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AN ASSESSMENT OF THE ROLE OF THE
COMMERCIAL BANK IN SAVINGS MOBILIZATION AND
UTILIZATION IN POST REVOLUTIONARY ETHIOPIA

By

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ADDIS ABABA UNIVERSITY

JUNE, 1981





AN ASSESSMENT OF THE ROLE OF THE
COMMERCIAL BANK IN SAVINGS MOBILIZATION AND
UTILIZATION IN POST REVOLUTIONARY ETHIOPIA

A Thesis
Presented to the
School of Graduate Studies

In Partial Fulfilment
of the Requirements for the Degree
of Master of Science
IN ECONOMIC DEVELOPMENT AND PLANNING

by
Mahtsentu Felleke
June, 1989

ADDIS ABABA UNIVERSITY
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ACKNOWLEDGEMENT

I would like to express my particular thanks to Dr. Assefa Tefferri, under whose supervision and guidance this thesis has been completed. Honestly speaking, the thesis would not have been finalized without his counselling.

I also wish to thank some staff members of the National Bank of Ethiopia, Research Division for their comment and advice. Thanks are also due to the staff members of the Commercial Bank of Ethiopia, Planning and Business Development Division for providing me with documents and data.

My deep appreciations go to all individuals who have helped me in completing this thesis.



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ABSTRACT

The main concern of this thesis has been to assess the role of the Commercial Bank of Ethiopia in savings mobilization and utilization. The necessary information was mainly obtained from secondary sources.

Simple techniques of analysis such as percentages, graphical representations, ratios, etc., are used to analyze the data.

The results indicate that the performance of the Bank in savings mobilization and utilization has, generally, been inadequate. The inadequacy of the Bank's savings mobilization effort is exhibited by the low levels of the banking ratio, changes in total bank liabilities as percentage of GNP, and by the ratio of bank deposits to money supply. The inadequacy of the utilization of savings is indicated by the absence of clear credit policy, excess liquidity reserve, the declining trend of loan-deposit ratio, and by the high security requirements.

The paper suggests some changes in the existing policy of the Bank. Thus, both lending and deposit interest rates, credit and branch expansion policy, and security requirements have to be changed in order for the Bank to play the maximum role in the growth of the Ethiopian economy.

CHAPTER I

1. INTRODUCTION

1.1 Statement of the Problem

The central issue of economic development is the problem of mobilizing and allocating resources for growth in such a manner that growth becomes self-sustaining. It is known that capital investment raises productivity and also that the rate of growth of production is mainly determined by the rate of capital formation. Any rise of the investment rate requires, in its turn a greater proportion of the national production to be saved. Given the low level of income in developing countries, it is in the short-run difficult to raise the rate of net domestic savings, a rate which in those countries hardly exceeds 15 percent of the national product and is mostly below 10 percent compared to 20-30 percent prevailing in the industrial countries.¹

Facts on the Ethiopian economy indicate that close to 50 percent of the GDP, 90 percent of exports, and over 80 percent of the employment is accounted for by the agricultural sector, manufacturing industry (including small scale industries and handicrafts) accounts for only about 11 percent of the GDP and about 31 percent of the total employment. The mining sector of the economy is still underdeveloped as its contribution to the GDP is less than one percent.²

¹Peter Marlin (ed), Financial Aspects of Development in East Africa, Weltform-verlag, 1970, pp. 14-50.

²The PMAC ONCCP, Ten Years Perspective Plan 1984/85-1993/94, A.A. Aug. 1984, P.20.

The growth performance of the economy over the past decade has been mixed. Between 1973/74 and 1977/78, the economy grew at the rate of less than one percent indicating a decline in per capita income since population was growing at a rate of 2.5 percent per year during the same period. Between 1977/78 and 1983/84 the growth rate of the economy although marked by ups and downs averaged about 3.9 percent per year.³

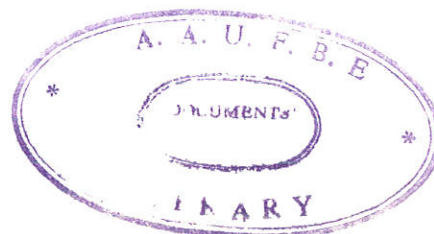
Economic growth since 1974 on the whole had been constrained by the low level of investment. Gross fixed investment as a ratio of GDP fell from about 10 percent in 1973/74 to 7.5 percent in 1977/78. Between 1978/79 and 1983/84 the trend was reversed as the investment ratio steadily rose to reach about 12 percent of GDP by 1983/84. In spite of the increasing trend, however, the country's investment ratio is still lower than the average of 14 percent for low income developing countries.⁴

The rise and fall in the investment ratio over the last 13 years was paralleled by a somewhat similar pattern in the domestic savings ratio. Gross domestic savings as a proportion of GDP fell from 13 percent in 1973/74 to about 2 percent in 1977/78. In 1983/84 it was estimated to be about 3.2 percent.⁵

³Ibid.

⁴Ibid. P. 21

⁵Ibid. P. 22.



The strategy for development in Ethiopia is the participation of the majority of the population in the development process. It includes reliance on local institutions and improved technology and indigenous effort for self-reliance and sustained growth. Thus, more reliance on domestic resources calls for increased domestic savings.

The significance of domestic savings is also emphasized by the United Nations Commission for development. For example, the Commission in its report concluded that the financing of development must be based on the maximum exploitation of domestic sources of funds. The Commission further emphasized the role of domestic finance in economic development as being the prerequisite for enabling countries to implement the social, political and economic policies which they consider most suitable for the improvement of their standard of living. The role of foreign finance in economic development can therefore only be of subordinate character.⁶

It is stressed in the Ten Year Perspective Plan that the financing of the investment programme will entail maximum effort to mobilize the necessary domestic and foreign resources. Domestic savings are projected at Birr 23.3 billion in current prices and will cover 55.5 percent of the planned total investment.⁷

⁶Methods of Financing Economic Development in Underdeveloped Countries, quoted in Edward Nevin, Capital Funds in Underdeveloped countries: the Role of Financial Institution, London Macmillan, 1961, P.XIII.

⁷ONCCP, Ten Years Perspective Plan, PP. 48-49.

The crucial importance of internal accumulation of investible funds for development is thus beyond question.

Broadly speaking, internal supplies of capital funds can be mobilized through two main channels-those of fiscal and monetary. The former involves important and difficult problems concerning the relationship between taxation and incentives, the type of tax most suited to the administrative machinery, etc., areas which this paper is not going to cover. The latter aspect, particularly the assessment of the Commercial Bank of Ethiopia (CBE) in savings mobilization and utilization, is the central issue of the paper.

In developing countries like Ethiopia, the margin of income above the subsistence level is narrow, making saving difficult. Other factors such as the rate of growth of population hinder the growth of savings, thereby limiting the amount of capital required for productive investment. Even if there are people who can afford to save, they either prefer to spend on traditional forms of unproductive investment such as the purchase of jewels and other materials of prestige, or imitate the consumer habits of the industrial society. Adverse effects are also produced by the widespread paucity of investment opportunities, the rudimentary nature of the local capital markets, etc.

Moreover, as in most LDCs, the inadequacy of measures in Ethiopia to effectively mobilize rural savings due to the assumption that the traditional sector is characterized by the low productivity compared with the modern sector led

not only to the low mobilization of savings but also to devote the largest part of their efforts to the mobilization of domestic personal savings and to the provision of credit facilities to the relatively small modern sector.⁸ Despite such efforts, mobilization of personal savings is practiced in Ethiopia by a small section of the urban population through traditional forms of saving such as 'Equb' and 'Idir'. The channeling of such savings into the modern sector through the intermediation of financial institutions is also far from being effective.

The practice of sound money management by individuals and the regular use of savings and credit facilities (where they exist) of the financial institutions by the broad section of the population is limited. This indicates the gravity of the problem in the mobilization and utilization of savings in the country.

An important task facing the country is thus the mobilization and utilization of such scarce financial savings by Commercial Bank branches.

⁸U.N., Savings for Development: Report of the International Symposium on the Mobilization of Personal Savings in Developing Countries, N.Y., Department of International Economics and Social Affairs, 1981, P.12.

As discussed in chapter two, commercial banks help mobilize savings. When considering the Commercial Bank of Ethiopia, its contribution for savings mobilization cannot be denied completely. However, the problem with the Bank is that the growth of deposits particularly saving and time deposits, have not been adequate. Moreover, the Bank has been facing a problem of utilizing its mobilized savings according to the priorities set out by national plans. Most of the credits have been channeled, into the trade sector of the economy thereby creating further distortions in the flow of credits and failing to provide adequate credit to the productive sectors of the national economy.

Short - term plans of the country as well as the Ten Year Perspective Plan, give priority to the development of the agricultural sector, since, as already pointed out, this sector is the backbone of the Ethiopian economy in terms of GDP, employment, foreign exchange earnings, etc. For fulfilment of plans the role of the Bank is, therefore, paramount.

The problems mentioned above, with emphasis on the mobilization and utilization of savings are examined critically in the following pages. Furthermore, the implications of the Bank's credit policy on savings mobilization is diagnosed with the ultimate aim of prescribing alternative policy measures.

1.2 Objectives and Significance of the Study

1.2.1 Objectives

The main objectives of research paper are summarized as follows:

- a) To explore in detail the structure, operations and determinants of the performance of the Commercial Bank of Ethiopia.
- b) To assess the level of financial development of the Bank, and also to examine the rate of change of this development in the post revolutionary period.
- c) To assess the performance of the Bank in savings mobilization, i.e., to look into the volume and rate of growth of savings channeled into the Bank during the same period.
- d) To examine critically, the direction and degree of utilization of savings among the different sectors of the economy vis-a-vis the priorities of the country as set out by the previous short and medium term plans, and the Ten Year Perspective Plan.
- e) To prescribe policy options in the light of the findings.

1.2.2 Significance

There exists little work done regarding the operation and structure of the commercial banking system in Ethiopia. And because there is no clear understanding of the commercial banking, there is no sound basis for the Bank's policies.

As the Bank is the main source of local funds, its role as savings mobilizer (in different forms of banking deposits and earnings that aid economic growth) is substantial. Moreover, the Bank's role in the proper and efficient channeling of credits into the various sectors of the economy in accordance with given priorities is undeniably important. Thus, works that alleviate the above problems and suggest alternative policies that could improve the volume and type of savings, and the utilization of credits are immensely important.

It goes without saying, therefore, that the significance of this paper in bringing forth the knowledge of operations and analysis of the performance of the Bank for formulating alternative policies that alleviate the problems mentioned earlier is out of question. Besides, the paper is important to bridge the existing research gap.

1.3 Methodology and Source of Data

1.3.1 Methodology

In this section the methodology considerations are given.

Time series data on demand, time and savings deposits, money supply, GNP, CBE credit and other related variables over the period of 1975 to 1987 are collected and compiled.

The following techniques are utilized to meet the specific objectives of this study.

1. To meet the objective of exploring the structure, operations and determinants of the Bank, its existing documents such as policies and procedures, manuals, proclamations, and related materials on commercial banking activities are reviewed and examined vis-a-vis theoretical and empirical facts.
2. The objective of assessing the level of financial development is met by analyzing the trend distribution of total liabilities of the CBE as percentage of GNP for the given period. As the economy of the country grows, the Bank's assets (= liabilities) must also increase, provided it receives an increasing amount of deposits and channels its savings to productive investment through time, in which case the percentage distribution of total liabilities to GNP must rise. This method has been successfully utilized by Ali Issa Abdi to study the role of commercial banks in the economic development of Eastern Africa. Since the structural characteristics of the Ethiopian economy are similar to those of Eastern Africa, the utilization of the same method is justified.⁹

⁹Ali Issa Abdi, Commercial Banks and Economic Development: The Experience of Eastern Africa, N.Y., Praeger Publishers, 1977, P.67.

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3. To evaluate the effectiveness of the Bank in savings mobilization, the trend of (a) demand deposits as percentage of money supply; and (b) time and savings deposits as percentage of money supply are analyzed. Money supply (M_1) is currency outside banks plus net demand deposits. The different types of deposits expressed as percentages of money supply explain the performance of the Bank in savings mobilization. The ratio of deposits to M_1 increases as the Bank's effort in mobilizing savings increases thereby showing the degree of institutionalisation of savings. This method has also been utilized by Ali Issa Abdi in the same study and for similar reasons mentioned above, it is also adopted here.
4. To examine the direction and degree of utilization of savings among the different sectors of the economy, simple quantitative techniques of analysis like proportions, ratios, graphical representations, etc., are employed.

1.3.2 Source of Data

All data on Bank liabilities, money supply, Bank's savings, credits, GNP, spatial distribution of CBE branches, population are taken from different issues of Statistical Abstract (CSO), Quarterly Bulletin (National Bank of Ethiopia) and Statistical Review (CBE) as the case may apply.

CHAPTER II

2. SURVEY OF LITERATURE AND BACKGROUND TO THE STUDY

In many less developed countries like Ethiopia, financial institutions other than commercial banks are usually narrowly distributed. In such countries very few people are accustomed to holding financial assets and making use of banking facilities. The prevalence of these situation is unfortunate despite the fact that the poorer the country the greater will be the need for financial institutions that mobilize saving and facilitate its utilization.

From the existing financial institutions in Ethiopia the commercial banks take the major share in branch network. Relatively speaking, the CBE is the dominant type of organized financial institution which is the forerunner in existence and enjoy market monopoly.

Therefore, the general theoretical and empirical discussions of financial institutions in this chapter relate more to the commercial banking system than other financial institutions in Ethiopia.

In the survey of literature such points as the theoretical and empirical findings on the role of financial institutions, the effect of financial market repression on savings and hence on an economy, and the growth theory of financial institutions are dealt with at length.

2.1 The Role of Financial Institutions in Developing Countries

Neo-classical growth theories provide mainly a negative role of the monetary process. According to these theories

"a reduction than an increase in real returns on financial wealth stimulates saving and investment"¹ and so accelerates economic growth.

Although theories of the role of finance in promoting economic growth in developing countries were popularized by such economists as Shaw, Mckinnon and Galbis, they are not totally new ones. The first modern economist to understand the role of finance was probably Joseph Schumpeter who looked the credit-creation function of banks as "..... the monetary complement of innovation", innovation and entrepreneurship being central to his explanation of development. John Gurley and Edward Shaw laid in 1955 the bases to the modern explanation of the role of finance. Recent works by Shaw, Mckinnon, Patric and others stress the significance of a strong and efficient financial system in promoting economic growth. They also refer to Taiwan and South Korea as empirical examples supporting their thesis².

¹Shigeyuki Abe, Maxwell J. Fry, and others, "Financial Liberalization and Domestic savings in Economic Development: An Empirical Test for Six Countries", The Pakistan Development Review, Vol. XVI, No.3, Autumn 1977, P. 298.

²Michael Dacosta, Finance and Development: the Role of International Banks in the Third World. Colorado, Westview press, 1982, P.P. 16-17.

We see that Shaw and McKinnon take direct issue with the neo-classical proposition, indicating that "crucial assumptions in this paradigm are erroneous in the context of less developed countries". McKinnon provides an alternative model in which he states that "real money balances are complements rather than substitutes to tangible investment". Shaw rejects the neo-classical growth models in favour of the debt - intermediation view. While McKinnon maintains the neo-classical "outside money" assumptions, Shaw assures an "inside money" economy in which money is backed, at least partially, by productive investment loans³.

The above and a number of other studies have attempted to clarify the already established hypothesis (Gurley and Shaw in 1955 and 1966, Patrick in 1966) that improvements in the financial intermediation process are a precondition to economic growth.

What is at issue in their studies is the growth of financial savings as an alternative to consumption and investment in inadequate return undertakings, and the channeling of such savings from surplus to deficit spending units. To stimulate investment following the Keynesian tradition, such a transfer appears to demand high interest rate as opposed to low interest rate policies (McKinnon 1973, Shaw, 1974)⁴.

³ Shigeyuki Abe, Maxwell J. Fry, and others, The Pakistan Development Review, P. 298.

⁴ P.C.I. Ayre (ed), Finance in Developing Countries, Franke Cass Ltd., 1977, P. 58.

The theoretical postulates of the new approach mentioned above rest on some facts mentioned below, concerning the nature of economies of the LDCs.

Developing economies are fragmented wherein the old and modern technologies exist side by side creating substantial disparities in rates of return to different investments. The second point is that a large number of the more modern production processes require comparatively large amounts of investment. Hence, indivisibilities become an important factor to be considered in the process of development.

A third point is the self-financing of investment. It is said that financial intermediation is in its infancy imposing serious financial constraints on external investment in new technologies with high return, while investment proceeds in the older, self-financed sectors yield low return. Thus, improvements in the process of financial intermediation tend to channel financial and real resources from the low-yielding investments to investments that are likely to result in acceleration in the overall rate of economic growth.

Finally, the role played by most governments in LDCs has not been conducive since various policies have contributed substantially to the malfunctioning of the financial system, and to the inefficient use of real resources. The widespread exercise of regulating interest rates, for instance, which financial institutions pay for their deposit liabilities has resulted in very low rates in the official markets, and this has generally led to a widening of the existing gap between

the demand for and the supply of funds contributing to open or repressed inflation and to the perpetuation of an unofficial non-institutionalized financial market⁵.

The findings for a sample of developing Asian countries show that between one-half and three fourth of net household saving is in the form of increases in tangible wealth and that most of the assets held by such savers are under their own direct control. The findings also indicate that, in general, the composition of individual real asset possessions in less developed countries consist mainly of land and land improvements, simple agricultural and handicraft tools, livestock, inventories like foodstuffs, and durable consumer goods like precious metals, jewellery, etc.⁶

From a higher percentage of tangible assets held in unproductive forms of sustained growth in less developed countries, some can easily be changed to productive capital goods. This is particularly true of precious metals, excess holdings of inventories, etc. The amounts kept in the forms mentioned above could be substantial and it may not be exaggerating to think of ratios of tangible wealth to GNP, even without including land, of 2 to 3 percent. A reallocation of as much as 10 percent of this possession in more productive forms could be equal to 20 to 30 percent of GNP and would increase the level of output by about 10 percent⁷.

⁵Ibid., P. 59.

⁶Hugh T. Patrick, "Financial Development and Economic Growth in Underdeveloped Countries", Economic Development and Cultural Change, Vol. XIV, No.2. January 1966, P. 178.

⁷Ibid., P. 179.

The need for keeping wealth in the form of food-stuffs, other primary products, and even in the form of finished manufactured goods well over normal consumption or production needs in developing countries is for the important reason that inventories are the only assets which are relatively liquid divisible and provide some protection against general consumer price inflation where a suitable financial asset alternatives are non-existent. Nevertheless, storage and spoilage costs are high and for individual commodities risks of price fluctuation could at times be unavoidable.

It is believed that in the early stages of development individuals could prefer holding of financial assets with more attractive terms to holding tangible wealth in excess of the normal consumption and production needs. Thus, individual holdings of precious metals, foreign exchange and other foreign assets can be changed directly to socially productive goods by foreign trade, with exchange of imports of precious metals or foreign exchange⁸.

