AN ANALYSIS OF FINANCIAL SECTOR AND CREDIT POLICIES DURING THE DERG PERIOD AND POST-DERG REFORMS

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Abstract

The paper provides systematic analysis of the past and current financial sector, credit, and other related policies in Ethiopia based on a critical examination of the provisions of the numerous proclamations, regulations, and directives governing economic activities in the country, the incentive/dis-incentive elements contained in them, and their consequences. It also gives an assessment of developments in the financial sector following the reform, as well as the depth and structure of the financial sector.

A severe form of financial repression which, unlike many other financially repressed economies where suppression was generally through taxes, stamp duties and an un-conducive legal framework, mainly took the form of outright prohibition and was driven by ideology, existed during the Derg regime. Financial institutions were effectively reduced into mere instruments for channelling private sector resources for public sector use. The government also reserved for itself a large share of the income transfers from ultimate lenders (i.e. savers) to borrowers resulting from ceilings on interest rates. Restrictions on private sector access to credit together with the stringent absolute limit on single borrower loans served as effective instruments in suppressing the private sector.

A marked increase in the magnitude of loanable funds of the banking system, mainly due to a switch out of non-earning existing assets, and a fundamental shift in the flow of credit towards the private sector occurred during the post-Derg period. Entry into the financial sector has been slow but steady. However, concentration in terms of ownership, asset portfolio, as well as institutional, sectoral and geographic distribution of intermediation services, remains too high. Besides, some regulatory issues of critical significance remain yet to be addressed.

1. ECONOMIC POLICY DURING THE DERG

1.1. Introduction

This paper discusses policies during the period of financial repression and the financial sector reforms and liberalisation that followed. The policies which were in

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place during the socialist period with a focus on government attitude towards the private and financial sectors, and on policies and measures affecting investment and credit are discussed in section 1. Section 2 gives the recent policy reforms/liberalisation and some aggregate outcomes. Section 3 outlines the depth and structure of the financial sector and concludes.

1.2. General Economic Policy of the Derg

Four months after it assumed power[1] the *Derg* declared *Hibrettesebawinet* (Ethiopian Socialism), explained to mean "equality; self-reliance; the dignity of labor; the supremacy of the common good; and the indivisibility of Ethiopian Unity", as its guiding ideology. It used the banner *Ethiopia Tikdem* (Ethiopia First[2]) which, it declared, means that the *common* good is paramount over *individual*, *corporate*, *ethnic*, or *regional* interest (PMGE 1974:8). The same declaration stated the economic policy of the *Derg* as:

> .... those resources that are either crucial for economic development or are of such a character that they provide an indispensable service to the community will have to be brought under government control or ownership. Essential economic activities which are not amenable to centralised public management will, though outside the public sector, be subject to public monitoring to ensure that the public interest is properly served. Activities in the private sector which are not harmful to the interest of society will be left in private hands in so far as they do not impede the objectives of "*Ethiopia Tikdem*" (PMGE, 1974:10).

The Derg found it necessary to clarify its economic policy, which it did by issuing (in February 1975) the Declaration on Economic Policy of Socialist Ethiopia. This delineated sectors and activities/areas reserved for the state, those for joint state-private capital participation/co-operation, and those left to the private sector, with the financial sector falling in the first group, i.e. exclusive reserve of the state. Small-scale business and industry, domestic and foreign trade, and road transport constituted the third category (PMAC, 1975a:3).

A swift wave of nationalisation followed. The financial sector was the first target: all banks[3] financial organizations and 13 insurance companies were nationalised in January 1975. Most of the banks in existence were state owned even before[4] while the insurance companies were private (and almost all foreign owned (Giday, 1991). Next, it nationalised 72 of the largest companies and acquired majority interests in 29 others (February 1975), promising to pay fair compensation, which it never did. If it did, however, it would have marked a major policy *inconsistency* and *double standard* since no compensation was promised or paid in the case of financial institutions. That it reneged on this promise was, perhaps, one of the early signs that it could not be trusted, hence the beginning of erosion of its credibility. To make the nationalisation drive complete, three other proclamations followed: The Public Ownership of Rural

Lands Proclamation No. 31/1975 (PMAC, 1975b), which made all rural lands collective property, and the Urban Lands and Extra Houses Proclamation No. 47/1975 (PMAC, 1975c), which transferred urban lands and extra (i.e. rented out) houses to the government, brought two of the main factors of production (land and capital) and the housing property under its control. Next came the Public Ownership of Private Schools Proclamation No. 54/1976, which nationalised schools.

In its determination to suppress the private sector, the *Derg* felt that the nationalisation and restrictions of activities for private sector participation were not sufficient. Thus, in December 1975, it issued the Proclamation Relating to Commercial Activities Undertaken by the Private Sector No. 76/1975, the purpose of which was to limit the type and extent of private capital in the economy as well as in the activities/areas left to the private sector (PMAC, 1975d). According to this legislation, new licenses were to be issued to individual enterprises based on the amount of capital invested. It put ceilings on the amount private entrepreneurs could invest: Br 200,000 (US $96,000) for retail establishments, Br 300,000 for wholesale establishments, and Br 500,000 (raised to Br 1 million in 1985) for industry. The capital limit does not apply to firms already above it, and does not take inflation into account. It also prohibited pulling together of capital through partnership or company (with the exception of general partnerships, which should not exceed 5 persons). While these limits would have led to proliferation of a large number of small businesses, there were other restrictions in the same legislation which ensured that this would not happen. The number of licenses (or business activities) was limited to one per individual and with no branches; and individuals with a permanent job or any other source of income were prohibited from getting a license. These restrictions in effect also limited re-investment of profits and dividends in new businesses or expansion of existing firms; only replacement investments are possible once the capital limit is hit.

To what extent these limits had been effectively enforced is, of course, another matter. There were attempts to find ways round them; e.g. getting licenses in the names of family members/relatives, understating capital when applying for license, etc. Befecadu (1994) notes that profitable opportunities created by shortages were large enough to tempt entrepreneurs to exploit them by circumventing the law, with help from those responsible for implementation of the legislation. "... limits on plant size as well as branching restrictions were ignored. Production went underground and industrial entrepreneurs mushroomed in the backyards, garages as well as open spaces". Nevertheless, the hostile government attitude towards the private sector remained a major obstacle to private investment and development. Moreover, for those sufficiently motivated to invest by circumventing the law, the bribes involved increased their costs of entry and of doing business. Another, perhaps more effective, limit on private investment came from the limits on single borrower loans (which were just Br 500,000 in the case of AIDB and Br 1 million in the case of CBE) intended to limit large exposures by banks (NBE, 1986c). This constitutes a constraint which is unlikely to be circumvented easily and, to the extent potential investors have no own

funds, a *binding* one. These low single borrower limits remained in place even after the ceilings on private capital were raised (discussed below).

Still another constraint was lack of access by the private sector to trained manpower. All college and university graduates were being allocated by the government and placement was strictly within the public sector only.

All the above measures aimed at stifling the private sector were further supported by a progressive business income tax; the marginal tax rates for unincorporated business incomes and profits were 82% in industry and 89% in agriculture, and were applicable to annual incomes above Br 36,000. These restrictions have implications on private sector credit demand (more on this later).

1.3. Reform Attempts by the Derg

In January 1983, the government, in an effort to promote development through foreign capital participation issued the Joint Venture Proclamation No. 235/1983. About 44.5% of the planned total investment in its Ten-Year Perspective Plan (TYPP), covering the 1984/85-1993/94 period, was to be financed from foreign sources. The joint venture legislation allowed participation of both private and public foreign capital (up to a maximum of 49%) in joint ventures with Ethiopian public (but not private) capital; provided business income-tax relief, and import and export duty exemption; and allowed remittance of foreign exchange and exemptions of taxes on dividends. However, neither did foreign resources flow in, nor was economic performance satisfactory.

As can be inferred from the measures that followed, there was dissatisfaction on the part of the government itself, although not admitted in public, in its economic achievements. Thus, in November 1988, the 9th Plenum of the Central Committee of the Workers Party of Ethiopia (WPE) passed thirteen resolutions which were to lead to the first major attempt at policy reform, including investment policy. Among the elements of the resolution were:

> "... raise the ceiling on private capital in small-scale industries .. [and] create legal conditions for private investors with adequate capital and management skills to participate without any capital limitations, privately, in partnership, concessional arrangements or joint ventures with the government in the fields of large-scale agriculture, animal husbandry and animal by-products, industry and services ..."

The guiding ideology, however, remained socialism: poor implementation, lack of commitment and adequate support rather than the socialist policy as such were blamed for the disappointing performance. The resolution also sought to create conditions conducive to enabling the private sector to "contribute to the construction of socialist economy" rather than to develop as a sector in its own right (resolution

10). It was to be covered in the indicative plan (resolution 5).

The resolutions were followed by two proclamations: the Small-Scale Industries Development Proclamation No. 30/1989 (1989) and the Hotel Services Development Proclamation No. 31/1989. The former raised the capital ceiling on investment to Br 2 million for individual entrepreneurs and Br 4 million for business organizations; permitted investment in more than one enterprise, provided the overall amount did not exceed Br 4 million for individual entrepreneurs and 8 million in the case of business firms; exempted co-operatives from any ceiling; provided customs duties exemptions for initial purchases of capital goods and income tax exemption to small-scale enterprises in manufacturing which export at least 10% of their annual sales. The latter raised the capital ceiling to Br 3 million for individual entrepreneurs and Br 6 million for a business organization; and provided tariff exemption on imports of basic infrastructure with value up to Br 300,000. However, these did not have any meaningful positive effects on investment.

