as financial institutions in managing their liabilities and financial resources at their disposal. Enterprises with good reputation would be in a position to raise fund from money markets whenever need arises which means alternative sources of short term finance. At the same time money markets help enterprises with excess fund to make short-term investment conveniently till parking funds are channelled to their final destiny.

e. The Ethiopian financial sector is not well equipped to provide medium and long term loans. To mitigate this problem the bond and share markets have to be revived. The absence of these markets means a major gap in both opportunities and financial support to savers and investors. Open trade in bonds and securities adds new dimension to finance and gives flexibility to the operation of enterprises as well as financial institutions.

Already shares are being traded informally and through some interested and self motivated financial institutions like CBE. What is required is organised market where securities can be trade. The past experience of Ethiopia is that financial institutions played crucially important role in the establishment of the embryo of share market in Addis Ababa before 1974. Even today the initiative need to come from them, as they are more exposed to such activities than any other establishment in the country.

f. The need for venture capital and merchant banks is even more till securities markets are revived. These institutions will help in solving problems associated with risk finance in Ethiopia. Moreover, merchant banks would play important role in giving services such as portfolio management, underwriting and the like.

g. Mutual fund scheme need to be established as it is important means to attract the savings of small and medium sizes. Such fund could be used to finance
projects or enterprises savers would like to promote. It can be a viable source to supplement equity finance. The success of such scheme requires professionals who efficiently manage the funds. Otherwise mutual fund will turn out to be mutual loss and adversely affect the future prospects of such schemes.

9.4.3 Towards the Government/ Monetary Authorities

a. Government should assist in improving the productivity of and profitability of borrowers involved in production. For instance the transformation of traditional agriculture by making available things like fertilizers, equipment’s on leasing, storage and marketing assistance, education of farmers and extension services. The government already provides some of these services. However, they need to be strengthened. Similar assistance should be given to the industrial (especially small scale ones) enterprises. Such efforts to enhance the productivity of agricultural and industrial sector, development of entrepreneurship and development of human resource will improve the performance of the economy. This will reduce chances of default and enhance further demand for the services of financial institutions. Hence the performance of the financial sector improves.

b. In order to mitigate the possible adverse effects consequent to banks lending to activities characterised by instability of earnings, a mechanism of risk reinsurance need to be devised. The government needs to consider suitable means to address this issue. Given this facility banks will not be shy at lending to risky but productive activities.

c. Till foreign investors entry of the financial sector is granted the government should devise a way by which foreign financial institutions with good experience (i.e. in promoting innovative local financial service providers) operate in collaboration with the domestic institutions. Such foreign institutions could serve as a source of initial capital, technical and managerial support in establishing institutions like venture capital, lease companies, merchant banks, which are highly needed in Ethiopia.
d. The government should help the growth and development of contractual savings. For instance the pension and life insurance institutions should be allowed or encouraged to hold higher yielding assets than the government paper and loan to banks, which currently dominate their portfolios. Further, the government should encourage private enterprises to contribute to the pension fund.

e. In order to solve the problem associated with collateral central asset registering organ should be established.

f. The government should see to it that the administrative and legal infrastructures are conducive for rapid economic growth in a more liberal atmosphere. The NBE should build up its regulatory and monitoring mechanism. Since building institutions and acquiring the skill required takes time the initiatives taken should be strengthened.

g. The recently enacted foreclosure law may solve large part of the problem of debt recovery. But foreclosure law can not be the ultimate solution for all the disputes that arise between borrowers and creditors. Therefore specialised courts or tribunals, which handle disputes that arise in the financial sector, need to be established. The establishment of such courts may expedite the development of alternative financial services to the traditional ones currently rendered by financial institutions, because such courts install confidence in the financial sector.

h. The necessary legal and regulatory framework for the activities in securities market should be framed and the embryo of stock exchange is revived. To this end training of manpower required should be done.

i. Efforts should be made to create cohesive, reliable economic and financial database. The value of such database for research work is immense. The effort made so far by MEDaC, NBE, CSA and others are commendable. Nevertheless, more efforts have to be made to make available comparable data in line with clearly defined economic concepts and available for a variety of classification within a wide group.
In conclusion the researcher would like to say that still a lot should be done to make Ethiopia’s financial sector more competitive. This Herculean task requires sustained efforts of the government, NBE and financial institutions. The liberalization policy adopted has made the role of the government rather more important and complex. The role of NBE has become even more challenging and requires more skill, than during the era of direct monetary controls. Banks and other financial institutions face both challenges (i.e. committed efforts to accelerate the development of the financial sector) as well as opportunity (i.e. chances of rapid growth as the awareness of the public increases and the economy develops given vast potential resources). Much progress is expected in the days to come given prompt and sustained efforts of all the concerned to face challenges and grab opportunities. May it be so!