The main problem is, however, that individuals who keep tangible wealth may not necessarily be those who are willing to hold productive assets. The possession of productive fixed assets in less developed countries often necessitates entrepreneurial and managerial functions in which all wealth holders are not willing to engage themselves. The possibility of holding superior financial assets as opposed to keeping

⁸Ibid.

inventories and specie as a store of value enables tangible asset holders to give them up for financial assets, and for others to arrange the transformation of these freed, tangible assets into a more productive form. What is so important is thus the shifting of individual real asset holdings to financial asset holding on one hand, and encouraging investors to incur financial liabilities in the form of credits that could be directed to productive investment⁹.

The effect of financial structure and development on economic growth is reflected by the adequacy of the channeling of resources through financial institutions. Financial savings and aggregate savings in general may increase depending upon the success of the intermediation function. Higher levels of capital formation in productive sectors and other essential sectors for development and social equity may also be brought about by improved financial intermediation.

The technique of transferring resources through financial institutions is by issuing their debts to surplus spending sectors and relending the funds to deficit spending sectors. Financial intermediaries thus minimize the basic conflicts that limit the transfer of resources by eliminating the coincidence of the occurrence of wants between borrowers and lenders. Moreover, financial institutions offer to savers divisible and highly liquid assets at a lower risk and to investors a large pool of resources, often at a lower cost.

⁹Ibid., P. 181

The success of the intermediation function is determined how well financial institutions satisfy the preferences of both the borrowers and savers.

Apart from the strong theoretical considerations on the fundamental question whether the saving-investment process of financial institutions brings forth higher savings than would be available, the empirical verifications of increased savings through financial intermediaries as institutions develop is also well established.

The reasons financial development may instigate an increase in the aggregate volume of real savings are basically "the opportunity to save via the introduction of new assets that dominate all previously available assets, the improved yield of the available variety of assets, and finally the direct institutional effect"¹⁰

Ali Issa Abdi explains the first reason as follows:

The improved opportunity to save effect is based on the assumption that the rudimentary nature of financial development in the developing economies retards the desire to save. The portfolio choice of domestic surplus units is limited to holding either currency or physical assets (including inventory changes). The introduction of other financial assets (such as savings certificates, savings and loan shares, and ... bank deposits) increase the variety of assets available. The new assets introduced by the development of financial institutions dominate the initially available assets in terms of earnings, safety, and liquidity, since the risks attached to them are small compared to the capital assets, and since currency is a barren asset at best¹¹.

¹⁰ Ali Issa Abdi. Commercial Banks and Economic Development, PP 3-4.

¹¹ Ibid.

In this connection Patrick says that there are a variety of relationships between the financial system and growth producing real factors. The most important of all the relationships, he stresses, the relationships of the stock of financial assets and liabilities to the real capital stock - its optimal composition and rate of growth and its efficient allocation and utilization is the most important. According to him, there are three major ways financial intermediation influences growth¹². First, by bringing about changes in its composition and ownership through intermediation among various asset holders, financial institutions encourage a more efficient allocation of capital. Financial institutions can influence people to save and invest by providing incentives in terms of interest rates. This helps the accumulation of capital. Lastly, they encourage an efficient allocation of new investment from less to more productive uses, by intermediation between entrepreneurs and savers.

It is known that savings mobilization is not an end in itself. The ultimate goal should be its efficient utilization for economic growth. The efficient allocation of savings rests on a premise that the more developed and efficient the financial institutional system, the higher is the volume of domestic private savings channeled into it. It is basically the capacity of financial institutions to provide assets

¹²Hugh T. Patrick "Financial Development and Economic Growth", PP. 177-178.

preferable to internal savings and primary securities ownership that justifies their existence and development. In addition, a transfer of savings from other channels, in particular from currency hoards, precious metal hoards, or excess inventory accumulation to financial institutions in favour of financial assets improve the efficient allocation of savings.

The distribution of savings differs from the most efficient distribution of investment due to the main reason that the former depends primarily on income while the latter depends on willingness to take risk and invest, entrepreneurial talents and knowledge, and skill. The corollaries of this are that, as explained earlier, individuals in developing countries tend to hold real assets, usually of relatively low productivity. Contrarily, efficient investors are not able to increase sufficiently their investment holding of productive and tangible assets and their issuance of financial liabilities. This is to say that savers are not necessarily investors and investors may not save enough to self-finance their desired investment outlay. As a result, marginal rates of return are not equated for different uses or among different users. This deficiency could not have been solved without recourse to financial intermediaries¹³.

¹³Ibid., P. 182.

The development of financial institutions not only increases the amount of capital available from any given amount of gross savings, but also helps allocate savings which may result in higher returns on investments. Again, where capital and money markets are not adequately developed, financial institutions provide the only means of financing large complex investments.

There are clearly some investments that due to indivisibilities in optimum plant size, need expenditures far in excess of the savings of most economic units.

Moreover, financial intermediation provides a variety of other incentives to investors.

The reduction in the effective interest rate reduces the cost of investment, the strength of the demand response depends on the elasticity of the marginal efficiency of capital schedule. It should be pointed out that financial intermediation does not mean that the interest rate necessarily declines over time, since in a growing economy investment demand may become increasingly strong. However, increased effective financial intermediation will produce a narrowing of the dispersion of interest rates among different types and levels of credit worthiness of users, among geographical regions, and over periods of seasonal fluctuations. This is the consequence of the improvement in financial markets¹⁴.

For many investors the increased access to funds as a consequence of financial intermediation may be more important than the reduction in costs. This is perhaps particularly true in developing countries.

¹⁴Ibid.



The availability of funds from financial institutions enables efficient investors to assume a greater debt position than they could otherwise and at the same time to undertake a larger amount of investment. In addition, access to financial funds on reasonable conditions can stimulate investors to expand their business sizes to conceivable opportunities. Not mere access to finance but the entire financial environment, and the rationalism it implies that stimulates creative investment responses¹⁵.

2.2 Financial Repression

The developing economy analyzed by McKinnon and Shaw is financially repressed. The central argument is that financial repression 'indiscriminate distortions of financial prices including interest rates' reduces, 'the real rate of growth and the real size of the financial system relative to non-financial magnitudes. In all cases this strategy has stopped or gravely retarded the development process'. Many developing countries have apparently slipped into financial repression inadvertently, the original policy was aimed at financial restriction¹⁶.

Financial restriction motivates institutions and financial instruments. For instance the banking system is protected-

¹⁵Ibid., P. 185

¹⁶Maxwell J. Fry, "Models of Financially Repressed Developing Countries"/World Development, Vol. 10, No.9 September 1988, P. 732.

high reserve requirements and obligatory holdings of government bonds can be imposed to obtain increased bank saving at zero or low interest rate to the public sector. Private bond and equity markets are put down by, for instance, transaction taxes, stamp duties, special tax rates on income from capital, a discouraging legal framework, etc. Ceilings on interest rate are imposed to suppress competition from the private sector. Under financial restriction, it was felt that ceilings on interest rates, high reserve requirements, suppression on the expansion of private capital markets, etc., can all increase the flow of domestic resources to the public sector without an accompanying rise in inflation or interest rates.

The transfer of higher proportion of resources from the financial system to the public sector reveals, for the most part, successful financial restriction¹⁷.

Selective or sectoral credit policies are common features of financial restriction. Selective credit policies necessitate sectoral credit policies, since financial liberalization enables financial channels to grow for redirecting subsidized credit.

The arguments expounded by McKinnon and Shaw assume that savings are positively related to the real rate of interest at each rate of economic growth. It is also contended that an administratively determined nominal rate of interest, which is common feature in less developed countries according to these

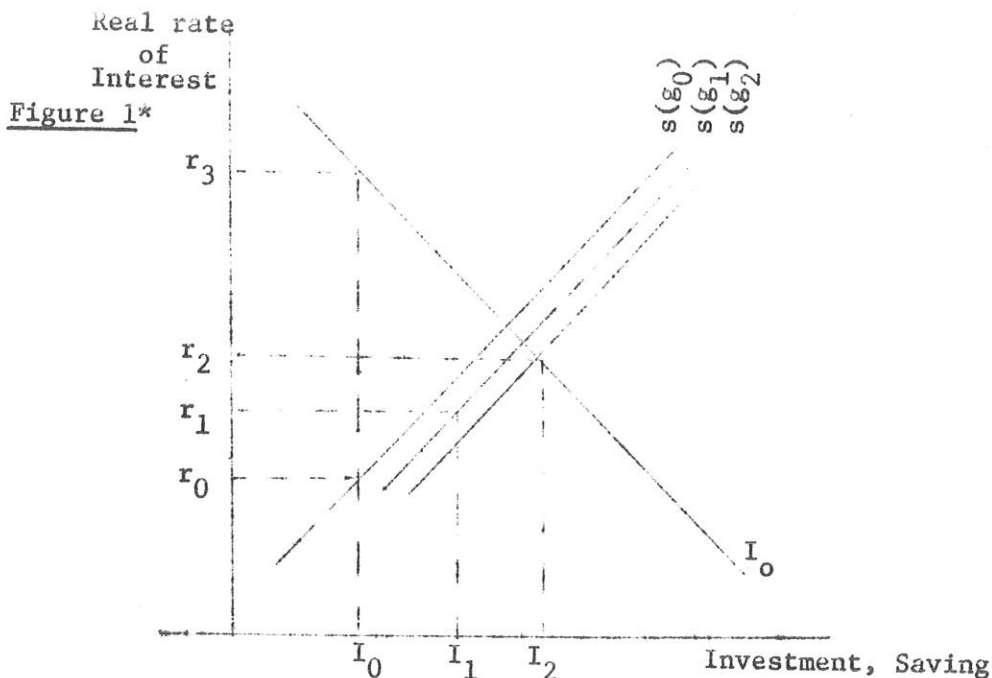
¹⁷ Ibid.

authors, holds the real rates below its equilibrium level in the figure shown below. This situation is known as one of financial repression in which a fixed interest rate such as r_0 gives rise to an amount of savings that limits actual investment to I_0 ¹⁸.

If loan interest rates such as r_3 are not allowed i.e., if loan rate ceilings are established, like institutional ceilings on deposits, non - price rationing of loanable funds must follow. Two important results from this situation are that, "first, savings remain at a low level and so investment since savings are the primary factors determining the real supply of credit, and second, investible funds are inefficiently allocated by means of non-price criteria. It is then claimed that both features prevent both the financial system and the overall economy from growing and developing."¹⁹

¹⁸Gerardo M. Gonzales Arriesta, "Interest Rates, Savings, and Growth in LDCs: An Assessment of Recent Empirical Research." World Development, Vol. 16, No.5, May 1988, PP. 589-590.

¹⁹Ibid.



The financial effects on savings from relaxing the intensity of financial repression is observed when one considers a higher institutional nominal rate of interest equal to r_1 . This mechanism will ration out many of low return investments previously financed, thus increasing the average efficiency of investment and raising economic growth, and this in turn shifts the savings function to s/g_1 . It is obvious that at the new rate of interest, actual investment I_1 will be higher than in the former situation because of increased savings²⁰.

²⁰Ibid., P. 590.

* You can, for example, see World Development, Vol.16, No.5, P.590, Vol. 10, No.9 (May and Sept. 1988 and 1982 respectively), Pakistan Development Review, Vol. XVI, No.3, Autumn 1988, P.301.

points on demand deposits and a 26 percentage points on long-term deposits is consequent upon a rise in the official ceiling on nominal interest rates from 15 to 30 percent. In addition, the ratio of M_2 to GNP rose from 9 percent in 1964 to 33 percent in 1969 showing an increase of financial savings for lending. Although there was a sharp increase in interest rates, private borrowing from banking system remained buoyant²⁴.

Similarly, V. Galbis concludes that financial policy should be to maximize financial saving through a policy of interest rate that adequately rewards savers providing them positive real rate of interest. The savings must be efficiently allocated in those economic units with the best contribution to the national income²⁵.

It is further recommended that nominal interest rate ceilings are highly destabilizing policies in the presence of inflationary shocks. As deposit rate ceilings in the U.S. and other industrial countries have been responsible for disruptive disintermediation in the periods of rising inflation and free market interest rates, all round ceilings on interest rate in developing countries have caused destabilizing portfolio shifts from financial to tangible assets when inflation accelerates²⁶.

²⁴Michael Dacasta, Finance and Development, P. 17.

²⁵P.C.I. Ayre, Finance in Developing Countries, P. 58.

²⁶Maxwell J. Fry, "Models of Financially Repressed Developing Countries", P. 732.

We conclude by remarking that the fundamental functions of financial institutions are to encourage savers to hold their wealth in the form of financial rather than less productive tangible assets. This will ensure efficient investment and allocation in the most productive sectors, and will provide incentives to attract increased saving, investment and production. To achieve these goals, however, policy makers must formulate proper and sound policies for the operation and development of financial institutions.

2.3 The Growth Theory of Financial Institutions

As we have said already, the growth of financial institutions promotes higher marginal propensities to save. One aspect of this may be described as a direct effect of institutional development on the aggregate volume of savings. The institution elasticity of private aggregate domestic savings would obviously depend on the existence of alternative channels. In postulating this effect, W.A. Lewis claims, "there is a whole range of savings institutions that can be developed. Experience shows that the amount of saving depends partly on how widespread these facilities are, if they are pushed right under the individuals nose, to the extent of having street savings group, or factory groups, or even deductions from earnings at source, people save more than if the nearest savings institution is some distance away²⁷.

²⁷ W. Arthur Lewis, The Theory of Economic Growth, N.Y. Harper and Row, 1970, P. 229.

In a more recent study, U Tun Wai, after estimating the relationship between financial savings and retained earnings, conclude, that "the statistical evidence seems to support the hypothesis that the greater the financial intermediaries the larger will be the amount of national savings"²⁸.

There are two basic paths to financial growth: these are demand - following and supply-leading phenomena. Their basic distinction is that the latter aggressively seeks entrepreneurs and encourages them to invest in new ventures while the former simply accommodates demand for funds and the adequacy of funds is not always assured²⁹.

Demand - following approach puts emphasis on the demand side for financial institutions. As an economy grows, new and increased demands for such institutions is created which is matched by the supply response of the growing financial system. According to this argument the shortage of financial institutions in developing countries is merely due to lack of demand for them.

Demand - following may be termed as a process in which "the creation of modern financial institutions, their financial assets and liabilities, and related financial services is in response to the demand for these services by investors and savers in the real economy ..., the evolutionary development of the financial system is a continuing consequence

²⁸Ali Isse Abdi, Commercial Banks and Economic Development, P.6.

²⁹H.T. Patrick, "Financial Development and Economic Growth", P. 174.

of the pervasive, sweeping process of economic development"³⁰. Changes both in objective conditions like the economic environment, the institutional framework, and subjective responses such as individual motivations, attitudes, tastes preferences, etc., shape the financial system emerged under this circumstances. The demand for services of financial institutions depends here on the growth of real production and on the monetization and commercialization of agriculture and other traditional activities. The faster the growth of real national income, greater demand of enterprises for financial savings arises since under most situations firms will be less able to finance further large investments from own profit. Financial institutions help transfer savings from individuals and slow-growing to fast-growing undertaking in the process of growth.

The supply response of the growing financial system in the demand - following process is presumed to emerge automatically. It is assumed that the availability of entrepreneurship in the financial sector is highly elastic relative to growing opportunities for profit from financial services, and thus the financial institutions grow sufficiently. It is also assumed that an attractive institutional, legal and economic environment exists. As a consequence of this, financial markets widen thus raising the chances of getting

³⁰ Ibid.

much credits reducing risk which in turn feeds back as a stimulant to real growth.

The demand-following approach implies that finance is essentially passive and accommodative in economic growth. However, the increased supply of financial services in response to demand may not at all be automatic, flexible, or cheap in developing countries. The banking legislation in early nineteenth century France, religious barriers against loans and interest charges in Italy may be cited as examples. Similar obstacles and market imperfections may dictate inadequate demand-following response by the financial system in less developed countries today. The lack of financial institutions, therefore, restricts or inhibits effective growth patterns and process³¹.

The supply-leading phenomenon, on the other hand, is the creation of financial institutions and supply of their services before they are demanded. Supply-leading has the functions of transferring resources from traditional sectors to modern sectors, and of promoting and stimulating entrepreneurial responses in these modern sectors.

New access to the supply-leading funds may substantially motivate entrepreneurs by opening new horizons on possible business alternatives, which is the most significant effect of all, particularly in developing countries where entrepreneurship is a major constraint on development.

³¹Ibid.

New government financial institutions can be created using government capital and perhaps directly subsidized by government as experienced in Russia in the latter part of the nineteenth century and by many today's developing countries. Secondly, private financial institutions may receive direct or indirect subsidies often the latter by numerous ways. Commercial banks issue banknotes under favourable collateral conditions although this may be less important today than its modern equivalents of allowing private financial institutions to create deposit money with low reserve requirements and central bank rediscount of commercial bank loans at interest rates effectively below loan interest rates. Thirdly, new modern financial institutions may at the beginning lend profitably large amounts of funds to traditional sectors and then gradually shift their provision of funds to the modern sector as the economy develops. Therefore, supply-leading finance gives an opportunity to encourage real growth by financial means. It is thus likely to play a more significant role at the beginning of the growth process than the later³².

³²Ibid.

CHAPTER III

3. THE COMMERCIAL BANKING SYSTEM IN ETHIOPIA

3.1 The Origin and Evolution of Banking

Commercial banks have contributed to the growth of today's more advanced countries by increasing the availability and amount of credits, by investigating or by participating in the financing of manufacturing projects and of public works, and by purchasing government bonds.

It is thus useful and instructive for today's developing countries that are thinking of the possible role of banks in helping to promote the growth of their economies, to look more closely at the role of the early banks.

The first people who are said to have began banking-like activities were the goldsmiths who still maintain strong boxes to keep their gold. Individuals who possessed such valuables as ornaments, gold coin and plate would deposit such items with goldsmiths and other reliable merchants in return for a receipt. The paper receipts issued by the goldsmiths were, in effect, promises to repay a stated value of gold at any time the depositor wanted it.

As the gold was less portable than the receipt, it became convenient for the depositor to pass on the receipts whenever he wanted to make payment to a third party, so long as the reputation of the goldsmith was enough to ensure acceptability

of his promise to pay. The fundamental principles of the operation of the modern banking system and the faith of the public in currency were thus established.¹

It was soon realized by the goldsmiths that they were asked at any one time to refund only a certain portion of the gold deposits and thus they could safely issue receipts in excess of the gold deposits still equally maintaining the confidence of the public. They could, thus, issue notes to borrowers who undertake to repay the amount with interest. This substantially increased the profitability of their operations. It is under those circumstances that the early goldsmith-banks were said to have been "Creating money": for the value of receipts could now exceed the amount of gold 'withdrawn from circulation' by the goldsmiths. The additional receipts issued did, however, mean an increase in the liabilities of the bankers, since they could be presented for repayment at any time. These liabilities are balanced by interest-earning assets: but it was still necessary for liabilities to be 'backed' by a sufficient reserve of gold."²

¹ I. Livingstone & H.W.Ord (ed), Economics For Eastern Africa, Heinman Educational Books Inc., 1980, P.366. Also see Belai Giday, Currency and Banking:Ethiopia, A.A., Commercial printing press, 1987, P.66.