In a drastic reversal of its socialist policy, as articulated in the Program of the National Democratic Revolution (PNDR), the government, following the resolution of the 11th Plenum of the Central Committee of the WPE, declared the New Economic Reform Program (NERP) in March 1990. The NERP aimed to promote a mixed economy and actively encourage the private sector (which, so far, it regarded as an adversary) through new incentives and elimination of state controls including limits on capital, area of participation (PDRE, 1990), marking a shift in the government's attitude towards the private sector from hostile to supportive.

Accordingly, in May 1990, a new investment decree (Special Decree No. 17/1990) was issued. Size restrictions on private investment were removed, and private sector participation was encouraged in most sectors except public utilities, banking and insurance which was subject to prior approval of the Council of Ministers. The restriction on foreign capital participation to joint venture with state capital only was lifted, allowing foreign investment directly and through joint ventures with Ethiopian private or state capital. A range of incentives including exemptions from customs duties and taxes, income tax holidays (albeit limited to investments of over Br 300,000 in agriculture and Br 500,000 in industry) and personal tax exemption to expatriate employees were provided to both domestic and foreign investors. Forms of business organizations such as ordinary and general partnerships, limited partnerships, share companies and private limited companies were allowed; restrictions on number of investment licenses and branches were lifted. The marginal business income tax was reduced from 89% to 59%, albeit for incorporated enterprises only (i.e. not for individual entrepreneurs). The investment decree was followed by a series of regulations designed to implement the new policy: regulations No. 7/1990, 8/1990 and 9/1990 referring to Licensing of agricultural projects, industrial projects and hotels and tourism, respectively, and regulation No. 10/1990 on the modalities of participation of foreign investors were issued. Moreover, the Multinational Investment Guarantee Agency (MIGA)[5] convention was ratified (decree

No. 39/1990). The government also signed the convention in September 1990.

Although the NERP significantly reduced (but did not remove completely, as we will see in the next section) restrictions on economic activity and discrimination against the private sector, and provided strong incentives, it came too late to see implementation. By then the government had lost control over most of the northern part of the country to the opposition forces and was facing major military defeat. Indeed, the reform itself arguably was partly motivated by its defeat in the war front; it hoped to buy popular support with the reform.

1.4. Financial Sector and Credit Policies of the Derg

All elements of financial repression existed in their severe form: controls on financial prices (i.e. interest rates and exchange rates) and restrictions/controls on new entry to the sector as well as on the activities and portfolios of existing financial institutions. The central bank, the NBE, had the power to "... control the operations of banks and other financial institutions" and to "... direct banks and other financial institutions to deny credit allocations to enterprises ..." (Proc. no. 99/1976, articles 9(4) and 9(5)).

All financial institutions (except the SACCs, whose asset[6] shares do not exceed 1% of the sector's assets and whose loan services are limited to their members) were publicly owned and entry was barred, thereby establishing a public monopoly in the financial sector. Moreover, the financial system has been segmented with financial institutions having specialized functions; specialisation not based on efficiency in risk and transaction cost considerations: individual institutions have been operating in specific businesses allocated to them, each enjoying a monopoly in its segment.

AIDB[7] (now DBE) specialized in development loans by raising funds only through (both foreign and domestic) borrowing and time deposits: although article 8(10) of proc. 158/1979 authorised the bank to accept savings deposits (but not demand deposits) it never did. Neither has it used equity participation despite a provision for this (article 8(9) of Proc. 158/1979) and the emergence of possibilities for equity investment due to the joint venture proclamation. HSB[8] (now CBB) had monopolised the loan business for housing development and construction industries. It was authorised to mobilise funds through time and savings deposits but not current accounts (Proc. no. 60/1975). The central bank also specified that time deposits of Government-owned Undertakings (i.e. public enterprises and state farms) shall be maintained only with the AIDB or HSB, while savings deposits shall be maintained only with the HSB or CBE[9]. Such enterprises were ordered to transfer their deposits maintained with other banks accordingly[10] (NBE 1986d, 1986e). Neither AIDB nor HSB provided other banking services such as overdrafts, remittance transfers, safe keeping and exchanges (import and export) to the general public. The EIC[11] and PSSA (now SSA), the only formal[12] contractual savings institutions, specialized in insurance and pensions, respectively.

Bank credit was administratively allocated, mainly to the socialised sector (i.e. Public Enterprises, State Farms, and Cooperatives). Interest rates on loans to different economic and social sectors were administratively fixed. The NBE set lending rates ranging between 4.5-9.5%, depending on the type of ownership and sector. Authorities used elaborated policies which specified financial instruments and their returns; interest rates on different types of deposits were administratively set. Time deposit interest rates ranging between 1-7.5% depending on type of depositor and maturity[13] were fixed – the minimum period required for time deposits to earn interest was 1 year. The structure of interest rates on savings deposits was such that large deposits earn a lower rate, the exact opposite of the structure commonly found in market-oriented economies: the interest rate on savings deposits up to Br 100,000 was 6% per annum while deposits above this were earning 2% (note that the minimum rate on savings deposit is higher than that on time deposits). The government also specified the types of instruments each financial institution could issue, hence public and private enterprises as well as individuals can hold, thereby severely limiting the ability to diversify portfolio and manage funds (e.g. Government Owned Undertakings were prohibited from holding time deposits with maturity longer than 1 year). The earning financial instruments available to the general public were restricted to savings and time deposits only. The use of credit instruments such as overdraft facility was discouraged. An unpublished government document, "Credit Policy for Banks", states that "overdraft facility, which is a hindrance to the rational and flexible allocation of funds by the banks must be discouraged"(emphasis added). Usury has been made illegal, driving the activity underground, hence making it not only difficult to borrow from the informal credit market but also expensive; i.e. interest rates such lenders charge may involve a premium for the risk of being caught.

The government restricted equities through its prohibition of the pulling together of capital through partnership (discussed earlier). It also restricted both foreign and domestic private bonds, thereby preserving a sheltered market for its bonds and bills (although they were not available to the general public) as a source of cheap funds. Not only did they offer low yields (only 3% for treasury bills and 5% for bonds until 1 October 1992) but were also illiquid since, given the absence of secondary market, they had to be *directly held* until maturity (rather than being traded).

In addition, high reserve and liquidity ratio requirements, and exchange rate controls were in place (the exchange rate was fixed at Br 2.07 to the US dollar).

Unlike many financially repressed developing countries where suppression was generally through various types of taxes, stamp duties and an unconducive legal framework, financial repression in Ethiopia mainly took the form of outright prohibition. The financial sector was simply regarded as a means of channelling resources in accordance with the national plan and as subservient to the real sector rather than as an economic activity in its own right.

> ... it has become necessary to establish a wider base for growth by reorganizing, co-ordinating, controlling and centralizing the banking system in order to assure a more rational and effective allocation of resources and banking services with due regard to the country's social and economic needs and in keeping with the broad objectives of the national plan [Proc. no. 99/1976] (emphasis added).

Credit policy was driven by ideology, as can be seen from the explicitly stated priority given to the socialised sector (*ipso facto* marginalising the private sector):

> " ... in the transitional period from a mixed economy to a socialist economic order; financial institutions will use the credit facility as factor of strengthening and expanding the socialized sector and encouraging projects for as long as such projects are economically and socially desirable; the socialized sector will receive priority in credit allocation" [NBE, 1976].

Financial institutions in effect served as means of generating and channelling resources to the public sector (i.e. central government, public enterprises, and state farms) in three ways. First, through the zero-yield required (and excess) bank reserves; second, through capital charges, taxes and 'dividends'. Public financial institutions had to pay a capital charge of 5% of the state capital plus the general reserve fund, and 50% profits tax, as well as sales & transaction taxes and excise taxes; to make special contribution (equal to 30% of net surplus) to the general reserve fund (until such fund equals 60% of the state capital); and transfer the residual surplus to the government, as an owner, as 'dividends' (Proclamation No. 163/1979).

The third is through credit. The public sector has been the major user of bank credit. The share in domestic credit of the central government alone (i.e. excluding credit to public enterprises and state farms), which was only 11% in 1974, averaged 47% during 1975-90 (and 50% during 1980-1990). In 1990/91 the central government and public enterprises together accounted for 87% of total loans & advances outstanding. To the extent that controlling deposit and lending interest rates results in income transfers from ultimate lenders (i.e. savers/depositors) to borrowers and that the share in total loans determines the proportion of these transfers going to a certain borrower, the government, by giving itself and public enterprises priority access to bank funds, reserved for itself a large share of the transfers.

There are also indications that banks channelled *private* sector resources to the *public* sector. While this is not peculiar to Ethiopia, it is large compared to other developing countries. The public sector had a negative resource balance, on the average, of 15% of GDP (the private sector had been the largest saver and the only sector with positive savings-investment balance) during 1981-90 (World Bank, 1991) which is almost twice the average figure for Sub-Saharan Africa (which is 7.6%) and more than twice that for low income countries (see Annex 2.3). And the ratio of private sector borrowing from CBE to private deposits with the same was only 17%

(the remaining 83% available for use by the public sector). Thus, in effect, the CBE served as an agency for channelling private sector savings for public sector use at low cost (Gebrehiwot, 1994). Private sector crowding-out had been quite high: its share in domestic credit, which was about 86% in 1974 fell to just less than 5% in 1990. 95% of HSB, 89% of CBE, and 78% of AIDB loan portfolios in 1989/90 were with the socialised sector (Gebrehiwot, 1994). Even in flow terms, the share of the private sector had been disproportionately low: between 1981/82 and 1989/90, public enterprises and co-operatives received more than 69% of the loans and advances disbursed by the banking system (NBE Annual Report, own calculation). It should, however, be noted that the observed low share of the private sector partly could have resulted from lack of private sector credit demand; the various restrictions the sector faced (discussed earlier) translate into limited demand for investment, and consequently for credit, by the private sector.

Discrimination against the private sector was not limited to credit access. The interest rate schedule (effective 1 July 1986) explicitly price-discriminated against the private sector: a directive by the NBE fixed lending interest rates of 9% for private, compared to 8% for public, industrial enterprises; and 8% for private as opposed to 6% for public enterprises in agriculture (NBE, 1986a). Private enterprises faced further discrimination in credit since banks required them to insure their assets (this was not a requirement for public enterprises,[14] for an insurance fee of 1 to 2 percent of the loan amount, thereby increasing their effective cost of borrowing. Additional discrimination, hence costs, emanated from bureaucratic hurdles in financial institutions and difficult procedures including the valuation of assets not only of borrowers' but also of their personal guarantors'[15] various (legal and illegal) charges therein, and delays in extending credit. There were also up-front charges demanded by unscrupulous loan officers. According to a World Bank study, "... such costs may be as high as 10 percent of the loan amount" and small borrowers are particularly vulnerable to this (World Bank, 1991, Annex IV). Moreover, the single borrower limits, of Br 500,000 and Br 1 million imposed on AIDB and CBE loans to private borrowers respectively, limited the amount of bank finance they can receive.

Despite all these, the NERP, which is widely regarded as far-reaching and which, in many respects, represented a radical departure from socialism, introduced neither changes in the credit and financial sector policies which were designed to build a socialist economy nor financial sector reform of any sort. This represents a major policy inconsistency in the NERP: trying to encourage private sector participation while continuing to discriminate against it in financial services. The government claimed now to believe in the role of the private sector in economic development, similar to "government organizations, cooperatives and mass organizations":

> " whereas it is believed that investments by participants in mixed economy, namely, government organizations, cooperatives, mass and private organizations, Ethiopian entrepreneurs and foreign investors can immensely contribute to the country's economic development by making available better

and wider supply of goods and services..." (Proc. No. 17/1990).

Yet, it failed to take measures to give it improved, if not equal, access to credit. Moreover, for all its pervasive problems of inefficiency, bureaucratic hurdles (even corruption) and complicated borrowing procedures, there was no attempt to reform the financial sector. The only indication of an intention on the part of the government to reform this sector comes from article 5(3) of the Council of State Special Decree on Investment No. 17/1990 (Negarit Gazeta, 1990b) which states that "investment in the provision of ... banking and insurance ... activities shall require the prior authorisation of the Council of Ministers".

Besides, unlike in the other sectors, this was never followed by any regulation designed to guide its implementation. Of course, as it turned out, even the reforms that were followed by such regulations were not implemented since the government was toppled in May 1991.

In summary, the *Derg* period was characterised by private sector restrictions, price distortions and institutional weaknesses. Despite some late reform attempts, the private sector had been subjected to sectoral restrictions; overly regulated and bureaucratized licensing system; cumbersome and time consuming business registration procedures, including acquisition of premises as a precondition for registration; difficulties of access to land, foreign exchange, trained manpower and other inputs; and gross discrimination in the formal credit market. Moreover, the financial sector remained a state monopoly and severely repressed.

Following the overthrow of the *Derg* regime, changes in economic policies as well as political, administrative and institutional structures began to be introduced by the Transitional Government of Ethiopia (TGE). The changes aimed at removing restrictions on private sector and price distortions, and institutional reforms. We now turn to a selective review of the relevant policy changes, in the light of private investment, availability of loanable funds, entry and competition in the financial sector, credit demand, and access to credit.

2. RECENT REFORMS AND LIBERALISATION

Policy, legal, regulatory, supervisory and institutional reforms have been undertaken. The TGE distributed its draft economic policy for the transition period for public comment. The Transition Period Economic Policy (TGE, 1991) clearly defined the role of the state in the economy, explicitly acknowledging state control over the entire economy as the major cause of economic decline and the need to shrink that role, concentrating on the social sectors and infrastructure. It also broadened the scope of private investment. Moreover, it gave full autonomy to state-owned enterprises (SOE) and financial institutions, and imposed hard budget constraints. SOEs are required to use profitability criteria and to operate in competition with the private sector, hence

ending the credit access priority and other special privileges they enjoyed: "they should be treated like any private enterprise without favours and privileges whatsoever" (TGE, 1991). In addition, it declared its intention to privatise.

The TGE adopted a World Bank/IMF supported SAP, launching the first three-year program in late 1992, which was continued by the EPRDF government which (voted in the May 1995 election) took power in August 1995. The main reforms covered by the SAP are exchange and trade systems; public enterprises; financial, agricultural and transport sectors; fiscal reforms; and investment promotion. Here the focus is on investment incentives and financial sector reforms/liberalization.

2.1. Investment Promotion

A number of legislative and institutional measures have been taken. A new investment code and tax system have been introduced. The Proclamation to Provide for the Encouragement, Expansion and Coordination of Investment No. 15/1992 laid the legal and institutional basis. The Investment Office of Ethiopia (now Ethiopian Investment Authority) was established to serve as a one-stop office for the administration of investment; the registration and business licensing system inherited from the previous regime involved several preconditions and cumbersome procedures of double-checking (e.g. acquisition of premises was a pre-condition for registration while potential investors had to go through a lengthy process to get a license).

Guarantees and constitutional protection of private investment were provided, ruling out by legislation, for the first time, nationalisation *without adequate compensation and legal procedure*. In contrast, both Proc. 242/1966 of the Imperial era and Proc. No. 17/1990 of the *Derg* were silent on this issue. In the latter case, despite the declared shift to mixed economy, the silence, given the *Derg's* history, not only of aggressive nationalisation, but also of expropriation of private property in violation of its own proclamations[16] fresh in people's memory, was perceived as deliberately leaving the option open, thereby creating uncertainty to potential private investors.

Fiscal incentives have been introduced to encourage private investment, the main instruments in use being tax holidays, customs duty exemptions on equipment & machinery, tax reductions, and investment tax credit. The tax holidays are non-discriminatory in the sense that both domestic and foreign investors are eligible and that they apply both to new investments as well as expansion or upgrading. However, they discriminate by size and location in the sense that large investments (i.e. above Br 250,000 in case of domestic investors, US $500,000 in case of foreign investors, and US $300,000 for joint ventures) and investments in "underdeveloped regions" receive favourable treatment (Proc. no. 37/1996). Income tax for organizations, which was 59%, has been reduced first to 40% in 1994/95, and then to 35% - a rate considered as internationally competitive standard (Proc. No. 62/1993; 36/1996). Moreover, export taxes have been abolished except for coffee (Proc. no. 38/1993).

Cognisant of the public nature of investment in R & D and training, all such expenditures have been made tax deductible. While the use of tax holidays and duty tax exemptions is not new in Ethiopia (both the Imperial and *Derg* regimes used them), it is apparently for the first time that tax incentives are provided to encourage *private* investment in R & D and training.

The incentives have been further improved by Proc. No. 37/1996 which systematised and consolidated them in line with the federal structure of the government. The proclamation: (a) expanded the scope for foreign capital participation by allowing foreign investment in the form of sole proprietorships, business organizations incorporated in Ethiopia or abroad, public enterprises or cooperative societies; (b) simplified the procedure for investment permit and eliminated the requirement for trade or operating license until the completion of project implementation and the commencement of production or rendering of service; (c) allowed foreign investors to operate foreign currency accounts in authorised local banks for transactions related with their investment; (d) permitted foreigners to remit incomes from liquidation of assets, transfer of shares, profits, dividends and employment as well as repayment of external loans and payments related to technology transfer; (e) reduced the required minimum share of domestic capital participation in joint ventures from 51% to 27%, eliminating, for the first time, the legal requirement of at least 51% equity holding by domestic partners - during the imperial as well as the *Derg* eras, foreign capital participation in joint ventures was limited to a maximum of 49%; and (f) abolished the cash deposit requirement on foreign investors of at least 25% of the investment capital to obtain a permit.

2.2. Financial Reform/Liberalisation

Public Enterprises Proclamation No. 25/1992 provides the legislative basis for the implementation of public sector reforms, divestiture and privatisation.

The financial reforms and (internal) liberalisation undertaken include elimination of priority access to credit; interest rate liberalisation; restructuring (including portfolio cleaning and re-capitalisation of state-owned banks) and introduction of profitability criteria; reduced direct government control of financial intermediaries and limits on central bank and banks loans to the government; enhancement of the supervisory, regulatory and legal infrastructure and power of the NBE[17] allowing private financial intermediaries through new entry of domestic private intermediaries (rather than privatisation of existing ones); and introduction of treasury bills auction markets.

Interest Rate Liberalisation

Financial liberalisation has been gradual rather than a big-bang. It began at the end of 1992 when nominal interest rates on deposits and loans were raised,[18] discrimination of credit access and interest rates by type of ownership (i.e. between SOEs, Co-operatives and private firms) eliminated, sectoral interest rate

discrimination reduced, and domestic establishment of private financial institutions allowed and encouraged (Proc. No. 29/1992; NBE 1992b). This was latter followed by a promulgation of a series of legislation relating to the financial sector.[19]

Further, liberalisation in September 1994 eliminated sectoral discrimination of lending rates, which had continued (favoring agriculture and housing & construction), albeit at a reduced degree; lending rates were increased to 14-15% for all sectors of the economy, and deposit rates to 10-12% (NBE 1994a, 1994b). On the average, interest rates were above inflation (see Table 1).

Table 1. Interest Rates and Inflation

	1992/93	1993/94	1994/95*	2 Jan. 1995 - 30 Nov. 1995	1 Dec. 1995 - 15 Sep. 1996	16 Sep. 1996 - 30 Dec. 1997
Nominal deposit rate	10-12	10-12	10-12	10	11	7
Nominal lending rate	11-15	11-15	14-15	15	16	10.5
Interest spread (nominal)	1-5	1-5	2-5	5	5	3.5
Inflation	10.0	1.2	13.4	0.9	0.9	-6.4**

source: NBE Annual Report, 1994/95.