² Ibid.

The early merchant banks developed along the lines described above. Nevertheless, another line of historical argument explains that monasteries, new religions orders, Jews, and French and English men had helped the development of banking, particularly in the western world.³

Cyril James explains that financial institutions make up an integral part of the network of civilization that has developed in the western world. "Money was used long before the golden age when Athens was governed by Pericles. Banking institutions had been operating in Mesopotamia so long before the time of Abraham that they had developed the standards of financial practice which were given legal sanction in the great code of Hammurabi".⁴

Money was circulated in communities around the Mediterranean during the years that followed the collapse of the Roman Empire, while gold and silver were used at the periodic Fairs in central Europe. Although some monetary institutions developed at a lower level survived the break up of Rome, banking seemed to have vanished from Europe although knowledge of banking practices may have lingered on in the commercial centres of the Saracentic Empire.

³ F. Cyril James, The Economics of Money, Credit and Banking, The Ronald Press Co., N.Y., 1946, pp. 106-113.

⁴ Ibid.

The Roman Emperors from Nero to Diocletian had undermined the monetary system to such an extent that imperial coin was no longer acceptable and, when monetary institutions slowly reappeared during the Middle Ages. During the later part of the Middle Ages, the growth of the operations of financial institutions was attributed by the monasteries. From the eighth century onwards, the monasteries of Western Europe became increasingly wealthy taking the advantage over the landlords that they were able to read and to keep accounts. Thus they usually operated their manors more profitably than did the landlords and the wealth that accrued from efficient agriculture was greatly augmented by the bequests and donations of the faithful.

Long before the end of the tenth century, people who wished to safeguard their treasure turned to the monasteries and thus the great abbeys were actively engaged in finance both as custodians and as trustees.

After the eleventh century, however, the monasteries became less important as financial institutions than the new religious orders which accumulated wealth for similar reasons. In spite of the fact that the wealth of the monasteries and religious orders drew most of the attention of the public, they were faced with a good deal of competition from the emerging Jews financiers. Thus, by the end of the twelfth century the Jews had grown too rich in England until the mass persecutions around 1290.

During the fourteenth and early fifteenth century, the official positions of Royal Exchanges and Royal moneyer were filled by Englishmen and Frenchmen.

Whether or not the goldsmith, the monasteries, religious orders, etc. had began banking practices, it is believed that the origin of banking is traceable to ancient Assyrians, Babylonians and Athenians. But the forerunners of modern banking are considered to be the Bank of Venice, the Bank of Genoa and the Bank of Amsterdam established in 1171, 1320 and 1609 respectively. The Martins Bank in London has been operating on its original site since Sir Thomas Gresham, a goldsmith, established it in 1563 "at a sign of Grasshoper."⁵

As early as the year 1200, bankers were advancing beyond the level of mere money changing and were entering into the activity of banking as it is presently defined. In Genoa, for example, they began to accept deposits of the current and the fixed period, to advance credit to merchants and traders, and were becoming involved in foreign trading and other business activities. Historical evidences reveal that they dealt in foreign currency and extended credits to be repaid at the Faire of Champagne in France, that served at the time as the great foreign exchange dealing house of Europe. The importance of the faire declined as the Italian bankers moved to establish branches in European cities not only to finance trade between

⁵Robert O. Edmister, Financial Institutions, Markets and Managements, McGraw-Hill Inc., 1980, P.73.

the countries but also to lend to merchants and businessmen of the countries into which they moved.⁶

It can be seen that even at this early stage bankers were helping to facilitate the flow of trade between countries and beginning to lend overseas.

Towards the beginning of the fifteenth century, the most important of the Italian banking house was Medici Bank founded in Florence in 1397.⁷ Apart from establishing foreign branches, the Medici lent heavily to monarchs.

While extending their activities to overseas by financing international trade and by lending to governments, banks were at the same time contributing to the expansion of commerce, manufacturing and infrastructure within their individual countries.

In England, for example, banks such as Lloyds were closely connected with industries. It is noted that the early banks "generally originated as the ancillary business of traders, manufacturers, and mining concerns".⁸

Usually secured by mortgages on property or by simple promissory notes, direct long - term loans to industry were

⁶Michael Dacosta, Finance and Development, P.26.

⁷Ibid.

⁸Ibid.

also common and substantial by historical standards. Banks in Britain were actively financing manufacturing industries, mining, etc., both for working capital and fixed capital investment. The contribution of banks to the excellent transportation system in Britain is significant.

In Belgium the banking system was probably even more directly involved in industry. These banks "actively sought new firms, underwrite their stock issues, finance potential stockholders, held stock in their own names, placed their officers on the boards of directors of companies they promoted, and ministered to the companies' needs for both working capital and new capital for expansion."⁹

German banks were also closely involved with industrial companies, not only by providing finance, but also by purchasing stock. They continue to perform that function today. In Russia, the banks assisted the state in financing railway construction.

Outside Europe, the "leading role" of the banking system in financing Japanese industrial growth has been propounded by Patrick as the best example of the sequence of supply-leading and demand-following finance. A modern banking system was created, which in the absence of large scale industrial demand for funds initially concentrated on financing agriculture, domestic commerce, etc., although Yamamura has disputed this thesis by pointing out that the banks only became interested

⁹ibid.

in those concerns which were already well-established and viable.¹⁰ In the United States, the rapid development was helped by bank financing of canals, railroads, and other public works.

3.2 The Development of Banking in Ethiopia

The origin of banking in Ethiopia dates back to 1905 when the Bank of Abyssinia was established in Addis Ababa under partnership with the British owned National Bank of Egypt. This bank was given the sole right of issuing bank notes and minting coins.

Bank of Abyssinia branch offices were opened in Dire Dawa, Dessie and Gore. It had also an agency office in Gambella and a transit office in Djibouti.

Other banks established in Addis Ababa at the time were Societe Nationale D'Ethiopia poure le Development de l'Agriculture et du Commerce opened in 1908. Banque de l'Indochine and Compagnie de l'Afrique Orientale were both opened in 1915.

The Bank of Abyssinia lasted until 1931 when it was replaced by the local Bank of Ethiopia. Bank of Ethiopia, the first indigenous bank, was established with a required capital of pounds sterling of 750,000¹¹. The new Bank took over the commercial activities of the former bank and was authorized to issue notes and coins; and had branches in Dire Dawa,

¹⁰H.T. Patrick, "Financial Development And Economic Growth", PP.177-18

¹¹Belai Giday, Currency & Banking: Ethiopia, P.71.

Debre Tabor, Harar, Gore, Dessie and an agency in Gambella as well as a transit office in Djibouti.

Bank of Ethiopia was in turn liquidated in 1936 when Italy invaded Ethiopia. During the five years of the war against Italy a number of Italian banks established branches in major towns of Ethiopia. Such banks include Banco D'Italia, Banco di Roma, Banco di Napoli and Banca Nazionale de Lavoro and were closed after the Italian defeat except Banco di Roma and Banco di Napoli which operated in Asmara and their sub-branches in Assab and Massawa.

In 1941 a British bank called Barclays Bank started banking services in Addis Ababa and operated until 1943.

In 1942 a government owned bank the State Bank of Ethiopia was established as a commercial bank with a capital of one million Maria Theresa Thalers. The next year the same bank was entrusted with additional responsibilities of a central bank and was authorized to control the issue of currency, to manage the foreign reserves of the country and to act as a fiscal agent of the government. The bank continued its operation with its dual responsibilities for twenty years until it was reorganized into separate commercial bank and central bank entities as of January 1, 1964.

The first privately owned commercial bank called Addis Bank was established in 1964 having a capital of Birr 250,000.00¹²

¹² Dembel Balcha, Analysis of the Contribution of Financial Intermediaries in the Saving and Investment Process in Ethiopia 1963 - 1973 (Ph.D. Dissertation), University of Microfilms International, 1986.

subscribed by its founders; and in 1967 the second private commercial bank - Banco di Roma (Eth.) with an initial capital of two million dollars was established. Another privately owned commercial bank called Banco di Napoli was set up in 1970.

There were three commercial bank offices in 1943, and this number rose to 21 in 1963, including a branch in Khartoum, and transit office in Djibouti. There were 121 branch offices in 1973, about one-third of which are concentrated in Addis Ababa and Asmara.¹³ The total number of branches reach 154 in 1987.¹⁴

The two commercial banks - the Commercial Bank of Ethiopia S.C. and Addis Bank - continued their operations with their stated objectives until 1980 when they were amalgamated to the present Commercial Bank of Ethiopia with the following new objectives.¹⁵

1. To extend commercial banking services throughout the country;
2. to encourage the mobilization of saving by making the people aware of the use of banking;
3. to extend loans, credits and all other banking facilities to any person for specific purpose and periods;
4. to spread widely banking habits among the people.

¹³Ibid.

¹⁴Commercial Bank of Ethiopia, Statistical Review, Planning and Business Development Division, A.A., No.6, June 1988, P.19.

¹⁵Negarit Gazeta Proclamation No.184 (A proclamation to provide for the Establishment of the Commercial Bank of Ethiopia), BSPP, 1980, P.100.

3.3. Functional Relation with the National Bank

The Commercial Bank and other similar financial institutions are controlled and supervised by the National Bank of Ethiopia. The purpose is, it is said, to guide them to operate according to sound banking practices.

Article 6 of the Monetary and Banking proclamation No.99 outlines the purpose of the National Bank as follows:¹⁶

The purpose of the National Bank by which it shall be guided in all its actions are according to the National plan to:

1. foster balanced and accelerated economic development;
2. promote and maintain high level production, employment and real income;
3. encourage and promote the full development of the productive forces of Ethiopia.

In order to fulfill the above purposes the National Bank enjoys a number of rights which are also indicated on the same proclamation.

¹⁶ Negarit Gazeta No.1, 21 Sept. 1976 (Proclamation No.99 of 1976 Monetary and Banking proclamation).

The strategy for development in Ethiopia is the participation of the majority of the population in the development process. It includes reliance on local institutions and improved technology and indigenous effort for self-reliance and sustained growth. Thus, more reliance on domestic resources calls for increased domestic savings.

The significance of domestic savings is also emphasized by the United Nations Commission for development. For example, the Commission in its report concluded that the financing of development must be based on the maximum exploitation of domestic sources of funds. The Commission further emphasized the role of domestic finance in economic development as being the prerequisite for enabling countries to implement the social, political and economic policies which they consider most suitable for the improvement of their standard of living. The role of foreign finance in economic development can therefore only be of subordinate character.⁶

It is stressed in the Ten Year Perspective Plan that the financing of the investment programme will entail maximum effort to mobilize the necessary domestic and foreign resources. Domestic savings are projected at Birr 23.3 billion in current prices and will cover 55.5 percent of the planned total investment.⁷

⁶ Methods of Financing Economic Development in Underdeveloped Countries, quoted in Edward Nevin, Capital Funds in Underdeveloped countries: the Role of Financial Institution, London Macmillan, 1961, P.XIII.

⁷ ONCCP, Ten Years Perspective Plan, PP. 48-49.

Thus as stated in article 9 the National Bank May: 17

1. Regulate the supply and availability of money and credit and applicable interest and other charge;
2. establish, consolidate or dissolve banks and other financial institutions and define or modify the functions thereof;
3. supervise, regulate and control the operations of banks and other financial institutions;
4. encourage organized bodies such as 'Idir' and 'Equb' to transact their business dealings through banks;
5. adopt measures which will ensure that monetary and financial resources are utilized in a socially beneficial and economical manner and at the same time foster the growth of the socialized sectors;

The same proclamation empowers the National Bank to ensure "the efficient and optimal allocation of monetary resources among banks". And also to set terms and conditions for short and long term refinancing facilities available to banks.

¹⁷ Ibid.

In addition, the National Bank issues directives with respect to credit transactions of the Commercial Bank and other institutions, as well as its own credit transactions with the Commercial Bank and other financial institutions.

Most important of all, the National Bank is empowered to determine or vary the rates of interest the Commercial Bank and other financial institutions charge for different types of loans, advances and other credit transactions and for different categories of borrowers, as well as pay on various types of deposits. The National Bank requires the Commercial Bank to keep with the former in cash and in other forms of liquid assets including Government securities, an amount equivalent to five percent of deposits.

The Commercial Bank must obtain approval from the National Bank for the opening, closing or transfer of a branch.

It can thus be noted that the Commercial Bank does not have any discretionary power that enables to carry out its objectives. However, this may not be taken as a unique limitation, since such power is exercised by almost all central banks in the world.

CHAPTER IV

4. AN ASSESSMENT OF THE ROLE OF THE CBE IN SAVINGS MOBILIZATION

The theoretical discussion of the previous chapter serves as a background for the examination of the Bank's policies and savings mobilization efforts which are treated below.

4.1 The Branch Expansion Policy

The branch expansion Policy of the Commercial Bank of Ethiopia (CBE), set out by the National Bank of Ethiopia in 1976 has the following objectives:¹

- a. To promote and accelerate a balanced regional distribution of banking services throughout the country and;
- b. to ensure that the banking system plays a more active role in economic development by taking the initiative to stimulate economic activity in potentially productive areas through the provision of banking facilities.

The policy stresses that financial institutions, which are instruments of the State, have the obligation to reach the small farmers, the industrial proletariat, the shopkeepers and cottage industry owners, etc. It is the policy of the Bank not to wait until a certain area is developed before branches are established.

¹ Letter of the Governor of the National Bank dated September 20, 1976 Ref.No. ERPD/93/76 (addressed to the Managing Director of the Commercial Bank of Eth.)

Instead, branches must be opened and they should strive to encourage the least developed but potentially rich areas. Furthermore, according to the policy, the overriding objective of financial institutions should not be the maximization of profit but the acceleration of the rate of economic growth and development as well as the uplifting of the standard of living of the broad masses. The policy points out that the future branch expansion policy of financial institutions should aim at an effective mobilization and proper utilization of the bank resources to meet the needs of planned and balanced economic development, taking into account the elimination of regional imbalances as well as servicing the masses.²

The directives for establishing new bank branches outline, that in order to facilitate the fair distribution of banking facilities and adequate bank services, the CBE and other financial institutions must open a branch in each Awraja where there are no branches in the three years effective from the operational date of the 1976 policy, provided circumstances permit.

According to the policy, areas other than Awrajas which must be equally considered for branch establishment

² National Bank of Ethiopia, Branch Expansion Policy, 1976, P.2.

must be those which have economic potential. Regions neglected for political and social reasons were given due consideration in the policy in establishing new branches in addition to the target of one branch for each Awraja.³

The policy states that an aggressive branch expansion can be instrumental to overcome the problem of unemployment, accelerate rural co-operatives, stimulate the growth of small scale and cottage industries and meet the economic, social, and political needs of the population. Finally, the policy points out the following by way of avoiding duplication of efforts, misallocation of financial and human resources and maintaining the maximum rationalization of banking, priorities in branch expansion.

1. Administrative regions that have been neglected in the past, particularly Gojjam, Arsi, Bale and Gamo Goffa;
2. each of the 52 Awrajas which at the time did not have bank branches;
3. potentially productive areas such as Wushwush, Asmara Valley (Sidamo region), Yabelo, Metekel, Dejene, Yubdo (Wellega), Geleb and Hamer Bako (Gamu Goffa), Coffee Improvement project areas (Goma and Manna) in Kaffa, Haru in Wellega,

³Ibid., P.3.

Darolebu in Hararghe, Mettu and Yayo in Illubabor and Yirga Chefe and Dale (in Sidamo); Awash valley particularly Amibara Bolehamo Anglél, Kibre Mengist (Sidamo); Bure (Gojjam), Sekota (Wello);

4. areas which are densely populated and where there are significant economic activities;
5. towns along regional and international highways and also those lying along the borders. These included Moyale, Mega, Yabelo, Finchawa, Agere Mariam, Fisiha Genet (Sidamo); Ferfer, Shilabo Kebre Dehar, Dga Harbour, Kurmuk, Asosa, Bambesi (Wellega), Jikao (Illubabor); Metema, Wagna, Chilga, Azezo, Sebdrat (Eritrea);
6. where peasant associations have large membership and are well organized. Such associations included at the time those in Kola Dega Damot, Ticho, Arba Gugu, Ambasel, Raya & Kebo, Webera, Garamuleta, Raya and Zebo, Debre Tabor, Horo Guduru;
7. areas where there are significant commercial, tourist and other economic activities;
8. areas where political considerations are of primary importance in accordance with government policy.

Table 4.1: Distribution of CBE Branch Offices by
Woreda and Awraja

No.	Administrative Region	No.of Awraja Towns	No.of banked Awraja towns	No.of Woreda Towns	No.of banked Woreda Towns	No.of Unbanked Woreda Towns	Total No of branch offices
1.	Arsi	3	3	22	2	20	5
2.	Bale	5	3	25	-	25	3
3.	Gamo Gofa	4	4	22	1	21	5
4.	Gojam	7	7	35	3	32	10
5.	Gondar	7	5	29	2	27	8
6.	Eritrea	8	6	33	-	33	9
7.	Harrarghe	13	10	66	3	63	15
8.	Kaffa	6	4	38	1	37	6
9.	Wellega	6	6	49	3	46	9
10.	Shōa	11	11	93	11	89	23
11.	Sidamo	6	6	34	5	29	11
12.	Illubabour	5	5	34	-	34	5
13.	Wollo	12	8	37	2	35	11
14.	Tigrai	8	6	55	-	55	6
15.	Assab Adm.	1	1	5	-	5	2
16.	Addis Ababa	-	-	-	-	-	26
T O T A L		102	85	557	33	544	154

Table 4.2: Towns with More Than One Branch

No.	Towns	Branches
1	Asmara	4
2	Assab Adm.	2
3	Addis Ababa	26
4	Nazareth	2
5	Jimma	2
6	Gonder	2
7	Dire Dawa	3
8	Dessie	2
T O T A L		43

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Source: Commercial Bank of Ethiopia,
Statistical Review, Planning
and Business Dev't Division, No.6
June 1988, P. 19 (for both Tables
4.1 and 4.2).