* interest rate figures apply only up to end of 1994 since a policy of a floor on deposit interest rates and a ceiling on lending rates was adopted as from January 2, 1995. The interest rate figures shown for the period since the beginning of 1995 are the respective floors and ceilings, hence the indicated spread is the maximum.

** for Fiscal Year 1996/97.

Since January 1995, the central bank switched to a policy of *floors*[20] on deposit interest rates and *ceilings* on lending rates, allowing banks to set interest rates (provided they do not discriminate between similar categories of depositors and of borrowers) (NBE 1994b, 1995c). The floors and ceilings restrict the pricing schedules of banks; i.e. limit the spread between deposit and loan rates (the maximum nominal spread was 5% between December 1995 and early September 1996, reduced to 3.5% beginning mid-September). Nevertheless, these rates, combined with relatively low inflation, resulted in positive real rates. This, together with the non-taxability of interest income and the implicit government guarantee on deposits, especially deposits with the CBE[21] make deposits quite attractive assets to savers. While controlling inflation rather than raising nominal interest rates has been the government's preferred means to achieve positive real rates, the ceiling on lending rates, by putting a cap on bank earnings from lending, avoids the risk of banks, eager to increase their market share, the new banks in particular, raising deposit rates too high in a competitive bid to attract deposits. Another argument in favor of a ceiling would be to prevent adverse selection among borrowers which may arise if lending rates are too high, leading to inefficient credit allocation, rather than as a mechanism to control the cost of capital.

In any case, further interest rates liberalisation was taken by eliminating the ceiling on lending rates (effective January 1998), hence removing the policy limit on interest spread (although, contrary to expectations, even a year after the ceiling was removed, most banks, including the private banks, continued to lend at more or less the same rate as before (see Gebrehiwot, 1998c)).

The liberalisation also raised nominal yields on treasury bills and bonds to 12% and 13% respectively (since October 1992), yielding positive real returns except in 1994/95. Later, a government securities market was established (January 1995) through the introduction of monthly (later made bi-weekly) auction of 91-days treasury bills, with 28-day and 182-day bills added in December 1996: T-bills are now on offer to financial institutions, business firms as well as the general public.

Bank Restructuring and Entry Rules

The state owned banks have been restructured financially and operationally. Changes in corporate governance have been introduced: banks have management autonomy and their own boards;[22] management have been replaced or reorganised; new incentive schemes have been introduced;[23] and banks are to operate in a competitive environment using commercial criteria. They have been re-capitalised to improve their solvency. Their portfolios were improved by cleaning up[24, 25] non-performing loans to Public Enterprises and Cooperatives through "carve-outs" or "debt socialisation" (i.e. banks received government bonds to replace non-performing loans) (Proc. No. 75/1993), partly to enable them to compete with new private banks which start from a clean balance sheet. It may also prevent the emergence of moral hazard in banks and the indebted public enterprises.[26] Re-capitalisation and clean up have created opportunity for banks to cut off insolvent clients should they choose to. Whether they will do so is another matter; even if banks are free to drop troubled firms, they may choose not to in an effort to maintain a client base, especially if it is to lead to mass bankruptcy. What happened in the Czech Republic is a good example. Czech banks were faced with the choice between dropping insolvent firms (while hoping to retain their business with the good firms in the face of increased competition from foreign banks) or raising interest rates on paying customers as a means of replenishing their capital and "buy time to sit on the loans to the troubled firms in the hope that these firms would form a captive client base". They chose the latter (Hayri and McDermott, 1995). Besides, the banks may believe that the insolvency of public enterprises in the past had to do with government intervention and lack of clear commercial criteria (after all, the banks themselves have been subjected to such circumstances). Now that the enterprises have autonomy and use profitability criteria, may be worth retaining them as clients.

Moreover, the banks have been converted into universal banks (i.e. allowed to do both commercial banking and brokerage, sale shares as agents, and participate in equity investment) (see Regulations No. 200/1994, 202/1994 and 203/1994). Restrictions on their portfolios[27] (including the kinds of businesses they can finance)

and financial instruments have been removed; banks are no longer required to specialise their credit services to certain sectors of the economy or hold government bonds. Nor do they face restrictions on the types and sources of deposits they accept. Moreover, banks are decentralising[28] loan decision-making which will have the advantage not only of making speedy processing of loans possible (thereby reducing transaction costs of borrowing), but also of reducing screening, hence transactions, costs of lending. Both tend to reduce borrowing costs, the former directly and the latter by inducing decreases in lending interest rates, assuming sufficient competition between banks and to the extent the other components of transaction costs (i.e. administrative costs and default risk costs- high provisions on substandard, bad and doubtful loans) do not increase so as to offset this effect.

Entry restriction into banking was lifted for domestic (but not foreign) private sector. Entry rules have been clearly defined: guidelines for entry including professional standards directors, managers, and principal officers are required to meet (articles 3(1e) and 30 of Proc. No. 84/1994)[29,30] minimum capital base and maximum ownership by a single shareholder[31] in banks (to limit ownership concentration[32]) have been issued. Capital adequacy and other prudential requirements have been specified: banks are required to keep at least 8% of risk weighted assets[33] or Br 10 million, which ever is greater[34] , hence complying with the Bank for International Settlements' (BIS) standard,[35,36] to protect depositors (Proc. no. 84/1994, article 13(1)). Large exposures/risk concentration limit (i.e. limit on exposure to a single borrower) of 10% of net worth[37] has been imposed, hence making loan portfolio diversification[38] a regulatory requirement. Rules regarding connected and insider lending (i.e. limits on accommodation) have been introduced: loans to bank directors, or business organizations in which the bank or its director(s) have stakes, or persons to whom the bank or its director(s) are guarantors, are controlled.

However, there are some regulatory issues which neither the banking proclamation (Proc. No. 84/1994) nor the various relevant NBE directives have addressed. The provision on ownership concentration does not explicitly address the issues of cross-ownership (ownership through affiliated companies or investors), hence leaving a potential for concentration. Given that there is no restriction on *inter-locking* directors, there is a potential for conflict of interest. Financial institutions have no code of corporate governance yet. There is no provision to ensure that sponsors of banks and insurance companies make sufficient financial commitments. The limits on accommodation are not comprehensive in that services provided to and fee-based transactions with *related parties* are not covered. Moreover, the regulation does not cover the possibility of insiders of different banks rewarding each other loans on the basis of reciprocity.

Legal Environment

Another major step, as far as banking is concerned, is the amendment of the 1960 Civil Code with respect to sale of bank collateral (Proc. No. 65/1997). The

amendment provides for an *agreement with the borrower* authorising lending banks to sell directly and quickly (with 30 days notice) collateral from delinquent borrowers, hence contribute to the effectiveness of enforcement of credit contracts. Moreover, urban land acquired through lease can now be used as collateral (although it is equally important that transferability is ensured). These are expected to reduce the constraints on lending/borrowing. However, the capacity and efficiency of the court system remains limited; although specialized commercial courts exist, their number is not large enough, not to mention their quality. Moreover, court fees are believed to be too small to encourage settlement outside the court system such that even minor disputes/small claims seek resolution through the court procedure. Although a formal enforcement mechanism should be low-cost, it should be the last, rather than the first, resort which aggrieved parties can turn to.

2.3. Some Aggregate Level Outcomes during the Period

Thee aim of this sub-section is to assess some relevant positive aggregate outcomes or developments during the liberalisation period, not to give rigorous analysis of effects.

Loanable Funds and Private Sector Credit

There are indications of significant increases in financial savings: growth rates of total deposits as well as its components, the two interest-bearing deposits in particular, during 1992/93-1995/96 were significantly higher compared to the 1986/87-1991/92 period while that of currency outside banks declined considerably (see Table 2). The time since the interest rate increase (for the period data is available) is relatively short for a significant change in agents' saving behavior to have occurred so as to generate new savings. This suggests that most of the observed increase is likely to be due to portfolio substitution out of non-deposit assets (currency, gold, curb market assets, real assets,[39] foreign assets) and out of non-earning bank deposits[40] (i.e. portfolio substitution in the stock of existing assets) rather than due to new savings. We should also note, however, that in 1994/95 Ethiopia enjoyed a coffee boom, hence an estimated windfall gain of 2.25% of GDP, resulting from high world price- IMF (1996). But, Table 2 also shows a slight increase in the share of currency outside banks in total financial assets, implying that no substitution out of currency has taken place. However, there has been a clear portfolio switch from non-earning to earning assets as can be seen from the decline in the share (in total financial assets) of demand deposits and the increase in the shares of time and savings deposits. A change in the structure of deposits can be observed from Table 3. The share of demand deposits decreased (by about 4%) while that of saving and time deposits increased since 1992/93, suggesting that, although demand deposits still account for a significant percentage of total deposits, some portfolio switch from non-earning to earning deposits has occurred.[41]

Table 2. Percent Growth of Financial Assets and Composition (average per annum)

	Growth (percent)		Average Share in Total Financial Assets*	
Year	1986/87- 1991/92	1992/93- 1995/96	1986/87-1991/92	1992/93-1995/96
Currency outs. Bank	18.6	7.3	41.3	42.5
Demand deposits	8.2	11.8	33.6	27.2
Saving deposits	13.5	25.9	22.6	26.6
Time deposits	-6.7	64.6	2.5	3.7
Total deposits	9.1	23.6	58.7	63.6

Source: calculated from NBE Annual Report and Quarterly Bulletin, various issues.
* total equals currency outside banks plus deposits

Table 3. Composition (%) of Non-central Government Deposits (1985/86 - 1995/96)

	1985/86	86/87	87/88	88/89	89/90	90/91	91/92	92/93	93/94	94/95	95/96
Demand dep	55.6	59.4	60.1	56.6	56.7	55.9	53.9	50.6	50.4	50.1	40.3
Saving dep	32.9	34.4	36.3	38.8	39.7	40.5	42.6	43.2	43.7	44.4	51.6
Time dep	11.5	6.2	3.6	4.6	3.6	3.6	3.5	6.2	5.9	5.4	7.9

Source: Calculated from NBE Quarterly Bulletin, various issues.