Table 4.3: Branch Development by Administrative Region
(End of June, 1988)

No.	Administrative Region	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	Total
1	Arssi	1	1	1	1	4	4	4	5	5	5	5	5	5	5
2.	Bale	1	1	1	1	1	2	2	3	3	3	3	3	3	3
3	Eritrea	8	8	8	8	8	8	8	8	8	8	8	8	9	9
4	Gamo Goffa	1	1	1	2	2	2	2	3	3	5	5	5	5	5
5.	Gojam	2	2	2	4	5	8	8	8	8	8	8	8	10	10
6	Gonder	3	3	3	3	4	5	5	6	6	6	6	7	8	8
7	Hararghe	8	8	10	10	10	11	11	11	11	11	13	14	14	14
8	Illubabour	4	4	4	4	4	5	5	5	5	5	5	5	5	5
9	Keffa	4	4	5	6	6	6	6	6	6	6	6	6	6	6
10	Sidamo	7	7	8	8	8	8	8	9	9	11	11	11	11	11
11	Shoa	15	16	16	16	17	18	20	21	23	23	23	23	23	23
12	Tigrai	5	5	5	6	6	6	6	6	6	6	6	6	6	6
13	Wellega	4	4	4	4	4	6	7	7	7	7	7	7	9	9
14	Wello	6	6	6	7	7	8	8	8	9	9	10	10	11	10
15	Addis Ababa	24	25	26	26	26	26	26	26	26	26	26	26	26	26
16	Assab	2	2	2	2	2	2	2	2	2	2	2	2	2	6
17	Djibouti	-	-	-	-	-	1	1	1	1	1	1	1	1	1
	T O T A L	95	97	102	108	114	126	129	134	138	142	145	147	154	154

Source: C.B.E., Statistical Review, June 1980, P.21

Table 4.4: Branches Opened (July 1974 - June 1988)

Year	Branches	Year	Branches
1974/75	1. Dubti 2. Mehal Gebeya	1979/80	1. Assosa 2. Shambu 3. Hirna 4. Batti 5. Addis Zemen 6. Chagni 7. Motta 8. Alaba Kulito 9. Bichena 10. Teppi
1975/76	1. Gulele 2. Meki		
1976/77	1. Andinet 2. Goba 3. Deder 4. Kibre Mengist 5. Mizan Teferi		
1977/78	1. Maichew 2. Alamata 3. Dangla 4. Dejen 5. Gidole 6. Bonga	1980/81	1. Holeta 2. Nejo 3. Effeson
1978/79	1. Debre Tabor 2. Finote Selam 3. Arsi Robi 4. Huruta 5. Tensai Berhan 6. Butajira	1981/82	1. Ginir 2. Yela Sawla 3. Dabat 4. Hagere Mariam 5. Zewai
		1982/83	1. Wereillu 2. Alem Ketema 3. Mehal Meda 4. Bekoji
1983/84	1. Yabelo 2. Chenchu 3. Jinka		
1984/85	1. Degehabour 2. Kebri Dehar 3. Mekane Selam		
1985/86	1. Nifas Mewcha 2. Melka Sedi		
1986/87	1. Adi Keyeh 2. Adet 3. Este 4. Agew Gimja Bet 5. Tenta 6. Arjo 7. Gulisso		
1987/88	1. Fugnan Birra		

Source: Commercial Bank of Ethiopia,
Statistical Review, June 1988, P. 23

Table 4.5: Population - Branch Ratio
Population in '000

Year	Total Number of branches+	Total Number of population	Annual Rate of Growth of		No. of people per Branch
			Branches	Population	
1975	95	23,906.3	-	-	251.6
1976	97	27,907.6	2.1	16.7	287.7
1977	102	28,637.1	5.2	2.6	280.8
1978	108	29,408.2	5.9	2.7	272.3
1979	114	30,250.6	5.6	2.9	265.4
1980	126	31,065.3	10.5	2.7	246.6
1981	129	31,904.1	2.3	2.7	247.3
1982	134	32,775.0	3.9	2.7	244.6
1983	138	41,036.0	3.0	25.2	297.4
1984	142	42,185.0	2.9	2.8	297.1
1985	145	43,350	2.1	2.8	299.0
1986	147	44,654.8*	1.4	3.0	303.8
1987	154	45,958.7*	4.8	2.9	298.4
Average	-	-	4.1	5.8	-

Source: (1) + Refer to Table 4.3

(2) CSO, Statistical Abstract (various issues)

(3) * CSO, Population of Weredas, and Towns, By Sex, And Average Household Size Based on the Preliminary Census Results, And Population Projections By Age - Sex Groups Rural Urban, For Total Country And Regions: 1984 - 1995. A.A., December 1985, PP.168-169.

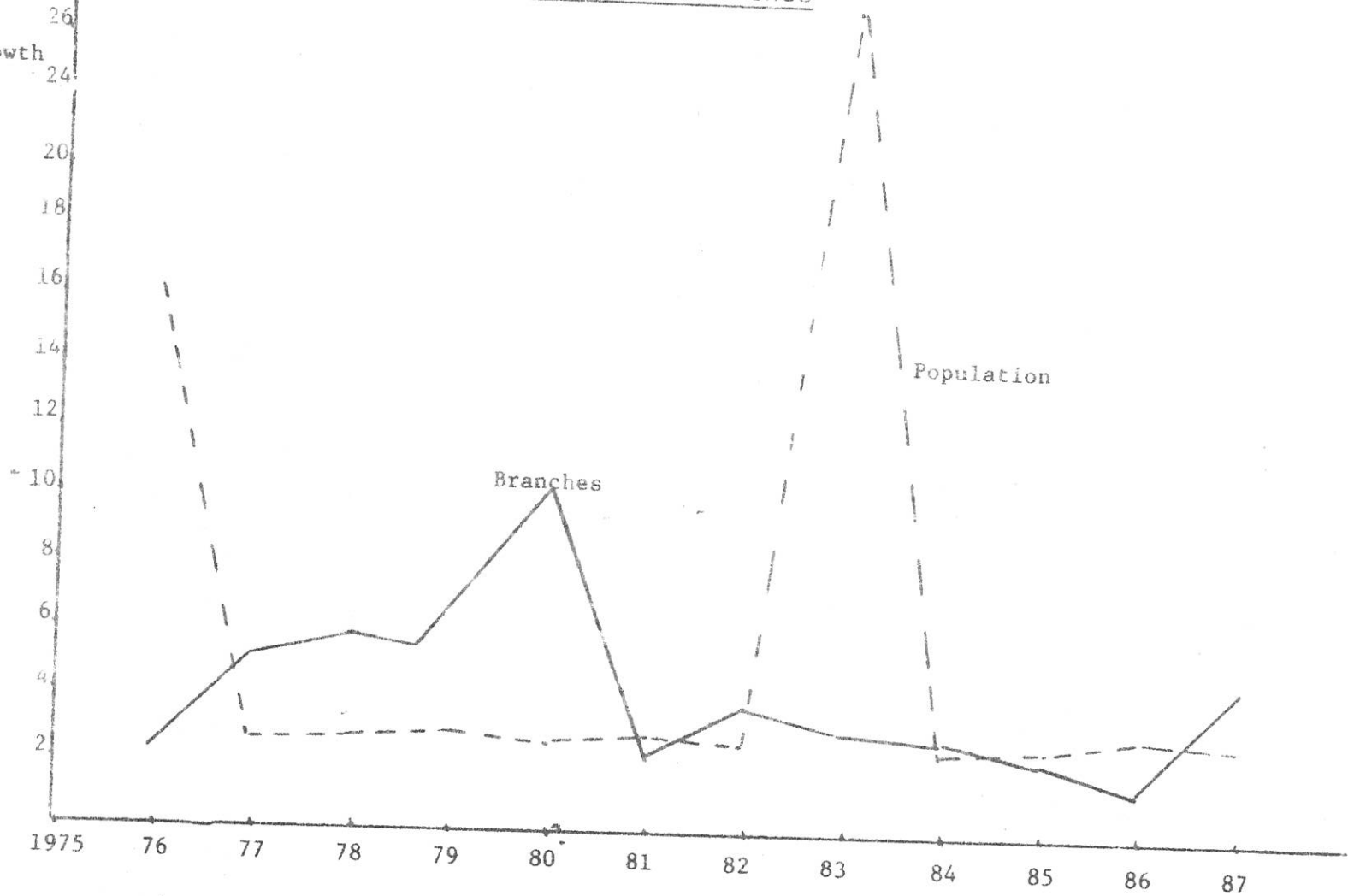
Table 4.5 indicates the growth rate of Commercial Bank branches and population. From 1976-1980 the annual rate of growth showed an increasing trend except 1979. From 1980 onwards, however, the annual rate of growth declined except in 1982 and in 1987. It is thus clear that the growth rate of branches does not show a general increasing trend.

Examination of the branch-population ratio supports the assertion that the branch expansion effort does not seem adequate. It is shown in the same Table that the total number of people served in one branch, i.e., the population branch ratio was 251,600:1, in 1975 and reached a maximum of 303,800:1, in 1986. The fact that the average rate of growth of branches is 4.1 percent whereas the corresponding figure for population is 5.8 percent, indicates that the branch population ratio has not been narrowing down. This situation is indicated clearly in Figure 4.1.

To correct this imbalance the bank has not introduced and exercised simple cost effective saving mobilization techniques such as factory groups, deductions at source, and mobile banking services. These simple techniques could cover areas that are remote and unbanked like military camps, training institutions etc. A. Lewis has also emphasized on these and other related simple techniques as we have seen in the earlier chapter. Such techniques could play more important roles particularly at the beginning than the Bank's classical approach of initially constructing relatively expensive buildings wherever the branch expansion policy permits.

Figure 4.1: Growth of Population and CBE Branches

Annual Rate of Growth
of population,
Branches.



Source: Based on Table 4.5

We stated in chapter two that there are two theoretical arguments for the growth of financial institutions. These are demand-following and supply-leading. The theoretical review supports that for developing countries like Ethiopia, the supply-leading approach is to be preferred, since this enables to motivate and attract both financial savings and provision of credits for selective productive investments. This is assuming that banks are more efficient and better able to analyze investments than the entrepreneurs themselves. This circumstance is thought to create a conducive situation for development in developing countries such as Ethiopia.

As we have seen above, it is the Commercial Bank's branch expansion policy to stimulate economic activities in potentially productive areas through the prior provision of banking services in potentially developing regions. The policy states that the Bank aims at an effective mobilization and utilization of resources.

This policy objective presupposes that the branch expansion policy supports the supply leading approach to bank development. In reality, however, this is not the case. We observe from the discussion made above that the bank has been opening additional branches in the capital city where there is an automatic demand for their services. New branches have also been opened in relatively advanced towns where demand for bank facilities is believed to exist adequately.

An interest rate is a rate commercial and other similar banks charge on the credits they extend to the different borrowers and on the various types of deposits they receive. While interest rates related to the former are treated in the next chapter, attention here is given to the latter.

The various types of deposits maintained with the Commercial Bank of Ethiopia are demand, time and saving deposits which are defined as follows.⁴

Demand deposits are non-interest bearing deposits maintained with the Bank, payable on demand to the order of the account holder or a third party through the medium of a cheque or any other instrument acceptable to the Bank.

Savings deposits are interest bearing deposits maintained with the Bank, attested by a passbook or any other instrument issued by the Bank, withdrawal voucher signed by the account holder at the Bank counter at the time withdrawal is requested.

⁴ National Bank of Ethiopia, Credit Regulation NBE/CR/2, May 12, 1986 quoted in Birritu, No. 30, July 1986, P. 14.

Time deposits are deposits maturing on a specific date agreed upon between the depositor and the Bank.

Deposit interest rates set out in 1976 have been applicable for most of the period under review. We see from Table 4.6 that the rates varied between 4 and 6 percent per annum. Interest rates of 4 and 5 percent have been applied for short periods of less than one year and for any deposit amount in excess of Birr 20,000.00. The 6 percent interest rate has been applied invariably for the rest of both time and savings deposits. This is summarized as follows⁵.

⁵Commercial Bank of Ethiopia, Terms and Tariff (Various years), A.A. P. 25-26.

Table 4.6: Interest Rate on Deposits (1976)

Description	Interest Rate per cent Per Annum
(a) Ordinary current account	NIL
(b) 30 days notice account	4
(c) Fixed deposits	
(i) Three months but less than six months	4
(ii) Six to twelve months	5
(iii) Over twelve months	6
(d) Saving accounts	
(i) Single name accounts	6
(ii) Two or more name accounts upto Birr 20,000.00	6
(iii) Business organizations, or associations accounts upto Birr 20,000.00	6
(iv) Balance in excess of the foregoing limits	4

Source: CBE, Terms and Tariff (Various years), A.A., PP. 25-26.

Table 4.7: Interest Rate on Deposits (1986)

Description	Percent Per Annum
Demand deposits (Current account)	NIL
Time deposits:	
- Financial institutions	1 year - 1.0
- Government owned undertakings	1 year - 1.0
- Private organizations, cooperatives, (except saving and credit cooperatives) urban dwellers associations, peasant associations, other mass organizations and professional associations	1 year - 4.0 2 " - 4.5 3 years - 5.0 5 years - 5.5
- Individuals, saving and credit cooperatives, 'Idir' and 'Equb'	1 year - 6.00 2 years - 6.5 3 years - 7.0 5 years - 7.5
Saving deposits,	
- Financial institutions, Government owned undertakings, cooperatives (except saving & credit cooperatives) urban dwellers associations peasant associations and other mass organizations and professional associations	Not allowed to maintain saving deposit accounts.
- Individuals, 'Idir', saving and credit cooperatives and private organizations:	
Upto Birr	100,000.00
in excess of Birr	100,000.00
- Others to be determined by the National Bank	6.00 2.00

Source: National Bank of Ethiopia, Credit Regulation NBE/CR/2,
May 12, 1986 (quoted in Birritu, No.30, July 186,
PP. 12-13.

The 1976 interest rate system gives the opportunity to eliminate any restrictions with regard to initial deposits of the fixed type and also that fixed deposits withdrawn before maturity forfeit only full annual interest benefits. This system also sets out that interest on deposits in excess of Birr 20,000.00 should be 4 percent per annum, provided the excess amount remained on deposit for not less than 30 days. Interest at the same rate was payable for each full 30 days period thereafter. No interest was paid on any deposit amount kept in the Bank for less than full 30 days⁶.

Deposit interest rates discussed above remained in force until 1986 during which time a revised interest rate system was introduced. (Table 4.7). The 1986 interest rate system is rather tighter in interest opportunities than the previous one. Time deposits of individuals, saving and credit cooperatives, 'Idir' and 'Equb' receive, for example, 6 percent per annum both in the old and the new interest rate regimes. The only difference in this connection is that an annual increment of 0.5 percent on savings is allowed for every additional year in the new system. The maximum period of maturity is five years, whereas a non-variable deposit interest rate of 6 percent per annum was applied in the old system, regardless of the number of years such savings units have been keeping their account in the Bank. Savings

⁶Ibid., P.26.

deposits account interest rate, which was 6 percent per annum in the old system, is unaltered in the new one. The difference between the two systems in this connection is that different interest rates are shown for deposits in excess of certain limits. In the old system, for example, an interest rate of 4 percent per annum was paid out for savings deposits in excess of Birr 20,000.00. In the new system, however, this limit is raised to Birr 100,000.00 but the rate of interest allowed is 2 percent. Private organizations, co-operatives (except saving and credit cooperatives), urban dwellers associations, other mass organizations and professional associations are not allowed to keep saving deposit accounts with the Commercial Bank. Such organizations can, however, keep time deposit accounts with the Bank at a reduced interest rate as shown in Table 4.7.

Further comparisons of the two systems reveal that the new deposit interest rates are more prohibitive to most savers than the old one. The 1986 system sets a very low annual interest rate of one percent for time deposits by financial institutions and Government-owned institutions. However, this rate was not less than 6 percent per annum in the old system. In addition, the old system provides interest rates for fixed deposits kept in the Bank for a period of less than one year. Interest rates of 4 percent and 5 percent per annum for fixed deposits of three to six months, and six to twelve months were charged, respectively, in the old system. However, this opportunity is non-existent in the 1986

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It seems, therefore, that the new system is devised as a way out to the problem of over liquidity of the Commercial Bank, since credit outlets are very limited as will be examined in the next chapter. On the other hand, we know that both AIDB and HSB are constrained by the limited branch network* to properly channel the additional savings into productive investment. This should be compared with the relatively large branch distribution of the Commercial Bank.

In fact it is the lack of adequate branch distribution of the AIDB and the inactive involvement of the Commercial Bank in rural credit provision that led to the introduction of the rural credit policy of 1986 by the National Bank.

.... The Agricultural and Industrial Development Bank which has been shouldering the lion's share of this heavy responsibility [development credits] is finding it increasingly difficult to achieve an adequate coverage of the vast rural sector due to its limited branch network and financial resources...¹¹

Currently AIDB relies upon Commercial Bank branches for operational assistance where ever it has not established branch offices. It is, therefore, clear that the efficient allocation of the additional funds by AIDB without an accompanying expansion of branches which is undone now, would be difficult. There is thus an apparent operational flaw.

¹¹ National Bank of Ethiopia, Rural Credit Policy (NBE/CR/6), June 24, 1986 (as quoted in Birritu, No.30, 1986, P.15).

* In 1985/86 the total number of branches of the Commercial Bank and other specialized banks reached 174. The same year the CBE branches totalled 147. Therefore, other banks totalled only 27 (see, for example, NBE, Annual Report, 1987, P. 33.).

In addition, even if we assume that the efficient channeling of additional saving of HSB is possible, it is known that such financing by HSB will be directed to the construction sector particularly to the construction of dwelling houses as HSB is a specialized bank in this sphere of activity. Although the construction of private dwelling houses is crucial in Ethiopia now, it is less productive than investments, say, in agriculture, industry and the like.

Therefore, the current system is more discouraging to both saving mobilization and utilization than even the previous one. The interest rate regimes of both the old and the new are, on the other hand, in conformity with the branch expansion policy discussed above, supporting the assertion that the Bank follows the demand-following approach to branch distribution, and its accomodative nature for credits.

The deposit interest rates discussed above have been non-variable throughout most of the period under review. As we have noted in chapter two, the scarcity of financial savings is not only due to the low economic surplus of the country but also mainly as a result of the low rewards and occasional sacrificies associated with financial savings.

We note from the above explanations that demand deposits do not earn any interest. Besides, as indicated in Table 4.8, time and saving deposits earn no real return. In fact, in most cases such deposits earn negative return as a result of the absence of adjustments corresponding to the general price increase. The real return in the whole period, except 1980/81, 1982/83 and 1983/84 is negative.

Table 4.8: Comparison of General Price Index and
Interest Rate

End of Period December	Interest Nominal	General Price Index (A.A.) 1963 = 100	Annual Percentage Change in Price Index	Real Return
1975/76	6.0	170.1	-	-
1976/77	6.0	218.7	28.6	- 22.6
1977/78	6.0	254.9	16.6	- 10.6
1978/79	6.0	291.6	14.4	- 8.4
1979/80	6.0	338.4	16.1	- 10.1
1980/81	6.0	353.5	4.5	1.5
1981/82	6.0	375.2	6.1	- 0.1
1982/83	6.0	391.6	4.4	1.6
1983/84	6.0	394.6	0.8	5.7
1984/85	6.0	427.8	8.4	- 2.1
1985/86	6.0	509.4	19.1	- 13..
Average			11.9	- 5.4

Source: NBE, Quarterly Bulletin, Vol.1, No.1 and Vol.2, No.1, 1985/86 and 1986/87 P.66 and P.63 respectively (for general price index) The last columns are own calculations.