There is also indication that savings mobilisation, hence availability of loanable funds, has increased. Deposits as a ratio of GDP increased from 21% in 1990/91 to more than 30% in 1996/97 while the ratio of broad money (M2) to GDP, which was 40% in 1990/91, increased to 44% in 1996/97.

Available loanable funds put an upper limit on domestic credit, hence on credit access. A look at the financial resources of the banking system shows that availability of funds has been increasing. Total non-central government bank deposits grew at an average rate of 16% per annum during 1991/92-1996/97 compared to just 7.4% during 1987/88-1990/91. Moreover, the banking system as a whole experienced continued rise in liquidity, in recent years in particular, in the sense that resources mobilised exceeded disbursements by a considerable margin (by a margin of 20 to 52%), between 1987/88 and 1995/96 (the period for which we have data on this) except 1993/94. Of course, there are differences between banks, which may not be surprising given that, during the period of financial repression, some banks faced more restrictions than others on the types of deposits they receive and that they were made to focus on loans of medium and long-term nature (e.g. financing agricultural and industrial development, housing, etc.). As discussed earlier, it is only recently that AIDB (now DBE) and HSB (now CBB) were allowed to accept demand deposits and to do universal banking. Liquidity at the CBE and HSB has been on the increase throughout this period. In fact, CBE continued to have substantial amounts of both excess reserves (which are non-earning) and excess liquidity: in June 1998 *actual* reserves were more than 15% of its total deposits, as opposed to the required 5%,[42,43] while the *actual* liquidity ratio was 51% of its short-time liabilities[44] compared to the 15% regulatory requirement. Theoretically, this excess liquidity (and reserves) may be due to lack of credit demand or due to preference by banks to accumulate excess liquidity rather than lend to *non-prime* borrowers[45] (e.g. this may happen if

banks are unable to buy sufficient government bonds or T-bills to absorb the excess) - but holding such huge non-earning excess reserves in the face of rising cost of funds (due to decline in the share of zero-cost demand deposits) and constrained loan earnings (i.e. interest rate ceiling) cannot be prudential. It should be noted that the excess liquidity problem is not unique to CBE; even the private banks, despite their limited capital and share in deposits (hence loanable funds) appear to have excess liquidity implying that an inter-bank money market may not solve the problem. That there has never been any transaction since the necessary regulatory mechanism for this market was in place starting September 1998 may partly be a reflection of this.

The AIDB, however, experienced a decline in liquidity starting 1991/92 partly due to a decline in its borrowing from the NBE, which has been its single most important source of funds; this is largely responsible for the decline in overall bank liquidity observed during the same fiscal year. The bank also had serious problems of loan recovery, especially from state-owned enterprises, including state farms, and co-operatives, both of which had priority access. The latter dissolved almost overnight (rather than through orderly liquidation) immediately following the March 1990, which allowed formation of co-operatives to be strictly voluntary and allowed members to dissolve them if they want to, leaving creditors banks with no one to claim payments from. Most co-operatives did not have tangible assets the banks can foreclose, other than their offices and stores, usually located in remote rural areas, hence difficult to liquidate. In addition to banks losing money (at the expense of the tax-payer), this may have signalled that you can borrow money from a bank and get away with non-repayment.

The observed rise in liquidity could not have resulted from a decrease in credit as there has been a substantial increase in bank credit. Gross domestic credit increased by about 92% between 1990/91 and 1995/96. Total fresh bank loans and advances disbursed, which was Br 1,476 million in 1992/93, reached Br 4,303 million in 1995/96; an increase of 192%. Loans and advances disbursals to the private sector in 1995/96 were 312% higher compared to 1992/93.

Furthermore, there has been a significant shift of credit towards the private sector. Central government's share in domestic credit outstanding, which had reached 40% in 1990/91 (end of the socialist era), declined to about 23% in 1995/96 partly due to the termination of government borrowing from the banking system (no fresh bank loans and advances were disbursed to the central government since 1994/95) and partly due to repayment of existing loans, hence releasing resources for private sector lending. The ratio of private sector (excluding co-operatives) credit disbursed to GDP rose from 1% in 1991/92 to 8% in 1994/95. In flow[46] terms, the proportion of bank loans and advances disbursed to the private sector, which remained well below 30% of total disbursals during the socialist period and was only 49% in 1992/93, increased considerably, reaching 91% in 1996/97 (see Table 4), the socialised sector receiving only 9%. In the case of AIDB, loans and advances going to the private

industrial sector, which, during the 1980s, never exceeded 11% of its disbursals to the sector, reached 36% in 1992/93. %. In other words, now it is the socialised sector that is being crowded-out.

Table 4. Private Sector Share (%) in Total Loans and Advances (disbursal) for the Period 1987/88 - 1996/97

Year	1987/88	88/89	89/90	90/91	91/92	92/93	93/94	94/95	95/96	96/97
Private sector's % share of Loans & adv. disbursed	23.0	22.9	27.9	39.8	44.9	49.0	80.6	80.8	69.2	90.9
Industry's % share	-	-	19.9	21.6	20.4	26.9	18.6	8.1	12.1	10.8

Sources: Calculated from NBE Annual Reports, 1987/88 to 1995/96, and other unpublished sources.

Entry and Competition

Following the lifting of entry restriction into the financial sector, several domestic private financial institutions have been established: as of November 1998 five banks, eight insurance companies, and eight registered "micro financing institutions" were in operation [despite the relatively high new entry paid up capital requirements of Br 10 million and Br 7 million for bank and insurance[47] respectively]. This raised the total number of banks and insurance companies to eight and nine respectively. There are stories that in the main urban centres, especially in Addis, the state-owned financial institutions are already beginning to face competition from the new FIs, especially in lending; private banks' share in the loan market has been increasing, reaching 17% of total loans disbursed in 1997/98 (MEDAC, 1999).

Nevertheless, the state-owned banks are still dominant in the markets for deposits and loans with little competition between them. Within this, the CBE has been, and still is, dominant in terms of market share in total deposits as well as credit and bank branches: As of June 1998, it accounted for more than 87% of the total deposits (96% of demand deposits, 87% of savings deposits, and 41% of time deposits – DBE and CBB accounted for more than 53% of the latter[48]). The private banks appear to be doing relatively better in attracting interest-bearing deposits (9.3% of savings and 5.5% of time deposits compared to only 3% of demand deposits), although it is not clear how much of this resulted from the banks' efforts rather than from the general reluctance on the part of the CBE to accept term deposits. CBE's nation-wide network of 168 branches (about 70% of all bank branches) gives it dominance in the payments system and better access to savings, the zero-interest demand deposits in particular, hence a comparative advantage. It should be noted though that this cost advantage is usually exaggerated, since the higher (non-earning) reserve requirement which the CBE has been subjected to (8%, compared to 5% for private banks – until it was reduced to 5% starting January 1998) partly offsets this cost advantage[49] over other banks. As in June 1998, CBE's share in total bank loans disbursed was 58% compared to about 87% in 1994/95.

Table 5. Percent Share in Total Bank Deposit Holdings and Loans and Advances Disbursed

A. Deposits Held	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1997/98
CBE	86.5	86.2	88.5	92.3	93.1	95.3	87.6
AIDB (DBE)	3.8	3.8	2.9	2.4	2.1	0.8	3.6
HSB (CBB)	9.7	10.2	8.6	5.3	4.8	3.9	3.2
Private Banks	-	-	-	-	-	-	5.6
B. Loans & Advances							
CBE	46.0	62.5	66.1	86.1	83.1	86.5	58.4
AIDB (DBE)	43.0	28.7	26.8	11.2	10.6	10.1	19.0
HSB (CBB)	11.0	8.8	5.1	2.7	6.3	3.4	0.8
Private Banks	-	-	-	-	-	-	21.8

Source: calculated from NBE Annual Report, various issues, and other unpublished sources.

As noted earlier, the interest rate spread for banks is narrow, perhaps too narrow to encourage entry if we consider the high cost of default risk implied by the required high provisions on bad and doubtful loans (100% and 50% respectively), and administrative costs, hence transactions costs of lending, and the non-earning reserve requirements. Such narrow spread, if it were the result of competition, would indicate efficiency of intermediation. However, being the result of *policy limits* and *preceding competition*, this spread may rather hinder competition since it does not give much incentive for new entrants to come in. It may also reduce the willingness of existing banks to attract interest-bearing deposits. It is also likely to hinder growth and branch expansion of existing banks. With this margin, the small banks may find it difficult to raise additional capital through new equity or retained earnings; the potential profits (compared to other sectors) are not attractive for new investors, and for existing bank shareholders to forego dividends in favor of re-investment. The relatively low dividend income tax (10%) and high capital gains tax (30%) may also induce preference for dividends over retention. While it may be argued that the low margin is a good thing as it puts pressure on banks to strive for efficiency (hence consumers may benefit from reduced transactions costs), the extent of underbanking of the economy (and the need to mobilise domestic savings and absence of alternative mechanisms of savings mobilisation such as post office savings facilities) calls for more banks and branches. For example, the population per bank branch is 232,098 (or 4.2 branches per 1 million persons) compared to branches per 10,000 persons of 2.4 in Italy, 6.5 in France and Germany, and 4.3 in Britain (more on this later). In view of this and the limit on the ability of existing banks to grow, allowing participation of foreign banks (through wholly owned bank subsidiaries, bank branches, or partnership with local investors)[50] may be desirable. This is in addition to the usual arguments for foreign banks participation arising from their role in enhancing credibility of reforms and modernisation of the banking system, as sources of additional capital and expertise, and their higher ability to make prudent risk judgement as well as to diversify risk over a wider international portfolio.

T-bill Market

There has been a gradual increase in sales volume of T-bills (from Br 210 million during the first auction to Br 830.5 million in the 82nd auction). However, the bills are mainly absorbed by institutional investors (such as the Pension Fund and the CBE[51])

and public enterprises rather than the private sector; the SSA, lacking alternative interest-bearing assets (CBE and other banks being reluctant to accept huge interest-bearing institutional deposits), and the CBE, with its excess liquidity,[52] have high demand for T-bills (as alternative to excess cash holdings), thereby depressing the auction-based nominal yield. Besides, investing in T-bills involves transaction costs. Hence, savers prefer savings and time deposits. Although some attribute the limited participation in the T-bill market by private institutions and the general public to the high minimum denomination of the T-bills (which was Br 50,000), its reduction to Br 5,000 (effective 26th August 1998) has not resulted in any noticeable change in participation;[53] neither the number nor the nature of participants has changed. The T-bills market thus remained thin and shallow with no participation by the general public (see Gebrehiwot, 1998d for an analysis of the T-bill market).

We now turn to an assessment of the extent of financial deepening and structure of the financial sector.

3. FINANCIAL DEPTH AND STRUCTURE OF THE FINANCIAL SECTOR

There are several indicators of financial sector development used in the literature, which, while individually imperfect, together give a useful picture of financial development. One is the relative size of the formal financial intermediary sector measured by the ratio of liquid liabilities of the financial system to GDP (liquid liabilities being currency outside banks, demand and other interest bearing liabilities of banks and non-bank financial intermediaries- M3 or M2). It indicates the degree to which the formal financial sector mobilises domestic savings. A second indicator is the ratio of stock market capitalisation to GDP (or GNP) which measures stock market development (i.e. relative equity market size): A higher ratio reflects greater financial development since better developed stock markets make it easier for individuals to price and diversify risk, to raise capital, and to take-over poorly managed[54] firms. The number of listed firms, trading volume and market concentration also give useful insights into the level of capital market development. A third measure is the share of private non-bank financial intermediary assets in total financial assets; it measures the importance of non-bank financial institutions that complement commercial banks and often also function as effective substitutes for the commercial banking sector when the latter is suppressed by regulations or taxation. A fourth measure is the degree of government ownership of commercial banks, indicating bank independence (or the lack of it) from government (Demirguc-Kunt and Levine, 1996).

In terms of the first indicator, deposits as ratio of GDP amounted to 29% while the broad money (M2) to GDP ratio was 45% in 1995/96. The latter, while high compared to countries like South Korea and Kenya, is still low compared to some East Asian countries such as Thailand and Malaysia (see Table 6). Size of the financial sector in

terms of its contribution to GDP remained low, reaching 7.2% in 1997/98, its highest ever.

Table 6. Broad Money (M2) as % of GDP - Comparative Data

Country	M2/GDP (%)
Ethiopia	45.0
South Korea	41.0
Kenya	38.0
Zimbabwe	26.0
Nigeria	25.0
Malawi	15.0
Thailand	74.0
Malaysia	85.0

Source: World Development Indicators CD-ROM, World Bank, February 1997.

Until 1994, the formal financial sector consisted of a central bank, three banks, two contractual financial institutions (the EIC and SSA) and about 484 Savings and Credit Co-operatives (SACCs[55]). Recently, financial sector size has increased through both branch expansion of the state-owned financial institutions and emergence of new private ones. Currently, there are eight banks, nine insurance companies and nine microfinancing institutions,[56] in addition to the EIC, SSA, and the SACCs. The emergence of microfinancing institutions, mainly designed to provide rural banking services, is an important step in the direction of financial deepening and, if successful, will fill a large gap in financial intermediation: mobilising small savings of and providing financial services (including interest-bearing financial assets) to the rural population which constitute about 85% of the total; whereas individual savings in rural areas may be small, the aggregate amount that could be mobilised, given the population size, is likely to be large.[57]

Nonetheless, the share of private non-bank financial intermediary assets in total financial assets is generally low. Besides, non-bank financial institutions (such as finance houses, leasing companies, discount houses, and venture capital schemes) as sources of finance to complement (let alone substitute) bank finance, have yet to emerge. Stock and corporate bond markets do not exist. In developed countries institutional investors such as mutual funds (unit trusts) and insurance companies, including private pension funds, are important sources of long-term corporate finance (as well as contributing to corporate governance). In Ethiopia, private pension funds are non-existent. The public pension funds are far from being important sources of investment finance. Although the SSA runs three separate *mandatory*, *contributory* and, *de jure*, *funded* public pension schemes[58] to which both employees and employers contribute, in the first two schemes contributions consistently failed to meet pension payments, forcing the government to adopt a *de facto* pay-as-you-go system (instead of the legislated fund system), paying benefits to civilian and military pensioners out of the national budget (Gebrehiwot, 1991b).[59] Though there are a large number of SACCs, they face legal restrictions on mobilisation of resources as

well as on the use of their funds in that they can only accept deposits (other than the regular contributions) from and lend to their members (and are subjected to reserve requirements), hence, do not serve as alternative sources of firm credit. However, since their funds are deposited in banks they are available for bank lending to firms, although this potentially involves a financial layering, hence high intermediation cost.

The structure of the financial sector has been characterised by high concentration in terms of ownership, asset portfolio (i.e. limited diversification across sectors, regions, etc.) as well as institutional, sectoral and geographic distribution of intermediation activities. All financial institutions except the SACCs (which hold just less than 1% of the sector's assets and lend only to their members) were state-owned, and had a common board. Although state ownership has continued, direct government control over them has been reduced considerably not just because they have autonomy but, more importantly, because *legislative* limits have been imposed on bank loans to the government). Banks dominated in the financial sector, accounting for more than 93% of net assets during 1986-1990. Within banks, two banks, the NBE and CBE, between them accounted for more than 71% of net bank assets. CBE and AIDB were the most important channels for bank loans, their share reaching 89% of non-central bank lending.

Another feature of the Ethiopian banking system is geographic concentration of services. For example, according to the World Bank (1991), about 80% of CBE and AIDB loans and 91% of HSB loans were in Addis Ababa, which is residence for only 5% of the population. There was no policy requiring banks to plough back a certain percentage of the mobilised deposits in the same area, to prevent the siphoning out of resources from rural and semi-urban areas for lending in major urban centres.

Financial deepening as measured by bank branch density, although still shallow, has increased recently. The population per branch, which was 276,923 persons (or 3.6 branches per 1 million population) in 1990, fell to 232,098 (or 4.2 branches per million) in 1997 (The figure will obviously be smaller if the microfinancing institutions are included, for which we have no information on number of branches.). Comparing this with the number of bank branches per 10,000 inhabitants of 2.4 in Italy, 6.5 in France and Germany, and 4.3 in Britain suggests the extent of under-banking. It should also be noted that most of the bank branches are concentrated in urban areas (see Annex 2) while a large majority of the population lives in rural areas with little or no modern transport link with the urban areas. Moreover, some of the branches provide very basic services only.

In summary, priority access to cheap credit by the public sector has been eliminated; limits on bank loans to the government imposed; private sector discrimination in credit removed; interest rates liberalised (i.e. administrative fixing of interest rates abolished and nominal rates increased); state-owned banks (and enterprises) restructured, made autonomous and use commercial criteria; private sector entry into banking permitted; and generous investment incentives introduced. However, there exist

some regulatory gaps with respect to ownership concentration, inter-locking, transactions with related parties, etc. Despite the emergence of a number of private banks, the state-owned banks remain dominant in terms of both assets and market share partly because the private banks are small.

Notes

[1] Following the mass movement of February 1974, the Co-ordinating Committee of the Armed Forces, the *Derg*, formed on 27 June 1974, declaring "*Ethiopia Tikdem*" (Ethiopia First) as its motto in July 1974, usurped power on September 12, 1974, establishing the Provisional Military Government of Ethiopia, PMGE.

2 However, this motto was quickly interpreted by some political organizations and activists as an indication of the fascist nature of the Derg government, drawing an analogy with the motto used by Mussolini, *Italia Grande*.

3 The nationalized private banks are the Addis Ababa Bank S. C. (60% domestic owned) and two fully foreign owned banks, namely Banco di Roma (Ethiopia) S. C., and Banco di Napoli (Ethiopia) S. C. The three were consolidated to form the Addis Bank (Proc. No. 69/1975), which itself was later merged with the CBE (Proc. No. 184/1980).

4 The state-owned banks were NBE, CBE, Development Bank of Ethiopia, Ethiopian Investment Corporation, Savings and Mortgage Corporation of Ethiopia S. C., and Imperial Savings and Home Ownership Public Association.

5 MIGA is an agency established on April 12, 1988 as an affiliate of the World Bank Group to provide international investors guarantee against risks such as currency transfer, expropriation, war and civil disturbance and breach of contract of the host government; and to provide advisory services to its member developing countries on means to improve their attractiveness to foreign investors.

6 Total assets of SACCs in 1990 were Br 90 million.

7 AIDB was re-established in 1979 by reorganizing the Agricultural and Industrial Development Bank S. C. (Proc. no. 158/1979).