* Excludes Rent

NB. : 6 percent interest rate is taken here for the reason that it has been applied both on time and saving deposits for one full year during the period under reference.

A very recent empirical evidence of Asian countries confirms with the above finding.

Depositing money with financial institutions is only one of the ways in which savers in developing countries can invest their savings; the purchase of real assets such as real estate and precious metals, the hoarding of cash and investments in the informal financial sector are important alternative forms of saving. The composition of total savings and hence the level of savings deposits depend primarily on the relative yields and risks on the various forms of investment, so that the effective real deposit rates paid by financial institutions are crucially important for the mobilisation of financial savings. Multiple regression estimates for many developing countries confirm that there is a significant positive correlation between the level of real deposit rates and the volume of financial savings. Nevertheless, in the eighties the authorities in many developing countries continued to set such a low limit on the nominal interest rate for savings deposits that the banks were unable to compensate savers for the loss due to inflation. Moreover, interest rate ceilings are rarely adjusted to fluctuating inflation rates, with the result that real interest rates fluctuate with inflation....¹²

It is thus simple to think that if conscious saving units purchase an item this year with the view to selling it next year, they would get more profit than they could obtain by keeping the same amount of money in the Bank.

Therefore, we understand that saving units are not encouraged to save in the bank under such circumstances, and as a result time and saving deposits are hampered, and thus can have a negative effect on the provision of credit if there is a proper and efficient allocation. This is examined in the next paragraphs.

¹²Kiel Uwe Corseplus, "Savings Mobilisation in Developing Countries", Intereconomics, January/February 1988, P.30.

4.3. Savings Mobilization Performance of CBE

One of the main functions of any Commercial Bank is to attract deposits of various types through appropriate means and channel them into productive investments.

In this connection, this sub-section is intended to give some insight into the main objectives of the research, namely, the assessment of the level of financial development and saving mobilization performance of the Commercial bank.

Table 4.9 indicates the level and direction of deposits by type. Total deposits including deposits of Central Government increased in absolute terms from Birr 696.8 million in 1975/76 to Birr 3,695.5 million in 1987/88 growing at an average rate of 15.1 percent. The average growth rate of total deposits is somewhat the same even if deposits of Central Government are excluded from the picture. The annual growth rate of total deposits is marked by ups and downs starting from the highest rate of 30.8 in 1975/76 to the lowest rate of 7.5 in 1986/87. Non-Central Government deposits also exhibit similar pattern of growth.

Demand deposit increased in absolute terms from the low level of Birr 341.8 million in the base year to Birr 2,251.2 million in 1987/88. The annual growth rates have been relatively progressive, although these too are marked by an up and down trend marking an average annual rate of growth of 17.2 percent.

Table 4.9 Deposits by Type

End of Period	Total Deposits (1)=2-9	(million Birr)											
		Non Central Gov't Deposits with Commercial					Central Gov't. Deposits with					Growth Rate of	
		Total (2)=3 to 5	Demand Deposits (3)	Savings Deposits (4)	Time* Deposits (5)	Total 6=(4)+(5)	Total (7=8+9)	National Bank (8)	Commercial Bank (9)	(1)	(2)	(10) = (3)	(6)
1975/76	696.8	670.8	341.8	214.5	114.5	329.0	120.7	94.7	26.0	-	-	-	-
1976/77	911.8	879.4	407.8	317.4	154.2	471.6	143.7	111.3	32.4	30.8	31.1	19.3	43.3
1977/78	1020.5	988.4	493.4	333.4	161.6	495.0	163.1	131.0	32.1	11.9	12.4	21.0	5.0
1978/79	1152.2	1111.4	604.7	371.0	135.7	506.7	166.2	125.5	40.7	12.9	12.4	22.6	2.4
1979/80	1341.7	1281.2	671.0	427.9	182.3	610.2	203.9	143.9	60.0	16.4	15.3	11.0	20.4
1980/81	1457.7	1356.8	694.5	472.4	189.9	662.3	280.2	179.3	100.9	8.7	5.9	3.5	8.5
1981/82	1622.4	1521.4	769.9	528.1	223.4	751.5	210.0	109.0	101.0	11.3	12.1	10.9	13.5
1982/83	1900.0	1791.0	930.8	609.1	251.1	860.2	218.0	109.0	109.0	17.1	17.7	20.9	14.5
1983/84	2224.8	2112.5	1108.1	718.3	286.1	1004.4	264.9	152.6	112.3	17.1	17.9	19.1	16.8
1984/85	2777.8	2687.9	1531.3	814.0	342.9	1156.6	342.7	252.8	89.9	24.9	27.2	38.2	15.2
1985/86+	3155.9	3048.7	1784.7	939.2	324.8	1264.0	547.2	440.0	107.2	13.6	13.4	16.5	9.3
1986/87+	3392.1	3264.8	2029.3	1053.2	182.3	1235.5	462.6	358.6	127.3	7.5	7.1	13.7	2.3
1987/88+	3695.5	3571.0	2251.2	1208.0	111.8	1319.8	-	-	124.5	8.9	9.4	10.9	6.8
Average	-	-	-	-	-	-	-	-	-	15.1	15.2	17.2	12.8

Source:- NBE, Quarterly Bulletin Vol. 1, No.1, 1985/86, P.45 & 52 and Vol.2, No.1, 1986/87, P.49.

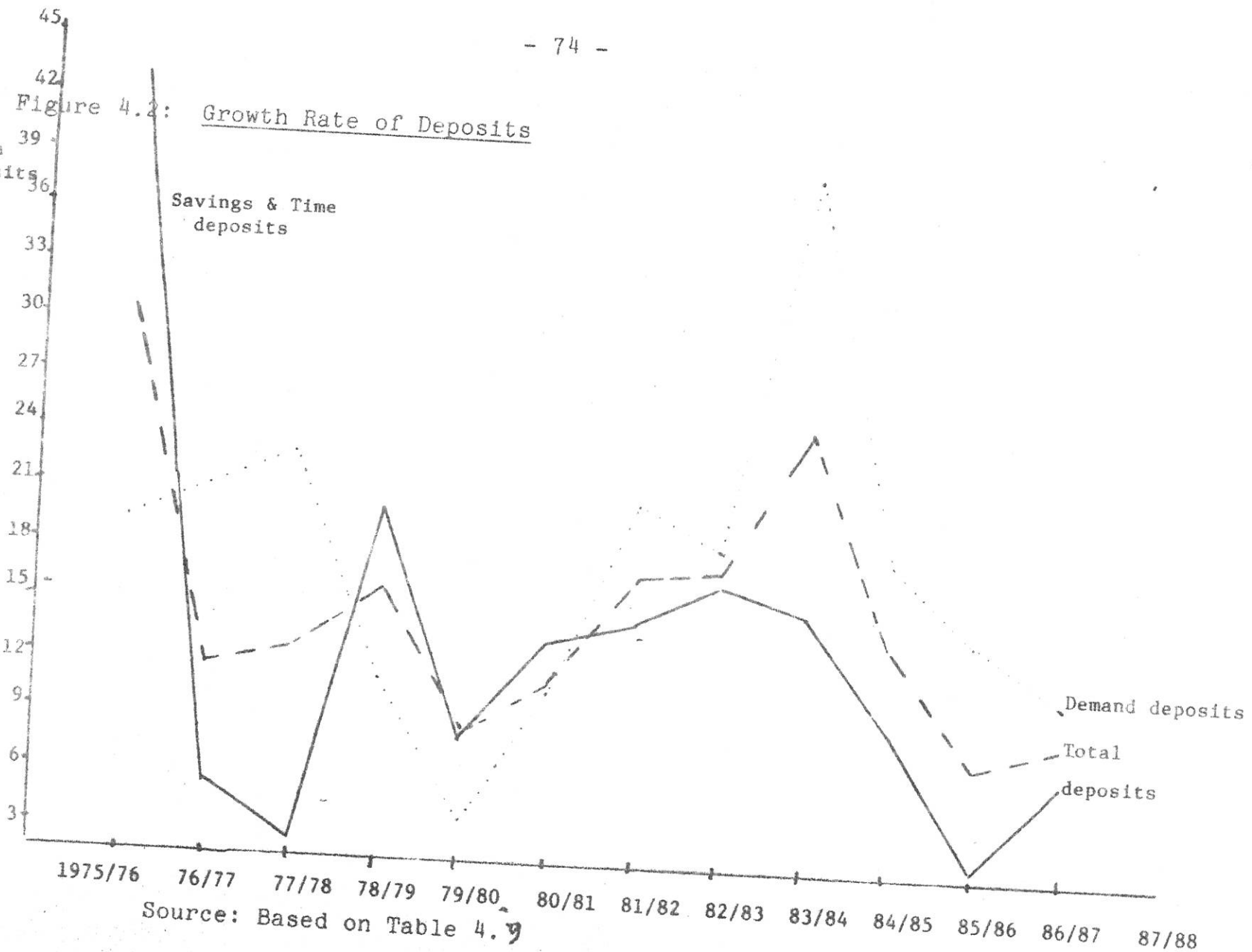
Note:- 1) * Time deposits of 90 days or over

2) + Data is taken from CBE, Statistical Review, PP. 2-3.

3) Growth rates are computed from the data.

The pattern of growth and volume of saving and time deposits can also be observed from the same Table. The annual rate of growth of saving and time deposits is generally speaking, lower than demand and total deposits. It starts with the highest rate of growth of 43.3 percent in 1975/76 and declines gradually to rates of growth of 5.0 percent and 2.4 percent in 1976/77 and 1977/78 respectively. In 1979/80 it registered a rate of growth of 20.4 percent and a declining rate of 8.5 percent in 1980/81. This was followed by increasing rates of growth until 1984/85 and in 1986/87 a negative rate of growth of 2.3 percent was registered. The average rate of growth of saving and time deposits is 12.8 which is less than that of demand and total deposits.

Figure 4.2 explains the situation well.



Further examination of the break down of deposits by ownership (Table 4.10) enables one to see that individuals and private organizations are relatively the major holders of Commercial Bank savings. They make an average share of 44.48 percent of total deposits. Despite the highest contributions of this saving group, however, there has not been a significant increase through time in the percentage share of total deposits.

Table 4.10 indicates also that public enterprises and agencies, and domestic banks and other financial agencies contribute a substantial share next to the share of individuals and private organizations. The share of these organizations too, unlike the former account holders has not shown a significant growth overtime. In fact, the last two years have witnessed a declining pattern for the reason of the revised interest policy.

Cooperatives make a lesser share of total deposits than the other savings groups, It is interesting to observe that their share has shown a consistent increasing trend over the period unlike the others, showing the new area the Bank must direct its saving mobilization activity. Still further analysis of total deposits disaggregated into demand, time and saving deposits separated by type of ownership reveals that individuals and private organizations, public enterprises and agencies, domestic banks and other financial agencies, contribute relatively substantial shares of total demand, time and saving deposits according to their order of listing. This is indicated in Appendices A.2 and A.1.

Table 4.10: Breakdown of Total Deposits by Ownership

Year	(million of Birr)														Total Deposit Ex. DJ	Total Deposits (including Djib.)
	Individuals & Private		Cooperatives		Public Enterp. Agency		Domestic Banks & Others		Central Gov't		Foreign Corresp.		Non-Residence			
	Amount	% Of Total	Amount	% Of Total	Amount	% Of Total	Amount	% Of Total	Amount	% Of Total	Amount	% Of Total	Amount	% Of Total		
1980/81	694.7	45.9	96.8	6.4	417.1	27.5	130.6	8.6	100.9	6.7	30.6	2.0	42.7	2.8	1514.8	1,514.8
1981/82	761.0	44.2	121.9	7.1	483.2	28.1	127.2	7.3	100.9	5.8	52.3	3.0	75.3	4.4	1722.0	1,729.0
1982/83	866.7	42.7	143.7	7.2	593.4	29.3	164.1	8.1	109.0	5.4	67.4	3.3	81.8	4.0	2027.5	2,037.6
1983/84	1019.3	43.9	165.5	7.1	733.7	31.6	170.4	7.3	112.3	4.8	35.4	1.5	86.0	3.7	2322.8	2,332.0
1984/85	1130.7	42.1	205.6	7.7	930.5	34.7	195.4	7.3	89.9	3.3	30.1	1.1	102.2	3.8	2684.2	2,693.1
1985/86	1333.5	43.7	238.8	7.8	1046.2	34.3	198.5	6.5	107.2	3.5	33.4	1.1	91.2	3.0	3048.7	3,060.3
1986/87	1562.2	47.7	269.1	8.2	903.9	27.7	292.6	9.0	127.3	3.9	23.7	0.7	86.1	2.6	3264.9	3,281.8
1987/88	1716.3	48.1	309.7	8.7	937.1	26.2	324.0	9.1	124.5	3.5	60.6	1.7	98.9	2.8	3571.0	3,586.7

Source: - 1980/81 : CBE, Statistical Review, Planning and Business Development

Division No. 6, June 1985, P. 4.

The relative stagnation of the contribution of individuals and private saving group is clearly observed if we take their share of contribution as a ratio of total deposits including Central Government. Taking total deposits from Table 4.9 and total deposits of individual and private organizations from Appendix A3, we get the following results.

Table 4.11: Share of Individuals and Private Depositors from Total Bank Saving

Year	Percentage share of individuals and private from total Bank saving
1980/81	30.4
1981/82	30.6
1982/83	30.4
1983/84	30.2
1984/85	27.3
1985/86	27.9
1986/87	30.6
1987/88	32.2
Average	30.2

We see that the individual and private saving group contributes on the average 30 percent of total Bank Saving.

This share is, however, less than that of some LDCs and developed countries.

It appears from the fragmentary data relating to financial savings in some LDCs that with the evolution of financial institutions, the non-corporate sector prefers to hold more than 50 percent of its financial saving in the form of saving and fixed deposits.... Thus the major part of financial saving seems to be in the form of claims on financial institutions.

The evolving structure of financial saving in LDCs does not seem to be different from the structure in the developed countries. In the USA, for example, the non-corporate sector holds about 50 percent of the financial saving in the form of deposits... In Japan... bank deposits form more than 80 percent of total financial saving of the non-corporate sector.¹³

As stated in chapter one, the level of development of the Bank is indicated by the banking ratio or the ratio of total bank liabilities (assets) to GNP. Changes in the value of total bank liabilities (assets) divided by GNP are taken as an indicator of the rate of growth of the Bank and this is shown in Table 4.12. The banking ratio which was 17.9 percent in the base year increased to 38.6 percent in 1985/86. The same ratio averaged 26.2 percent over the period 1975/76 - 1985/86. We may observe from the Table that the banking ratio exhibited increasing trend with the exception of 1978/79 which showed slight slide down when compared with that of the previous year. This growth is however, due to sharp increases in demand deposits, particularly in recent years.

Changes in total bank liabilities as percentage of GNP was 0.004 in 1975/76 and declined to 0.001 in 1985/86. This ratio is not only insignificant but also shows a generally declining tendency depicting the unparallel rate of growth of the Bank and the national economy

¹³V.V. Bhatt and Jacob Meerman, "Resource Mobilization in Developing Countries: Financial Institutions and Policies: World Development, Vol.6, No.1, January 1978, P. 53.

Other indicators of the operational effectiveness of the Bank give more detailed measures of the relative institutionalization of savings. Thus the ratios of bank deposit liabilities to total money supply indicate the level of savings channeled into the Bank. This is also indicated in Table 4.12. Demand deposits as ratios of money supply (M_1) show a relatively general increasing trend with some shocks marked in the period. This ratio which was 31.3 percent in the base year reached 56.1 percent in 1985/86.

The same ratio for time and saving deposits, on the other hand, shows a different picture. The character is that the ratio is not only low but also that it does not exhibit significant increase through time indicating that the Bank's effort in mobilizing saving and time deposits from individuals and private organizations has not been increasing as money supply increases.

In summing up this chapter, it may be said that unlike the branch expansion policy of the Commercial Bank, the growth of branches is not only showing a declining tendency especially in recent years but also that they are still concentrated in the capital city and other advanced towns of the country where demand for their services is believed to exist. This reveals the fact that the Bank's policy adheres in reality to the demand-following approach, which approach is said to play not a dominant role in credit expansion.

Table 4.12: The Level of Development of the CBE

End of Period	(Million Birr)									
	Demand Deposits (1)	Time and Savings Deposits (2)	(1+2) (3)	Total Liabilities (4)	Money Supply M_1 (5)	GNP (6)	Total liability as percentage of GNP (7)	Change in total Bank Liabilities as percentage of GNP (8)	Demand deposits as percentage of M_1 (9)	Time & Savings deposits as percentage of M_1 (10)
1975/76	341.8	329.0	670.8	1,064.7	1,092.8	5,964.0	17.9	-	31.3	30.9
1976/77	407.8	471.6	879.4	1,360.4	996.5	6,822.5	19.9	0.004	40.9	34.7
1977/78	493.4	495.0	988.4	1,543.4	1,187.2	7,220.0	21.4	0.002	41.6	33.8
1978/79	604.7	506.1	1,110.8	1,639.3	1,341.3	7,987.5	20.5	0.001	45.1	34.6
1979/80	671.0	610.2	1,281.2	1,961.8	1,443.0	8,498.9	23.1	0.002	46.5	31.1
1980/81	694.5	662.3	1,356.8	2,084.7	1,715.2	8,888.2	23.5	0.002	40.5	31.8
1981/82	769.9	751.5	1,521.4	2,413.3	1,892.2	9,162.6	26.3	0.002	40.7	31.1
1982/83	930.8	860.2	1,791.0	2,877.5	2,180.4	10,026.5	28.7	0.002	42.7	29.9
1983/84	1,108.1	1,004.4	2,112.5	3,225.1	2,379.3	9,960.6	22.4	0.001	46.6	31.1
1984/85	1,531.3	1,152.9	2,683.5	3,521.2	2,692.1	9,820.9	35.9	0.001	56.9	32.7
1985/86	1,784.7	1,264.0	3,048.7	4,064.4	3,179.6	10,479.7	38.6	0.001	56.1	31.2
1986/87	2,029.3	1,235.5	3,264.8	4,086.5	3,390.5	-	-	-	-	-
1987/88	2,251.2	1,319.8	3,571.0	-	-	-	-	-	-	-
Average	-	-	-	-	-	-	26.2	0.002	44.4	32.2

Source: National Bank of Ethiopia, Quarterly Bulletin, V.1, No.1, First Quarter 1985/86, P. 45. and Vol. 2, No.1, First Quarter 1986/87, P.42 & 45; CBE; Statistical Review, No.6, June 1988, P.1; and CSO, Statistical Abstract, 1980, P. 169.

M_1 = is defined as currency outside banks and net demand deposits.

The administratively determined deposit interest rates of the Bank show almost no real return to depositors since the rates remained unaltered through time and no corresponding adjustment to general price increases has been made. In addition, the recently introduced deposit rates give rather narrow interest opportunities and the interest rate policy is restrictive in nature. This situation does not only discourage savers but also pushes them to join the unorganized financial market which is dangerous to the growth of the Bank.

As assessment from different angles of the Bank's saving mobilization effort indicate that it is generally inadequate. The banking ratio, which shows the development of banks through time, exhibited only a sluggish increase. Changes in total bank liabilities as percentage of GNP, which show the rate of growth of the Bank, declined through time. The level of savings channeled into the Bank as measured by the ratio of Bank deposit liabilities to M_1 is not satisfactory, particularly the time and saving deposit aspect of the ratio remained almost stagnant. The percentage share of deposit of individuals and private organizations from total bank savings has not increased as indicated in Table 4.11. While it is said that private organizations and individuals are relatively the major contributors of time and saving deposits, the above situation means, therefore, that the Bank's effort in saving mobilizations is inadequate.

CHAPTER V

5. THE ALLOCATION OF CREDITS BY THE CBE

It is said that saving mobilization is not an end in itself. Its ultimate goal is the efficient allocation to the most productive sectors. Thus the most important of all the functions of the CBE is the efficient and selective allocation of credits. In order to carry out this function it is important that the Bank must have clear policies and strategies that enable to solve economic problems of the country in their crucial order.

In addition, the Bank must adopt lending rates that should attract borrowers to undertake productive investments in the different sectors of the economy. Both credit and interest rate policies and the Bank's effort in the proper allocation of credits are examined below:

5.1 Credit and Interest Rate Policy

5.1.1 Credit Policy

The credit policy issued by the NBE in 1976 outlines that the CBE and other Banks must ensure the provision of credits to the various investors.

... banks should endeavour to ensure that no physical production is curtailed, or hampered, or slowed down due to lack of funds. It is, therefore, the responsibility of financial institutions to provide all the credit required by the various sectors of the economy as long as the money lent out is matched by the value of goods and services produced or to be produced.¹

¹NBE, Credit Policy for Banks, 1976, PP. 1-2.

The policy states that credit should be extended on the basis of the principle of centrally planned economy and priorities are made to strengthen the socialized sector. In this connection it is further explained that the policy is geared effectively to provide the quantity of money required for the realization of planned targets determined by the central planning authorities.

In the transition period from a mixed economy to a socialist economic order, financial institutions will use their credit facility as a factor of strengthening and expanding the socialized sector and of encouraging the socialization of others in as far as the ultimate objective of a socialist economic system is the collective ownership of the means of production.²

Therefore, taking the above criterion into consideration, the Commercial Bank and other banks are expected by the policy to provide preferential treatment to the socialized sector, i.e. to the state enterprises and cooperatives.

As regards the private sector, the policy notes that "it [the private sector] will be accorded the required loans based on state priorities and in accordance with the potential economic and social contribution it may make".³

According to the development criterion, which takes into consideration the inter-relationship of the various sectors of the economy in terms of the capacity of one sector or sectors to enhance the development of others, credits are extended according to the following priorities with differentiated interest rates.⁴

²Ibid., PP. 3-4.

³Ibid., P.4.

⁴Ibid., PP. 5-11.

- a) Agriculture,
- b) Industry - with preferences to agro - based industries units whose outputs are directed to the enhancement of agricultural production, mass consumption, export market and import substitution, and also to small scale industries preferably cooperatives, industries producing large scale capital goods, labour intensive industries with high value added of final goods,
- c) The mining sector is given similar treatment as industry;
- d) Trade - the policy states that priority of fund allocation is to be made to the socialized sector. However, credit to the private sector is given in accordance with national priorities. According to the policy the Bank takes the following general priorities: domestic trade in essential goods, exports in general and imports of socially necessary goods,
- e) Services - with priorities in catering, transport, repair maintenance,
- f) Building and construction - large scale infra-structural constructions of long gestation period,
- g) Personal loans.

On the functional alignment of banks and the linkage of the economy the policy points out that "not only do banks monitor the integrated interaction between the two core sectors of agriculture... and industry but also help in establishing the graduated and balanced linkages among the small scale, the light, and heavy industries..."⁵

It is the guiding principle of the policy that the relationship among banks should be governed by the principle of functional specializations through internal arrangements on expediting the allocation and collection of credits, on assessing the social and economic value of the credit requested. The National Bank may require the Commercial Bank to channel a certain proportion of its funds to AID-Bank whenever it is required.⁶

In 1986 the National Bank issued a rural credit policy that enabled the Commercial Bank to join the AIDB in meeting the demand for rural credits, particularly for short term working capital credit requirements of the rural economy, such as credits to services or producer cooperatives, and short term and/or medium term credits to cottage handicrafts and small scale industry operators including cooperatives' production or manufacturing. Credits extended in this manner are used to finance the purchase of inputs, to cover operating expenses, for the processing and marketing of cash crops, for

⁵Ibid., P. 12

⁶Ibid., PP. 13-18.

dairy production, for the manufacture of building construction, hand tools and farm implements, kitchenware and utensiles, for the making and processing of hides and skins, clothes, carpets, for dairy production, rearing of draught animals, etc.⁷

The CBE was expected by the policy to device appropriate lending mechanisms and the National Bank to monitor closely the efficiency and efficacy of the policy and its implementation, and the CBE and AIDB to cooperate in the recovery of credits, exchange of credit facilities, etc.

Again in 1988 the National Bank issued a revised credit policy by repealing that of the 1986.

The revised rural credit policy (RRCP), has the following objectives,⁸

1. To expand credit operations in the rural sector by the provision of:
 - Short term credit for agricultural production and marketing and for other rural activities; investment credits for the agricultural and non-agricultural activities in the rural sector;
2. To identify and develop viable economic ventures in the rural sector,
3. To popularize the benefits of institutional borrowing.

⁷ National Bank of Ethiopia, Rural Credit Policy (NBE/CR/6), June 24, 1986 (as quoted in Birritu, No.30, 1986, PP.15-17.

⁸ National Bank of Ethiopia, Revised Rural Credit Policy NBE/CR/7/88, 1988, P.2.

NOTE:- "Agricultural Activity" includes, according to the policy activities such as livestock development, sheep and goat raising, poultry, fisheries, horticulture and plantation.

To sum up this section, the following points are remarked. In spite of the overemphasis of the 1976 policy on the provision of credits to the state enterprises and cooperatives, it left the banks to extend credits according to their "functional specializations" through internal managements, instead of giving clear operational guidelines. Thus extension of credits to the rural area has entirely been the line of activity of the AIDB. This situation has also led the Commercial Bank to confine itself with its traditional operation of providing credits to the urban area. This situation continued until 1986 when the Commercial Bank was made to extend short-term rural credits, mainly for working capital.

Here again there has been an operational flaw in that the Commercial Bank has been made to extend only short term credits. However, it is clear that short-term credits alone cannot bring about rural transformation. Thus a revised rural credit policy to be carried out by the bank was introduced in 1988. The new policy enables the Commercial Bank to extend short and medium term rural credits. We note that the Bank is not still allowed to avail long term investment credits despite the fact that it has excess liquidity reserve and larger distribution of branches than other financial institutions.

5.1.2. Lending Rate Policy

Anlike the deposit interest rates, the credit interest rates established in 1976 were fixed between a minimum of 7.5 percent and a maximum of 10 percent per annum.

Generally speaking, this system favoured the export sector by providing a lower annual interest rate than the other sectors. This is indicated in Table 5.1.

Large Scale agricultural producing and/or industrial manufacturing enterprises were charged lending rate between 8-9 percent per annum. All loans for imports or for import credits were charged a rate of 9.5 percent per annum exclusively.

Lending rates on business, personal or real estate loans other than those mentioned above varied between 8.5 -10 percent per annum.

This lending rate system had been operational until 1986, when another system was introduced.

In the new system the cooperatives are given preferential treatment and are made to enjoy a low interest rate between 4.5-6.0 percent per annum. This is indicated in Table 5.2.

A relatively higher lending rate than cooperatives is deviced for Government owned undertakings. The CBE charges a minimum rate of 3.5 percent on Central Government short term loans and a maximum of 8.0 percent per annum on credits for industry, mining, power, water resources, domestic trade, hotels and tourism, construction, and an annual interest rate of 6 percent is charged on all other imports than fertilizer, seeds, and pesticides.

We also see that credits to individuals and private organizations are generally charged the highest rates, i.e. between 6-10 percent per annum.

We can observe that there is no basic difference between the two systems, save the introduction of low interest rates for cooperatives and some Government owned undertakings.

Table 5.1: Lending Rates (1976)

Description	Interest rate per annum
1. <u>EXPORT</u>	
(a) Merchandise Export Product First 3 months	7½% per annum
(b) Merchandise Export Products After 3 months	8½% per annum
(c) Advance on or Discount of Foreign Export Bills	8% per annum
(d) Overdraft or Discount of Promissary Notes supported by stock lists	8½% per annum
2. Large Scale Agricultural Producing and/or Industrial Manufacturing <u>Enterprises(*)</u>	
(a) Advanced against Promissory Notes subject to confirmation by head Accounts Department that the Notes are eligible for rediscounting	8% per annum

Description	Interest rate per annum
(b) Overdraft, Business Loans and/or advance against Promissory Notes Not eligible for re-discounting	9% per annum
(c) Advance against pledge of Merchandise to such enterprise, subject to prior confirmation by head office Accounts Department that the customers' promissory Notes drawn under the instrument of pledge are eligible for rediscounting	
First 3 months	8½% per annum
After 3 months	9% per annum
(d) All Loans for imports or for import credits.	9½% per annum
3. <u>Business Loans, Personal or Real Estate Loans</u>	
(a) Advance for purchase of shares	8½% per annum
(b) Overdraft, Advance against Promissory Notes, Trade Bills Discounted, Business Loans	9½% per annum
(c) Personal Loans	10% per annum
(d) Advance against pledge of agri- cultural products other than → exportable commodities	9½% per annum

-
- (e) Advance against deposit (110%) 8% per annum
- (f) Overdraft or business loans secured partly against deposits and partly against other types of security (where the deposit is less than 110% of the advance) 9½% per annum
- (g) Personal loans secured partly against deposit and partly against other types of security, (where the deposit is less than 110% of the advance) 10% per annum
- (h) For construction of a house reparation completion, modification, and extention 9% per annum
- (i) For purchase of a house 10% per annum.
-

Source:- CBE, Terms and Tariff (R/1r/4/76 and R/22/2/77, PP. 27-28.

* Enterprises with a paid in capital of Birr 200,000.00 or more that is substantiated by the organizations registration with the concerned ministry and presentation of other documentary evidence such as audited balance sheet.

Table 5.2: Interest Rates of Long and Short-Term Loans and Advances (1986)
(percent per annum)

	Cooperat.	Gov't. owned <u>Undertakings</u>	Individuals and Private <u>Organizations</u>	Financial Insti- <u>tutions</u>
Agriculture	5.0	6.0	7	-
Industry, Mining & Water Resources	6.0	8.0	9	-
Domestic Trade	6.0	8.0	9.5	-
Transport & Communication	6.0	8.0	8.0	-
Export Trade	6.0	6.0	6.0	-
Import Trade				
- Fertilizers, Seed & Pesticides	5.0	6.0	7.0	-
- All other imports	6.0	8.0	9.5	-
Hotels and Tourism	6.0	8.0	9.0	-
Construction	6.0	8.0	9.0	-
Housing:				
- Construction	4.5	4.5	7.0	-
- Purchases	6.0	6.0	8.0	-
Central Government				
- Short term	-	33.5	-	-
- Long term	-	5.0	-	-
National Bank of Ethiopia	-	-	-	2.5-4.0
Personal	-	-	-	-
Others	-	-	10.0	-
Penalty	2.0	To be determined by the Bank 2.0-5.0	2.0-5.0	-

Source: National Bank of Ethiopia, Credit Regulation
NBE/CR/1 Interest Rates on Deposits and Loans and Advances (as
quoted in Birritu, No. 30, 1986, P.13).

5.2 Credit Instruments and Securities

The 1976 credit policy sets a limit on the credit the Bank extends to state enterprises and cooperatives, single private company or individuals, and personal loans do not exceed 10 percent, 5 percent and 1 percent respectively of their capital and reserve¹¹. Lendings in excess of this limit must be referred to and authorized by the National Bank.

The credit instruments to be used are overdrafts, term loans, trade bills discount, letters of credit, advance on bills, letters of guarantee, etc.

The Terms and Tariff of the Bank defines an overdraft as follows:

An overdraft facility is a simple form of finance in which a customer may be allowed to draw beyond the deposits made in his existing current account through the medium of approval by the Bank's appropriate loans committees to be utilized for the sole purpose of the customer's day-to-day financial needs and business operations.¹²

The same operational manual outlines that an over draft is assumed to solve short-term financial problems, and is normally extended for six months duration. The granting of such finance is backed by a viable project. According to the policy, overdraft must be discouraged as it creates obstacle to the rationale and flexible allocation of funds by the Bank.¹³

¹¹ National Bank of Eth., Credit Policy, P.20.

¹² CBE, Terms and Tariff (Various years), P.20.

¹³ National Bank of Eth., Credit Policy, P.20.

The economic sectors for which overdraft facility is accorded are industries, exports and imports.

The industrial sector may require an overdraft facility to supplement its own working capital and for the purchase of raw materials, and spare parts. Construction firms are given similar treatment and are provided with overdraft facility for projects at hand, and for such expenses as overhead supply of construction materials and those engaged in road construction. Exporters and importers are also provided with overdraft facilities.¹⁴

A term loan is another type of Bank-finance repayable by periodic instalments. The Bank is allowed to provide short term loan of one year, normally provided for working capital and medium term loan which is an extended form of short term loan, and repayable within a maximum period of five years. Medium term loan is provided for the purchase of capital goods, trucks and public transport vehicles. Another form of term loan is personal loan, on which the highest interest rate is charged.¹⁵

The 1976 credit policy gradually abolished the trade bills discount since this facility amounts to granting a clean overdraft facility.

The other credit instrument is a letter of credit. As the name implies, a letter of credit is "a written instrument issued by the buyer's bank authorizing the seller to

¹⁴ CBE, Terms & Tariff, PP. 25-26.

¹⁵ Ibid., PP. 27-29.

Credits to the private sector must be backed by securities of residential or commercial building, trucks, tankers, trailers, buses and other vehicles, bank guarantees, blocking of deposit accounts, treasury bills and government bonds, insurance bonds, life insurance policies at surrender value, merchandise, plant, machinery and equipment, letter of guarantee from a state enterprise, cooperative or association and personal guarantee.

The securities required by the Bank from private organization and individual borrowers are very high that they limit or avoid bank borrowing. Consequently, at the time of applying the 1976 credit policy some loans were cancelled as stated below.¹⁹

CBE loans amounting to Birr 11.3 million in Addis Ababa Region, Birr 1.5 million in the Northern Region and Birr 75,000 in the Eastern Region were cancelled due to lack of acceptable security in 1976 alone. On the other hand, 67 loans amounting to Birr 6.1 million in Addis Ababa Region, 8 loans amounting to Birr 525,000.- in the Northern Region and 5 loans amounting to Birr 220,000.- in the Eastern Region were closed due to partial conversion of their overdraft facility to business loans. And finally 8 loans amounting

¹⁹Commercial Bank of Ethiopia, Report on the Findings of CBE's Liquidity Appraisal Committee, A.A., Feb., 1977, P.51.

to Birr 290,000.- in Addis Ababa Region and one loan amounting to Birr 18,000.- were closed due to full conversion of their overdraft facility to business loan in course of 1976.

Thus, for the three regions combined loans amounting to Birr 20 million were closed either due to lack of adequate security or to partial or full conversion of their overdraft facilities to business loan in the course of 1976.

It is further stated that the security requirements that are being demanded by the Bank for credits are more than customers can conveniently bear. The 2:1 security/loan ratio has not only out-lived its utility but has also become an effective brake for an aggressive credit expansion programme.²⁰ This is further explained below.

²⁰ Ibid., P. 73.

Table 5.3: Loan-Security Ratio

<u>Security</u>	<u>Working Capital</u>	<u>Loan</u>	<u>Security Loan Ratio</u>	<u>Working Capital Loan Ratio</u>
29,800	50,000	10,000	3.0	5.0
12,880	93,000	6,000	2.1	15.3
14,900	18,000	5,000	3.0	3.3
18,850	10,000	4,000	4.7	2.5
131,785	194,000	30,000	4.3	6.6
6,400	10,500	2,000	3.2	5.2
26,800	17,500	5,000	5.4	3.5
14,600	55,000	5,000	2.9	11.0
22,600	41,000	10,000	2.3	4.1
26,800	18,000	6,000	4.4	3.1
24,300	112,987	12,000	2.1	9.5
22,600	25,000	8,000	2.8	3.1
25,624	30,000	10,000	2.6	3.0
14,304	9,000	4,000	3.5	2.2
17,200	17,000	5,000	3.3	3.3
19,200	15,700	6,000	3.1	2.6
11,900	6,200	5,000	2.4	1.2
5,200	5,000	2,500	2.0	2.1

Source: CBE, Report on the Findings of CBE's Liquidity Appraisal Committee, A.A., Feb., 1977, P. 73

The Bank requires a minimum of credit security on letter of credit of 25 percent for a minimum capital and reserve of between Birr 400,000.- Birr 50,000.- from 25 percent to 30 percent for Birr 150,000.- Birr 400,000.- and 25 percent to 40 percent for Birr 40,000.-. This reveals that business units with higher capital are required less security than those with lesser capital.²¹

... The existing margin requirement on letter of credits favours large business undertakings to those engaged in small trading activities. The Bank's policy not only discourages small traders who most need its assistance but also negates the existing economic policy of the country.²²

5.3 Allocation of Credits

Table 5.4 indicates that the total allocation of credits has been increasing in absolute terms from 1975/76 - 1981/82. The next three years, i.e., 1982/83 - 1984/85 showed a declining trend in the total provision of credits. The period 1985/86 - 1987/88 has again witnessed increasing trend reversing the previous situation.

The sectoral distribution of credits is also indicated in the same Table. Moreover, table 5.5 depicts the percentage share of credits among the different sectors of the economy. It is observed that the agricultural sector, which is the backbone of the Ethiopian economy received only 11.2 percent in 1975/76, which is however, the highest of its shares in the period and exhibited a declining trend in 1976/77 and 1978/79. The years that followed showed a more or less

²¹Ibid., P.76.

²²Ibid., P.77.