8 HSB was created by merging the Savings and Mortgage Corporation of Ethiopia S. C. and the Imperial Savings and Home Ownership Public Association (Proc. no. 60/1975).

9 CBE was created in 1963 as a result of the division of the State Bank of Ethiopia, which has been discharging both central bank and commercial bank functions since its establishment in 1942. Accordingly, the National Bank of Ethiopia was created to do central banking functions and the CBE to do commercial banking business (Proc. No. 207/1963).

10 These restrictions meant that public enterprises lacked liquid asset management options.

11 EIC was established in 1975 by consolidating all existing insurance companies, almost all foreign owned, which were nationalized (Proc. No. 68/1975).

12 Informal or less formal traditional ones like Iddir exist in large numbers.

13 For Financial Institutions and Government Owned Undertakings 1%; Private Organizations, Urban Dwellers Associations, other Mass Organizations and Professional Associations 4-5.5%; and Individuals, Savings and Credit Cooperatives, Idir, Ikub 6-7.5% (NBE 1986a).

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39 While it is not clear whether and to what extent economic agents in Ethiopia use inflation hedging, that inflation has been consistently low (in 1995/96 and 1996/97 in particular) may also have reduced the need for inflation hedges, thereby encouraging a switch out of hedge assets into interest-bearing assets.

40 Whereas repatriation of flight capital is, theoretically, another possible source of growth in deposits, to the best of the author's knowledge there is no systematic study showing whether capital flight of any significance took place in Ethiopia during the period of repression and of any capital repatriation following liberalisation.

41 The shrink in the share of the interest-free demand deposits plus the floor on deposit interest rates have implications on banks' cost of funds which, together with the required high provisions on bad and doubtful loans, increases total costs (more so for the state-owned banks given that loans granted before liberalisation but not yet matured earn the low rates of the repression period, and the substantial rise in wages and salaries). This in turn, together with the ceiling on lending rates, has implications on profits, hence viability, of banks, and, consequently, the health of the banking system. While an investigation of this is beyond the scope of this paper, it is certainly an issue that needs to be addressed in future research.

42 The required reserve ratios were 10% of demand deposits and 5% of savings and time deposits until 1986 when a lower and consolidated ratio of 5% of total deposits was introduced by the Credit Regulation - NBE/CR/2 Reserve Requirement in May 1986. Only the CBE was subject to the statutory reserve and liquidity requirements (i.e. liquid assets equal to 20% of its short-term liabilities were required in addition to the reserves of 5% of its total deposits as non-earning deposits with the NBE) until 1994 (Supervisory Regulation - NBE/SU/1 Liquidity Requirement, May 12, 1986); the liquidity ratio has been reduced to 15%. It should be noted though that the excess reserves of the CBE were being on-lent by the central bank, the NBE, to the former AIDB.

43 The reserve requirement for the CBE was increased to 8% effective 19th December 1995. For private banks the reserve and liquidity requirements were lower; 5% and 15% respectively of demand, saving and time deposits and similar liabilities with one month maturity (NBE- SBB/ 5/1995; NBE- SBB/ 6/1995).

44 Short-time liabilities are defined as all liabilities payable in one year including demand, savings and time deposits.

45 In some cases *temporary* high or excess liquidity may be observed which may result from a deliberate decision by a bank facing high non-performing loans (or a requirement by the regulating body) to slowdown new lending until the situation is rectified.

46 Shares in loans and advances disbursed are more appropriate than shares in outstanding credit because the latter, being stocks, include bank loans extended to public enterprises, coops and the central government during the socialist period that are not fully repaid (i.e. partly reflect past credit policy).

47 To engage in long-term insurance business only the capital requirement is Br 4 million while for general insurance it is Br 3 million.

48 Most of the observed decrease in CBE's share in total time deposits resulted from the large time deposits by the Social Security Authority (SSA) with the DBE and CBB which increased the latter's share considerably.

49 Given that reserve requirements are non-interest earning (at least to the extent that the requirement is not met using T-bills), a higher reserve requirement increases the cost of funds to a bank.

50 The main reason for not allowing foreign banks has been the absence of regulatory and supervisory capacity that can cope with foreign banks given their sophisticated technology (a legitimate fear in view of the frequent occurrence of large scale financial scandals and fraud, even in countries with fairly developed regulatory and supervisory capacity, and financial crisis), although, as would be expected, the domestic private banks often put forward the old infant industry protection argument against allowing wholly-owned foreign banks and bank branches, especially into the short-term lending business, while welcoming their participation in partnership with them. Another argument emphasizes the *strategic* nature of the banking industry, hence the need to retain domestic control so as to use financial resources domestically to promote development (whereas foreign banks' credit allocation is guided by their international, as opposed to local, opportunities and strategies) which requires indigenous development of enterprises and institutions (including banks). There are also other arguments for being cautious in allowing foreign banks discussion of which is beyond the scope of this paper. See Stiglitz (1994) for this.

51 Other institutional investors in T-bills include EEPCO (Ethiopian Electricity and Power Corporation), Maritime, and EIC (Ethiopian Insurance Corporation), and Awash International Bank (AIB). Recently, participation by non-bank institutions and private organisations has increased.

52 Since T-bills are among the assets that are accepted by the NBE as liquid assets for the purpose of bank liquidity requirements, they offer banks the opportunity to meet this requirement while at the same time getting a return, albeit small, rather than holding idle cash balances.

53 However, reducing the minimum denomination has both direct and indirect effects of participation which work in opposite directions, and the net effect depends on which of the two dominates; the direct effect (which is positive) is that smaller denomination means that T-bills become within the reach of small savers. The indirect effect arises from the fact that, given the supply of T-bills, which currently depends on the financing needs of the government (rather than as a monetary policy tool), the increase in participation, i.e. higher demand for T-bills, will reduce the yield on T-bills by raising the offer price, (making it less attractive relative to interest-bearing bank deposits) which in turn discourages participation. What incentives do savers have to hold T-bills whose yields are far lower than the return on deposits (even taking safety considerations into account), which involve transaction costs (e.g. bid documentation, including a bid bond equal to 5% of the amount demanded, and redemption process), which are not always available (auctions are held fortnightly), and which are relatively illiquid (T-bills have to be held until the redemption period since there is no secondary market) when they can hold bank deposits with a guaranteed minimum interest of 6%, and which are more convenient (just going to the nearest bank branch) and relatively liquid?

54 Recent empirical evidence, however, indicates that poorly performing firms are not the typical targets of hostile takeovers (see Mayer, 1997).

55 Most of the SACCs are owned by public sector employees partly because the legislation which provided the legal framework during the Derg period, the Co-operative Societies Proclamation No. 138/1978, provides for SACCs to be formed by "individuals working in one undertaking or office" while there were no private enterprises with employees large enough to form SACCs.

56 Considering those registered with the NBE.

57 A quick arithmetic gives us an idea about the potential: with 85% of the 56.4 million Ethiopians living in rural areas, under the conservative and simplistic assumption of an annual average saving of Br 20 per person, close to one billion Br of savings a year could be mobilized. The existence of rural savings which can be mobilized through *appropriate* financial markets has been well documented in the rural finance literature (see Kehnert and Von Pischke 1982; Meyer 1987), which also finds some evidence that the marginal propensity to save in rural areas is higher than usually assumed, even higher than in urban areas (see Alamir 1974; Williamson 1968).

58 These are the Public Service Civilian Pensions Fund, the Public Service Military Pensions Fund and the Pensions Fund for Employees of (government-owned) Undertakings.

59 One major recent step is the finalisation of preparations for the conduct of an actuarial study by an international expert. Currently, SSA faces limited opportunities to invest even the limited funds it has (not more than 1 billion) due to absence of long maturity non-deposit financial assets and the reluctance on the part of banks, CBE in particular, given their excess liquidity, to accept large interest-bearing deposits, forcing it to regularly participate in the T-bills market despite the low yields. A large proportion (about 46%) of its total funds are held as time deposits with DBE and CBB, the rest invested in government bonds and T-bills.

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Notes

[1] Following the mass movement of February 1974, the Co-ordinating Committee of the Armed Forces, the *Derg*, formed on 27 June 1974, declaring "*Ethiopia Tikdem*" (Ethiopia First) as its motto in July 1974, usurped power on September 12, 1974, establishing the Provisional Military Government of Ethiopia, PMGE.

2 However, this motto was quickly interpreted by some political organizations and activists as an indication of the fascist nature of the Derg government, drawing an analogy with the motto used by Mussolini, *Italia Grande*.

3 The nationalized private banks are the Addis Ababa Bank S. C. (60% domestic owned) and two fully foreign owned banks, namely Banco di Roma (Ethiopia) S. C., and Banco di Napoli (Ethiopia) S. C. The three were consolidated to form the Addis Bank (Proc. No. 69/1975), which itself was later merged with the CBE (Proc. No. 184/1980).

4 The state-owned banks were NBE, CBE, Development Bank of Ethiopia, Ethiopian Investment Corporation, Savings and Mortgage Corporation of Ethiopia S. C., and Imperial Savings and Home Ownership Public Association.

5 MIGA is an agency established on April 12, 1988 as an affiliate of the World Bank Group to provide international investors guarantee against risks such as currency transfer, expropriation, war and civil disturbance and breach of contract of the host government; and to provide advisory services to its member developing countries on means to improve their attractiveness to foreign investors.

6 Total assets of SACCs in 1990 were Br 90 million.

7 AIDB was re-established in 1979 by reorganizing the Agricultural and Industrial Development Bank S. C. (Proc. no. 158/1979).

8 HSB was created by merging the Savings and Mortgage Corporation of Ethiopia S. C. and the Imperial Savings and Home Ownership Public Association (Proc. no. 60/1975).