Table 5.4: Sectoral Allocation of Commercial Bank Credits

Period	(in '000 Birr)											
	Agriculture	Industry	Domestic Trade	Export	Import	Hotels and Tourism	Transport	Building and Construction	Other Service	Personal	H.S.B.	Total
1975/76	53,600.-	76,900.-	100,800.-	93,200.-	89,400.-	-	-	71,100.-	64,900.-	5,800.-	-	565,700.-
1976/77	57,200.-	84,900.-	87,600.-	113,300.-	91,900.-	-	-	68,900.-	86,400.-	4,300.-	-	594,500.-
1977/78	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	625,200.-
1978/79	21,500.-	133,900.-	144,300.-	92,500.-	155,400.-	-	-	70,000.-	-	7,900.-	-	625,500.-
1979/80	37,800.-	127,000.-	244,800.-	113,200.-	136,800.-	-	-	62,600.-	79,600.-	-	-	811,000.-
1980/81	46,856.-	128,981.-	146,348.-	91,239.-	376,957.-	6,098.-	67,227.-	95,679.-	-	9,200.-	-	995,623.-
1981/82	44,081.-	147,220.-	158,722.-	122,805.-	352,014.-	5,592.-	69,204.-	114,439.-	7,149.-	12,150.-	44,088.-	1,056,304.-
1982/83	44,868.-	122,375.-	181,324.-	172,094.-	218,136.-	5,481.-	81,791.-	150,324.-	6,662.-	9,678.-	22,083.-	994,816.-
1983/84	41,012.-	113,657.-	155,353.-	160,588.-	212,892.-	9,994.-	79,331.-	151,182.-	9,084.-	9,131.-	21,200.-	963,424.-
1984/85	45,352.-	108,656.-	75,029.-	170,175.-	219,393.-	8,443.-	83,092.-	152,343.-	13,574.-	10,930.-	20,317.-	907,304.-
1985/86	45,214.-	102,676.-	134,650.-	210,470.-	131,325.-	11,593.-	75,175.-	163,635.-	16,708.-	10,139.-	19,433.-	921,016.-
1986/87	68,550.-	126,119.-	180,105.-	148,912.-	249,787.-	13,217.-	75,957.-	157,517.-	17,628.-	10,623.-	18,550.-	1,066,965.-
1987/88	71,565.-	164,017.-	247,382.-	156,694.-	329,264.-	11,008.-	117,860.-	173,787.-	14,544.-	11,026.-	17,667.-	1,319,850.-

Source:- 1) From 1976 - 1979/80; C S O, Statistical Abstract (Various issues)

2) CBE Statistical Review, P.6

Table 5.5: Percentage Distribution of Credits Among Sectors

Period	Agriculture	Industry	Domestic Trade	Export	Import	Hotels and Tourism	Transport	Building and Construction	Other Services	Personal	Financial Institutions
1975/76	11.2	13.6	17.8	16.5	15.8	-	-	12.6	11.5	1.0	-
1976/77	9.6	14.3	14.7	19.1	15.5	-	-	11.6	14.5	0.7	-
1977/78	-	-	-	-	-	-	-	-	-	-	-
1978/79	3.4	21.4	23.1	14.8	24.8	-	-	11.2	-	-	-
1979/80	4.7	15.7	30.2	13.9	16.9	-	-	9.8	-	1.3	-
1980/81	4.7	12.9	14.7	9.2	37.9	0.6	7.7	9.6	-	1.1	-
1981/82	4.2	13.9	15.0	11.6	33.3	0.5	6.8	9.6	-	1.2	2.4
1982/83	4.3	12.3	18.2	17.3	21.9	0.6	6.6	10.8	0.7	1.2	2.3
1983/84	4.3	11.8	16.1	16.7	22.1	1.0	8.2	13.1	0.7	1.0	2.2
1984/85	5.0	12.0	8.3	18.8	24.2	0.9	8.2	15.7	0.9	1.0	2.2
1985/86	4.9	11.1	14.6	22.8	14.3	1.3	9.2	16.8	1.5	1.2	2.2
1986/87	6.4	11.8	16.9	14.0	23.4	1.2	8.2	17.8	1.8	1.1	2.1
1987/88	5.4	12.4	18.7	11.9	24.9	0.8	7.1	14.8	1.7	1.0	1.7
Average	5.7	13.5	17.3	15.5	22.9	0.9	8.0	13.5	1.1	0.8	1.3
							7.9	13.1	3.8	1.0	2.0

Source: Computed from Table 5.3

Similar shares. The average share of the agricultural sector remained at 5.7 percent in the period under review. Although the Bank's credit allocation to the industrial sector is higher than the share of agriculture, it has likewise remained stagnant. The share of the sector averaged 13.5 percent.

The trade sector of the economy-domestic trade, export and import - has been benefiting from relatively substantial credits of the Bank. In 1975/76 the trade sector shared 50.1 percent, i.e., 17.8, 16.5 and 15.8 percentage points for domestic trade, export and import respectively, of total credits. We can see that the trade sector has been taking the highest shares of credits through out the period. It is observed from the Table that the share of the trade sector has been more than the shares of other sectors taken together. On the average the trade sector has received 55.7 percentage points. It is interesting to note that the share of the rest of all sectors taken together averaged 47.9 percentage points.*

A look into the distribution of credits by ownership classification reveals that public enterprises and agencies have been relatively the major users of the Bank's credit. Table 5.6 indicates that private and individuals take the

* The numbers do not add up to 100 percent due to rounding of figures

second place while the cooperatives take the last and least place in obtaining credits. The increased credit in 1986/87 and 1987/88 is due to the effect of the revised rural credit policy.

We see that the distribution of credits to public enterprises increased from Birr 415.7 million in 1979/80 to Birr 625.7 million and Birr 664.1 million in the next two years consecutively. From 1982/83-1984/85, however, the credit provision did not increase when compared with that of 1981/82. The annual average credit intake of the public enterprises stood at 10.8 percent.

The credit allocation to public enterprises, as well as private and individuals is, generally, not encouraging. This is believed to be due to a combination of factors such as "....the improvement in ~~the~~ liquidity situation of public enterprises as a consequence of the Government's transfers, a general decline in business activity, and the Government's tight import policy"²³

A further explanation is given by a study made in 1977 which states that:

²³ IMF, Recent Economic Development in Ethiopia, Washington, D.C., IMF, 1986, P. 32.

Table 5.6: Distribution of CBE Credits by Users

(in million Birr)

Period	Public Enterprises Agencies		Private and Individuals		Cooperatives		Total	
	Amount	Annual Rate of Growth	Amount	Annual Rate of Growth	Amount	Annual Rate of Growth	Amount	Annual Rate of Growth
1979/80	415.7	-	308.8	-	5.7	-	730.2	-
1980/81	625.7	50.5	366.4	18.6	3.5	38.6	995.6	36.3
1981/82	664.1	6.1	388.9	6.1	3.4	2.9	1056.3	6.1
1982/83	598.1	9.9	398.2	2.4	4.4	29.4	994.8	5.8
1983/84	589.7	1.4	370.4	7.0	3.4	22.7	963.4	3.2
1984/85	543.8	7.8	361.3	2.5	2.2	35.3	907.3	5.8
1985/86	565.8	4.0	352.4	2.5	2.8	27.3	921.0	1.5
1986/87	655.5	15.9	381.6	8.3	29.8	964.3	1067.0	15.9
1987/88	846.6	29.2	452.5	18.6	20.7	30.5	1319.9	23.7
Average		10.8		5.3		113.7		8.4

Source: C.B.E., Statistical Review, P.5

* Data is from C.B.E., Annual Report, 1979.

... a large number of the state owned undertakings resort to the banking system on a modest scale and some have even ceased to avail of their credit facilities. This is mainly accounted by increased gains from production, the large demand for their products and stagnant capacity expansion programs. The non-utilization of credit facilities has been particularly pronounced in the textile, beverage, food, footwears, and leather branches of the manufacturing industry.²⁴

These views are also supported by the Commercial Bank, and it is said that some declines of credit amounts is due to collection of outstanding loans and lack of additional requests. For instance, it is mentioned in the 1982/83 annual report that outstanding loans and advances of the Bank as at June 30, 1983 decreased by 5 percent due to "... the increased settlement of loans in arrears and the low demand for fresh credit during the year".²⁵ It is further reported that while import trade utilized Birr 218.1 million of the outstanding loans in the same year, the volume of credit intake by this sector was less than that of the previous year by Birr 133.9 million (or 38 percent). The explanation is that "...significant loan repayments (were made by importers which further contributed to a general decrease in the overall loan balances."²⁶

²⁴ CBE, Report on the Findings of CBE's Liquidity Appraisal Committee, P. 99.

²⁵ CBE, Annual Report, 1982/83, P. 15

²⁶ Ibid., P.20

Table 5.7: Loan Collection and Arrears

Period Ending June	Overdue A	ALD B	LIR C	Irregular Loans D=A+B+C	Current E	Total F=D+E	E/F%	1 Million Birr	
								Annual Rate of Growth of D	C as % D
1981	241.9	61.0	78.4	381.3	614.3	995.6	61.7	-	20.6
1982	224.7	63.3	84.9	372.9	683.5	1056.4	64.7	- 2.2	22.8
1983	95.6	131.2	82.2	309.0	685.8	994.8	68.9	- 17.1	26.6
1984	68.3	136.8	85.9	291.0	672.4	963.4	65.7	- 5.8	29.5
1985	88.7	136.9	85.6	311.3	596.0	907.2	65.7	7.0	27.5
1986	68.6	133.3	82.7	284.6	636.4	921.0	69.1	- 8.6	29.1
1987	108.7	135.6	83.5	327.8	739.1	1066.9	69.3	15.2	25.5
1988	74.7	137.8	79.4	291.9	1028.0	1319.9	77.9	- 11.0	27.2
							Average	- 3.2	

Source: CBE, Statistical Review, 1988 (June), P.10

- Note:- 1 - Overdue loans-loans not settled in full on or before expiry date
 2 - ALD - Outstanding Loans and Advances
 3 - LIR - Loans in realization, which are long outstanding loans in connection
 nationalization of different economic units.

The decrease in the loan balance of the 1983/84 over the previous year is also said to be "... the underutilization of overdraft facilities by major borrowers due to their healthy liquidity position and the low-demand for fresh credit because of general business decline."²⁷

In this connection it is helpful to see the effort of the Bank in collecting outstanding loans and arrears.

Table 5.7 indicates that about 3.8 percent of the loans and advances in 1981 are overdue, i.e., borrowers did not respect the agreed time limits to pay back the amounts they borrowed. The figure amounted to Birr 381.3 million in absolute terms. The overall outstanding figure has been reduced a little bit through time by an average growth rate of 3.2 percent per annum.

The available data indicate that claims of the CBE on nationalized industries is 26.1 percent of total outstanding loans.

5.4 Saving Mobilization and Utilization

Although the trade sector of the economy has been benefiting from Bank credits, the overall credit allocation by the Bank is low when compared with the growth of total deposits, liquidity reserve ratio and loan deposit ratio.

²⁷ CBE, Annual Report 1983/84, P. 15.

Table 5.8: Comparison of Deposits and Credits

Period	D E P O S I T S			Total Credits (4)	(in Million Birr)			
	Demand (1)	Saving and Time (2)	Total (3)		Growth Rates of			
					(1) (5)	(2) (6)	(3) (7)	(4) (8)
1975/76	341.8	329.0	670.8	565.7	-	-	-	-
1976/77	40.78	471.6	879.4	594.5	19.3	43.3	31.1	5.1
1977/78	493.4	495.0	988.4	625.2	21.0	5.0	12.4	5.2
1978/79	604.7	506.7	1111.4	625.5	22.6	2.4	12.4	0.1
1979/80	671.0	610.2	1281.2	811.0	11.0	20.4	15.3	29.1
1981/81	694.5	662.3	1356.8	995.6	3.5	8.5	5.9	22.8
1981/82	769.9	751.5	1521.4	1056.3	10.9	13.5	12.1	6.1
1982/83	930.8	860.2	1791.0	994.8	20.9	14.5	17.7	-5.8
1983/84	1108.1	1004.4	2112.5	963.4	19.1	16.8	17.9	-3.2
1984/85	1531.3	1156.6	2687.9	907.3	38.2	15.2	27.2	-5.8
1985/86	1784.7	1264.0	3048.7	921.0	16.5	9.7	13.4	1.5
1986/87	2029.3	1235.5	3264.8	1067.0	13.7	-15.7	7.1	15.8
1987/88	2251.2	1319.8	3571.0	1319.9	10.9	13.0	9.4	23.7
Average	-	-	-	-	17.3	12.2	15.2	7.9

Source: Obtained from Tables 4.9 and 5.4

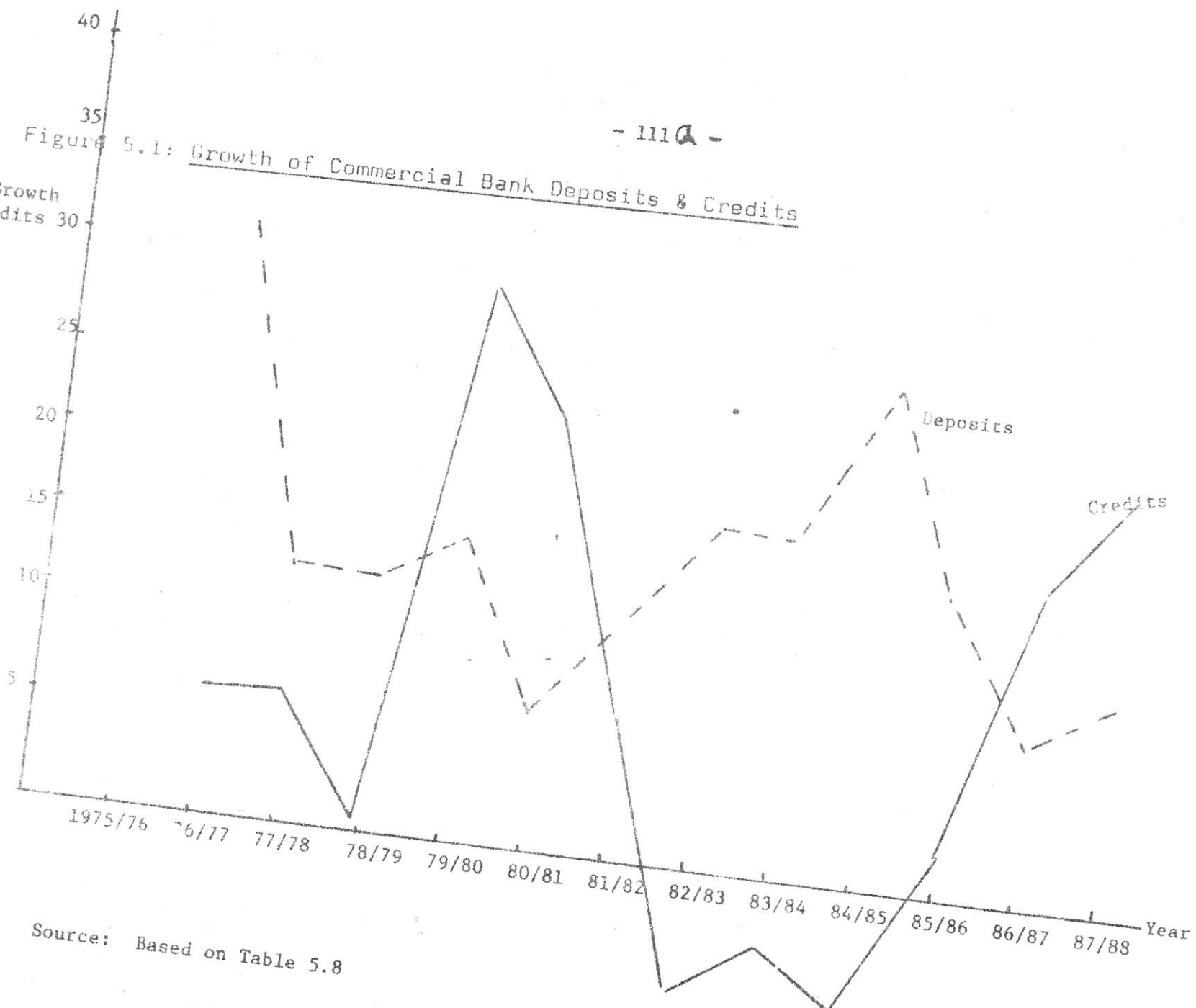
Table 5.8 indicates that the absolute figure of total deposits has generally been increasing over the period under review. However, as explained in chapter four, the rate at which total deposits has increased is not totally even. We note that from 1976/77 - 1980/81 a general declining trend is shown except 1979/80. From 1981/82 until 1984/85 the situation was not only reversed but also the rate of growth was relatively substantial. The period 1985/86 - 1986/87 showed a declining rate of growth again, with a relative increasing rate in 1987/88. The saving and time deposit indicates a general stagnation in the growth rates.

The situation is ever worse if we look at the credit side of the same Table. From 1976/77 - 1979/80 credit provision was growing at an increasing rate except 1978/79. The next years 1980/81 - 1984/85 exhibited a remarkable decline in the rate of growth. The period 1985/86 - 1987/88 was then followed by an increasing trend.

Examination of the liquidity reserve of the Commercial Bank gives us a clear picture that the Bank has not been allocating its mobilized savings efficiently and also that there is a substantial amount of unused excess reserve. Liquidity reserve is a certain percentage of total deposit liabilities commercial banks must hold in the form of liquid assets. The reserve requirements are usually expressed in terms of cash and other (less liquid) reserves.

Figure 5.1: Growth of Commercial Bank Deposits & Credits

Rate of Growth
in % credits



Source: Based on Table 5.8

Table 5.9: Reserve and Liquidity Position of CBE

End of Period	(million Birr)											
	Reserve Requirements (1)	Actual Reserve (2)	Excess Reserve (3=2.1)	Net Demand Deposit (4)	Foreign Asset (5)	Net Foreign Asset (6)	Loans & Advance Incl. Central Gov't. (7)	Loans & Advance Excl. Cent (8)	Liquidity Ratio (9)	Total* Deposit (10)	Loan Ratio 11=7/10 (11)	Deposit 11=8/10 (12)
1975/76	20.6	200.4	169.8	282.6	168.2	147.3	630.6					
1976/77	38.6	281.4	242.8	299.7	184.1	161.8	655.5	565.7	123.0	670.8	94.0	84.3
1977/78	41.2	227.3	182.1	329.9	142.4	115.4	783.7	594.5	147.9	879.4	74.5	67.6
1978/79	49.5	207.1	162.3	389.9	105.8	82.2	826.0	625.2	102.7	988.4	79.3	63.3
1979/80	49.5	144.4	94.9	389.2	202.6	153.5	1001.1	625.5	74.2	1111.4	74.1	56.3
1980/81	67.5	415.7	348.2	677.5	191.9	101.6	1257.9	811.0	78.4	1281.2	78.1	63.3
1981/82	75.5	543.0	467.5	765.4	212.9	37.8	1400.7	995.6	76.4	1356.8	92.7	73.4
1982/83	89.1	405.6	316.5	921.9	175.9	38.3	1928.2	1056.3	75.9	1321.4	92.1	69.4
1983/84	105.0	676.2	571.2	1096.4	222.2	115.1	1905.5	994.8	48.2	1791.0	107.7	55.8
1984/85	134.4	579.1	444.7	1333.6	169.3	72.0	2396.3	963.4	72.2	2112.0	90.2	45.6
1985/86	152.4	998.3	845.9	1587.7	217.5	134.0	2404.3	907.3	48.8	2687.9	89.2	33.8
1986/87	163.2	1201.5	1038.3	1827.7	195.7	125.9	2542.4	921.0	71.3	3048.7	78.9	30.2
1987/88	178.6	1180.9	1002.3	2002.6	205.4	98.3	2843.1	1067.0	72.6	3264.8	78.0	32.7
Average								1319.9	63.9	3571.0	79.6	37.0
											85.3	54.8

Source: CBE, Statistical Review, P.16, CSO, Statistical Abstract, 1977 and 1978, P. NBE, Quarterly Bulletin, P. 49,53 (1985/86)
* Obtained from Table 5.8

Note: (1) Reserve requirements: 5% of CBE Total deposits
(2) Actual reserve: Reserve with NBE plus cash in hand (local currency)
(3) Liquidity ratio: (Actual Reserve + (Foreign Assets Net of short term Liabilities divided Net demand deposits).

This ratio is 123.0 percent in the base year as shown in column 9 of the Table. The same ratio taking liquidity reserve requirement as defined above for the same period is 63.0 percent. Therefore, the actual liquidity ratio is greater by more than 90 percent of the required reserve ratio.

The loan deposit ratio, including Central Government, shows a general declining trend from the high ratio of 94.0 in the base year to the low ratio of 79.6. The same ratio excluding Central Government is also indicated in Table 5.7. We can note that this ratio started with the highest 84.3 in the base year and gradually declined afterwards and reach the lowest ratio of 30.2 in 1985/86.

Comparison of the Bank's actual performance with the Ten Year Perspective Plan is not made possible, since separate financial plans for financial institutions is not given separately. However, it is possible to see the Bank's performance vis-a-vis the Ten Year Perspective Plan in general terms.

Table 5.10: Sources of Domestic Credit
(in Million Birr)

	1983/84	1993/1994	Annual Growth Percent	
			1984/85- 1993/94	1993/1994 1983/84
Total Domestic Credit	1897.7	5135.6	33495.5	10.5
Repayments	1538.9	4351.3	27875.1	11.0
Deposits	267.6	564.6	4124.8	7.8
Demand deposits	147.6	312.6	2264.1	7.8
Time Deposits	48.4	99.0	727.3	7.4
Saving deposits	59.5	126.5	947.3	7.8
Reserve deposits	12.1	26.5	186.1	8.2
Liquidity reserve	61.6	177.2	1151.9	11.1
Other liquidity reserves	26.5	37.2	330.7	3.4
Depreciation Charges	3.1	5.3	43.0	5.5

Source: The PMAC The ONCCP, Ten Years Perspective Plan
1984/85 - 1993/94, A.A., August 1984, P.366.

As can be discerned from the above Table, total domestic credit is expected to grow at an annual rate of 10.5 percent. Nevertheless the above discussions indicate that the CBE's credit extension has been growing at an average rate of 7.9 percent per annum, and this is well below the forecasted rate of growth. The rate of growth of total deposits as envisaged in the perspective plan is 7.8 percent per annum, but the actual performance, as given out in Table 5.8, is 15.2 percent per

annum on the average. This is well above the planned target. However, it looks that this has been underestimated as other banks are also included. As explained in chapter four the CBE is expected to play a more aggressive role than its current performances in savings mobilization. The Ten Year Perspective Plan envisages Birr 33.5 billion of domestic credit. The largest share of 83.1 percent is forecasted to come from repayments on outstanding and new credits, while various bank deposits are expected to be the next major source with an estimated share of 12.3.²⁹

Since credit repayments are expected to play an enormous role as sources of funds, considerable efforts will be made to raise collections from the present poor record to 90 percent of the amount due. The expected increase in various bank deposits, on the other hand, depends upon the realization of planned increases in output and productivity, the growth of personal incomes, qualitative changes in saving habits of the people, and bank branch expansion.³⁰

Regarding the use of these resources, the plan envisages that close to 73 percent of the cumulative credit expansion would be allocated to state, cooperative and private enterprises to satisfy their financing needs for both working capital and investments. The remaining 27.3 percent is expected to be extended to the Central Government in the form of direct advances, treasury bills and bond purchases.³¹

²⁹ The ONCCP, Ten Year Perspective Plan, p. 367.

³⁰ Ibid.

³¹ Ibid.

However, from the poor credit performance of the Bank, it is unlikely that it plays its share successfully as envisaged in the plan period. This is well indicated in the above discussions. We also see that the 73 percent of the cumulative credit expansion to state, cooperative and private enterprises looks much unlikely, as examined above, especially with the existing policy. The available data indicate that CBE's claim on Central Government was 10.7 percent of its total deposits in 1975/76. This share increased consistently and reached 41.5 percent in 1985/86.³² From this one is able to understand that the Bank's effort in allocating credits as forecasted in the perspective plan (i.e. 73 percent of credits to be allocated to state, cooperatives and private organizations and 27.3 percent to Central Government) seems out of reach.

In summing up this chapter the following points must be remarked. Despite a growing emphasis on various policies for rural credit expansion, the Commercial Bank has neglected the rural area in the provision of credits except very recently. The 1986 rural credit policy permits the Bank to participate in short term credit provisions. This policy is criticized for its limited activity and lack of medium and long term allocation of credits to bring forth a qualitative change in

³²NBE, Quarterly Bulletin, Vol,2, No. 1, 1986/87 (First Quarter), P.49.

the rural life. This policy correction was made only in 1988 by introducing a revised rural credit policy, the operational results of which are to be seen through time.

Despite the emphasis of the credit policy to give priority to the agricultural, industrial and mining sectors, credit allocation to the socialized units of these sectors has not been adequately expanded. Relatively speaking, the trade sector of the economy has been the most important beneficiary of credits.

Although the growth of savings mobilization is better than credit utilization, mobilization of saving deposits from non-corporate units is showing a stagnant growth. The allocation of credit is in general, showing an overall declining trend. The bank's actual liquidity reserve ratio has reached the unprecedented high figure. The loan - deposit ratio is showing a declining trend; both witnessing the accumulation of idle financial resource of the Bank that should have been redirected for productive investments.

CHAPTER VI

6. CONCLUSION AND RECOMMENDATIONS

6.1 Conclusions

As indicated in chapter one the purpose of this study has been to make an assessment of the performance of the CBE in savings mobilization and utilization. The statement of the problem was thus that deposits, particularly savings and time deposits are showing sluggish rate of growth and that the Bank is facing a problem of using the mobilized resources efficiently.

In order to examine this problem certain objectives and method of study were set. Thus, exploring the structure, operations, and determinants of the performance of the CBE, assessing its level of financial development and examining this development through time, evaluating the Bank's performance in savings mobilization as well as utilization were the stated objectives. These objectives were examined using simple techniques of analysis relying on the available data, existing policies and manuals, and vis-a-vis theoretical and empirical studies. Some of the summary results are given below:

I. The theoretical bases of this study are that domestic mobilization of financial resources is important for capital formation and growth, that an efficient allocation of the mobilized resources is imperative, and that commercial banks must

relative, ...

provide an appropriate institutional apparatus through which savings can be directed from less essential expenditure to more productive investments. As the survey of literature shows, a growing consensus hold that financial development facilitates real growth and that financial underdevelopment constrains the growth process. More significantly, the thesis that financial development matters for real growth is based on the measurable increase in financial assets associated with a real increase in GNP.

II. Unlike the branch expansion policy of the Bank, the growth of branches is not only showing a declining tendency but also that all are concentrated in the capital city and other relatively advanced towns where demand for their services exists adequately. From this situation it is not difficult to discern that the Bank's policy adheres to the demand following approach, which approach only accommodates demand for credits. Consequently the Bank lacks the major role to play in credit expansion and thus in economic development. Therefore, a proper mix of demand following and supply-leading approach may help for the development of the Bank.

It is said that CBE branches exist almost exclusively in urban centres, although about 90 percent of the Ethiopian population live in the rural areas. This means that the branches give services to the 10 percent urban population or that even if it is thought that

some of the rural population have access to bank facilities, their cost of transportation is so high that it is not encouraging for further use and as a result they would opt for alternative services from the informal markets.

III. The administratively determined interest rates bring no real benefits to depositors since such rates have hardly been adjusted to corresponding general price increases, leaving depositors with no incentive to bank saving. In addition, the recently introduced interest rates give rather narrow interest opportunities, thus the deposit interest rate policy is restrictive in nature. This leads savers to join other financial markets as confirmed by one study "... many people join these associations (savings and loan) in Addis Ababa, Ethiopia in order to secure a loan for the purchase of a car or a house..."¹

IV. An assessment from different directions of the Bank's saving mobilization effort enables one to safely conclude that it is generally inadequate. The banking ratio, which shows the development of banks through time, exhibited only a sluggish increase. Changes in total bank liabilities

¹Marvin P. Miracle, Dian S. Miracle and Laurie Cohen, "Informal savings Mobilization in Africa" Economic Development and Cultural Change, Vol. 28, No. 4 July 1980, P. 714.

as percentage of GNP, which indicate the rate of growth of the Bank, declined through time. The level of saving channeled into the Bank as measured by the ratio of the bank deposits to M_1 is not satisfactory, particularly the saving and time deposit aspect of the ratio remained almost stagnant. The percentage share of individual and private organization deposits from total bank saving has not only increased but also it is less than other developing countries. While it is said that individuals and private organizations are relatively the major contributors of time and saving deposits, the above situation means, therefore, that the Bank's effort in saving mobilization is not adequate.

- V. There has been lack of clear credit policy and as a result inability of the Bank to extend efficiently adequate credits according to plan priorities. The 1976 credit policy left all banks to extend credits according to their functional specializations instead of giving clear operational policies. Thus the CBE has been confined mainly with its traditional activity of extending credits to urban demands. This continued until 1986 when the Bank started provision of short term rural credit. But the later policy is also criticized for not enabling the Bank to allocate medium and long term credits. Thus, correction was made in

1988 by introducing a revised rural credit policy that enabled the Bank to provide short-term and medium term credits. Despite its relatively large branch network and excess liquidity reserve holdings the existing credit policy does not still allow the Bank to extend long term investment credits.

Moreover, despite the emphasis of the various heretofore credit policies on the provision of credit to agriculture and industry, the actual situation shows only a minor and unincreasing share to these important sectors of the economy with apparent highest credit provision to the trade sector, thus creating further imbalance between economic sectors and hence making little contribution to growth.

Thus the allocation of credits has not been encouraging as the following summarized points would show.

- a. There is an excess of liquidity reserve well above the required level;
- b. The loan deposit ratio is showing a declining trend;
- c. The security requirements of the Bank particularly for lendings to individual and private organization is very high thus discouraging borrowing;

d. It is said that demand for credits in public enterprises has declined due to their improved liquidity position and absence of further capacity expansions and new establishments, minimizing further credit outlets of the Bank and new outlets of credit are hardly existing.

The low intake of CBE credits is also jeopardized by factors such as foreign exchange limitations, effect of drought, absence of clear Government policy for the private sector, and tight import control and the like.

VI. All the above indicate that the linkage between financial savings, financial intermediation and economic development is weak.

6.2 Recommendations

To alleviate the above problems the following possible alternative policy measures and areas for further research are recommended.

I. The Bank should not follow supply-leading approach alone to branch expansion although this approach is said to play a dominant role in economic development through efficient and selective expansion of credits. A proper mix of both supply-leading and demand following approach may be preferred for the proper expansion of its branches. Besides, the expansion of branches should be directed to the rural areas. Apart from

opening branches in potentially viable areas. The introduction of facilities such as the use of mobile banks, deductions at source, factory, groups etc. enable increased mobilization of financial savings. Experience shows that the amount of saving depends partly on how widespread financial institutions are.

II. Saving units, particularly non-corporate saving units, must be protected against rising inflation through an appropriate means. One of the mechanisms could be through periodic interest rate adjustments that should be able to bring about real benefits and attract non-corporate saving units. Experience shows that real interest rate enables higher financial savings. But this measure is recommended along with changes in the credit policy.

III. For optimum use of the Bank's excess liquidity reserve and for continuing provision of credits a change in the credit policy is important as follows:

- a. reduction of emphasis on high security requirements and relying on the soundness of schemes and projects;
- b. clear Government policy measures on private investment through bank borrowing is deemed necessary.

The implementation of the above institutional and policy measures might not only minimize misallocation of resources but also most importantly, might create a strong linkage among financial savings, credit allocation and economic development.

APPENDICES

APPENDIX A.1: Branch Distribution by Administrative Region (June, 1988)

Arsi

1. Arsi Robi
2. Assela
3. Bekoji
4. Huruta
5. Tensae Berhan

Bale

1. Bale Goba
2. Dodola
3. Ginnir

Eritrea

1. Adi Keyeh
2. Adi Ugri
3. Asmara Main
4. Elizabeth II Avenue
5. Keren
6. Mekali Ketema
7. Massawa
8. Zerai Deres

Gamo Goffa

1. Arba Mich
2. Chenchä
3. Ghidole
4. Jinka
5. Yela Sawla

Gojjam

1. Adet
2. Agew Gemja Bet
3. Bahir Dar
4. Bechena
5. Chagni
6. Dangla
7. Debre Markos
8. Dejen
9. Finote Selam
10. Motta

Gondar

1. Addis Zemen
2. Debre Tabor
3. Este
4. Gonder Main
5. Gonder Market
6. Humera
7. Nefas Mewcha

Hararghe

1. Alemaya
2. Aseb Teferi
3. Detachatu
4. Deder
5. Degehabur
6. Dire Dawa
7. Fugna Birra
8. Gelemso
9. Gode
10. Harrar
11. Hirna
12. Jijiga
13. Kebri Dehar
14. Megala
15. Melkasedi

Illubabour

1. Buno Bedelle
2. Gambella
3. Gore
4. Matta
5. Teppi

Keffa

1. Agaro
2. Bonga
3. Hirmata

Shoa

1. Adama
2. Alaba
3. Alem Ketema
4. Akaki
5. Bako
6. Butajira
7. Debre Birhan
8. Debre Zeit
9. Effeson
10. Fitcha
11. Ghion
12. Hagere Hiwot
13. Holeta
14. Hossana
15. Mehal Meda
16. Metahara
17. Meki
18. Mojo
19. Nazareth
20. Shashamane
21. Wonji
22. Wolkite
23. Zeway

Sidamo

1. Aleta Wendo
2. Awassa
3. Dilla

4. Jimma
5. Limu Sultu
6. Mizan Teferi
7. Negele Borena
8. Yabelo
9. Yirga Alem
10. Yirga Cheffe
11. Wolaita Sodo

Tigrai

1. Adigrat
2. Adwa
3. Axum
4. Enda Selassie
5. Mekele
6. Maichew

Wollo

1. Alamata
2. Assaita
3. Bati
4. Combolcha
5. Dessie
6. Dupti
7. Mekane Selam
8. Mugad
9. Tenta
10. Woldia
11. Woreilu

4. Hagera Mariam
5. Kibre Mengist

6. Moyale

Wollega

1. Arjo
2. Assosa
3. Dembi Dollo
4. Ghimbi
5. Gulisso
6. Mendi
7. Nekempte
8. Nejo
9. Shambu

Addis Ababa

1. Aba Koran
2. Abyot Square
3. Addis Ababa
4. Addis Ketema
5. Africa Hall
6. Air Port
7. Andinet
8. Anwar Mesgid
9. Arada Ghiorgis
10. Arat Killo
11. Bole
12. Finfine
13. Ghandi Road

14. Gulele
15. Kirkos Kabele
16. Kolfe
17. Lideta
18. Mehal Cebeya
19. Nefas Silk
20. Mehal Ketema
21. Paulos
22. Selassie
23. Senga Terra
24. Tekle Haimanot
25. Temenja Yaz
26. Tewodros Square

Assab

1. Assab
2. Key Bahir

Agencies

1. Addis Ababa International Airport
2. Asmara International Airport
3. Assab Port

Source: Commercial Bank of Ethiopia, (C.B.E.)
Statistical Review, June, 1988, P. 20.

APPENDIX 2.2: Breakdown of Demand Deposits by Ownership

Year	Private & Individuals	Cooperatives	Public Enterprise & Agencies	Domestic Banks and Other Fin.	Central Gov't	Foreign Correspondents	N/Re-sidents	Total Demand Deposits
1980/81	220.9	73.5	353.6	29.0	100.9	31.8	42.7	852.4
1981/82	234.5	92.2	379.2	38.6	100.9	52.3	57.3	972.9
1982/83	260.2	113.4	481.0	58.4	109.0	67.4	81.8	1,171.1
1983/84	318.4	126.3	583.0	60.7	112.8	35.5	86.0	1,322.4
1984/85	335.8	164.0	743.4	65.9	89.9	30.0	102.2	1,531.3
1985/86	397.9	193.1	877.1	84.8	107.2	33.4	91.2	1,784.7
1986/87	484.4	247.2	902.7	203.9	127.3	23.7	86.1	2,029.3
1987/88	423.3	286.5	935.0	321.5	124.5	60.6	98.9	2,251.2

Source:- Commercial Bank of Eth. Statistical Review, Planning and Business Development Division, No. 6 June 1988, P.2.

APPENDIX A 3: Breakdown of Savings Time Deposits by Ownership

(in Million BARR)

Year	S A V I N G S					Total Saving deposits	T I M E					Total Saving & Time Deposits
	Individual & Private	Cooperatives	Public Enterp. & Agen.	Domestic Banks & Other			Individual & Private	Cooperatives	Public Enterp. & Agen.	Domestic Banks & Other Fin. Age.	Total Time Deposits	
1980/81	443.3	29.2	3.6	0.5	472.4	20.2	3.2	55.1	101.1	189.9	662.3	
1981/82	497.1	23.1	5.9	1.3	527.5	22.7	5.7	98.2	87.3	221.9	749.2	
1982/83	377.0	24.8	5.8	1.1	608.1	28.9	8.2	105.6	104.5	248.2	856.3	
1983/84	672.8	31.1	11.1	2.1	717.1	27.2	8.0	139.6	108.5	283.3	1,000.4	
1984/85	758.3	35.4	18.1	3.1	812.8	36.5	8.2	169.0	126.4	340.1	1,153.0	
1985/86	881.6	41.0	14.5	2.0	939.2	54.0	4.7	154.4	111.7	324.8	1,264.0	
1986/87	1,036.6	15.4	4.2	0.1	1,053.2	87.2	6.5	0.0	88.6	182.3	1,235.5	
1987/88	1,190.7	16.1	1.2	0.1	1,208.0	102.5	7.1	0.0	2.4	111.8	1,319.8	

Source: CRE, Statistical Review, Planning & Business Development Division, No. 6, June, 1988, p. 2.

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DECLARATION

I, the undersigned declare that the thesis is my original work and has not been presented for a degree in any other University.

Name: Mahtsentu Felleke

Signature: _____

Place: Addis Ababa

Date of Submission: June, 1989

DECLARATION

I, the undersigned declare that the thesis is my original work and has not been presented for a degree in any other University.

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