9 CBE was created in 1963 as a result of the division of the State Bank of Ethiopia, which has been discharging both central bank and commercial bank functions since its establishment in 1942. Accordingly, the National Bank of Ethiopia was created to do central banking functions and the CBE to do commercial banking business (Proc. No. 207/1963).

10 These restrictions meant that public enterprises lacked liquid asset management options.

11 EIC was established in 1975 by consolidating all existing insurance companies, almost all foreign owned, which were nationalized (Proc. No. 68/1975).

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38 One problem with the limit on exposure to a single borrower to 10% of bank's net-worth is that it puts a limit on the ability of small banks, including most of the new private banks, to serve large corporate customers as far as their capital remains small.

39 While it is not clear whether and to what extent economic agents in Ethiopia use inflation hedging, that inflation has been consistently low (in 1995/96 and 1996/97 in particular) may also have reduced the need for inflation hedges, thereby encouraging a switch out of hedge assets into interest-bearing assets.

40 Whereas repatriation of flight capital is, theoretically, another possible source of growth in deposits, to the best of the author's knowledge there is no systematic study showing whether capital flight of any significance took place in Ethiopia during the period of repression and of any capital repatriation following liberalisation.

41 The shrink in the share of the interest-free demand deposits plus the floor on deposit interest rates have implications on banks' cost of funds which, together with the required high provisions on bad and doubtful loans, increases total costs (more so for the state-owned banks given that loans granted before liberalisation but not yet matured earn the low rates of the repression period, and the substantial rise in wages and salaries). This in turn, together with the ceiling on lending rates, has implications on profits, hence viability, of banks, and, consequently, the health of the banking system. While an investigation of this is beyond the scope of this paper, it is certainly an issue that needs to be addressed in future research.

42 The required reserve ratios were 10% of demand deposits and 5% of savings and time deposits until 1986 when a lower and consolidated ratio of 5% of total deposits was introduced by the Credit Regulation - NBE/CR/2 Reserve Requirement in May 1986. Only the CBE was subject to the statutory reserve and liquidity requirements (i.e. liquid assets equal to 20% of its short-term liabilities were required in addition to the reserves of 5% of its total deposits as non-earning deposits with the NBE) until 1994 (Supervisory Regulation - NBE/SU/1 Liquidity Requirement, May 12, 1986); the liquidity ratio has been reduced to 15%. It should be noted though that the excess reserves of the CBE were being on-lent by the central bank, the NBE, to the former AIDB.

43 The reserve requirement for the CBE was increased to 8% effective 19th December 1995. For private banks the reserve and liquidity requirements were lower; 5% and 15% respectively of demand, saving and time deposits and similar liabilities with one month maturity (NBE- SBB/ 5/1995; NBE- SBB/ 6/1995).

44 Short-time liabilities are defined as all liabilities payable in one year including demand, savings and time deposits.

45 In some cases *temporary* high or excess liquidity may be observed which may result from a deliberate decision by a bank facing high non-performing loans (or a requirement by the regulating body) to slowdown new lending until the situation is rectified.

46 Shares in loans and advances disbursed are more appropriate than shares in outstanding credit because the latter, being stocks, include bank loans extended to public enterprises, coops and the central government during the socialist period that are not fully repaid (i.e. partly reflect past credit policy).

47 To engage in long-term insurance business only the capital requirement is Br 4 million while for general insurance it is Br 3 million.

48 Most of the observed decrease in CBE's share in total time deposits resulted from the large time deposits by the Social Security Authority (SSA) with the DBE and CBB which increased the latter's share considerably.

49 Given that reserve requirements are non-interest earning (at least to the extent that the requirement is not met using T-bills), a higher reserve requirement increases the cost of funds to a bank.

50 The main reason for not allowing foreign banks has been the absence of regulatory and supervisory capacity that can cope with foreign banks given their sophisticated technology (a legitimate fear in view of the frequent occurrence of large scale financial scandals and fraud, even in countries with fairly developed regulatory and supervisory capacity, and financial crisis), although, as would be expected, the domestic private banks often put forward the old infant industry protection argument against allowing wholly-owned foreign banks and bank branches, especially into the short-term lending business, while welcoming their participation in partnership with them. Another argument emphasizes the *strategic* nature of the banking industry, hence the need to retain domestic control so as to use financial resources domestically to promote development (whereas foreign banks' credit allocation is guided by their international, as opposed to local, opportunities and strategies) which requires indigenous development of enterprises and institutions (including banks). There are also other arguments for being cautious in allowing foreign banks discussion of which is beyond the scope of this paper. See Stiglitz (1994) for this.

51 Other institutional investors in T-bills include EEPCO (Ethiopian Electricity and Power Corporation), Maritime, and EIC (Ethiopian Insurance Corporation), and Awash International Bank (AIB). Recently, participation by non-bank institutions and private organisations has increased.

52 Since T-bills are among the assets that are accepted by the NBE as liquid assets for the purpose of bank liquidity requirements, they offer banks the opportunity to meet this requirement while at the same time getting a return, albeit small, rather than holding idle cash balances.

53 However, reducing the minimum denomination has both direct and indirect effects of participation which work in opposite directions, and the net effect depends on which of the two dominates; the direct effect (which is positive) is that smaller denomination means that T-bills become within the reach of small savers. The indirect effect arises from the fact that, given the supply of T-bills, which currently depends on the financing needs of the government (rather than as a monetary policy tool), the increase in participation, i.e. higher demand for T-bills, will reduce the yield on T-bills by raising the offer price, (making it less attractive relative to interest-bearing bank deposits) which in turn discourages participation. What incentives do savers have to hold T-bills whose yields are far lower than the return on deposits (even taking safety considerations into account), which involve transaction costs (e.g. bid documentation, including a bid bond equal to 5% of the amount demanded, and redemption process), which are not always available (auctions are held fortnightly), and which are relatively illiquid (T-bills have to be held until the redemption period since there is no secondary market) when they can hold bank deposits with a guaranteed minimum interest of 6%, and which are more convenient (just going to the nearest bank branch) and relatively liquid?

54 Recent empirical evidence, however, indicates that poorly performing firms are not the typical targets of hostile takeovers (see Mayer, 1997).

55 Most of the SACCs are owned by public sector employees partly because the legislation which provided the legal framework during the Derg period, the Co-operative Societies Proclamation No. 138/1978, provides for SACCs to be formed by "individuals working in one undertaking or office" while there were no private enterprises with employees large enough to form SACCs.

56 Considering those registered with the NBE.

57 A quick arithmetic gives us an idea about the potential: with 85% of the 56.4 million Ethiopians living in rural areas, under the conservative and simplistic assumption of an annual average saving of Br 20 per person, close to one billion Br of savings a year could be mobilized. The existence of rural savings which can be mobilized through *appropriate* financial markets has been well documented in the rural finance literature (see Kehnert and Von Pischke 1982; Meyer 1987), which also finds some evidence that the marginal propensity to save in rural areas is higher than usually assumed, even higher than in urban areas (see Alamir 1974; Williamson 1968).

58 These are the Public Service Civilian Pensions Fund, the Public Service Military Pensions Fund and the Pensions Fund for Employees of (government-owned) Undertakings.

59 One major recent step is the finalisation of preparations for the conduct of an actuarial study by an international expert. Currently, SSA faces limited opportunities to invest even the limited funds it has (not more than 1 billion) due to absence of long maturity non-deposit financial assets and the reluctance on the part of banks, CBE in particular, given their excess liquidity, to accept large interest-bearing deposits, forcing it to regularly participate in the T-bills market despite the low yields. A large proportion (about 46%) of its total funds are held as time deposits with DBE and CBB, the rest invested in government bonds and T-bills.

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Annex 1. Percent Growth Rate

year	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95
Narrow Money				9.7	6.7	19.5	22.9	11.6	10.8	10.5	18.5
- currency outs.	5.9	17.2	9.5	9.5	14.3	25.4	39.6	13.0	13.1	5.6	13.1
net demand dep.	21.6	19.1	14.6	10.0	-0.5	13.1	2.7	9.3	11.8	13.7	26.5
Quasi-money	13.8	15.6	8.1	6.6	15.3	12.3	6.3	18.5	18.8	26.2	39.1
- saving dep.	13.3	15.5	12.2	14.7	13.2	15.2	6.5	19.	22.9	15.7	28.3
- time dep.	19.9	-4.3	-41.9	-30.0	36.7	-12.5	4.7	10.5	102.2	23.3	61.9
Broad money				8.9	8.9	17.6	18.7	13.2	12.7	14.4	24.2
Tot. dep	19.5	20.1	5.1	7.3	6.6	12.9	9.2	13.6	20.7	19.0	26.6

Source: calculated from NBE Annual Report, and Quarterly Bulletin, various issues.

Annex 2. Percent Distribution of Bank Branches by Location

Bank	Addis Ababa	other Areas
Commercial Bank of Ethiopia (CBE)	19.4% (33)	80.6% (137)
Construction and Business Bank (CBB)	25.0% (5)	75.0% (15)
Development Bank of Ethiopia (DBE)	5.3% (1)	94.7% (18)
Awash International Bank S. C. (AIB)	63.6% (7)	36.4% (4)
Dashen Bank S. C. (DB)	38.5% (5)	61.5% (8)
Bank of Abyssinia	100% (2)	0.0% (0)
Wegagen Bank S. C.	25% (2)	75.0% (6)
Total	**22.6% (55)**	**77.4% (188)**

Source: National Bank of Ethiopia.
▲ figures in parenthesis are number of branches.

Annex 3. Consolidated Public Sector Deficit as Percent of GDP (A) Sub-Saharan Countries

Country	Percent (period)
Burkino Faso	4.0 (1984-89)
Cote d'Ivoire	8.5 (1981-89)
Ethiopia	15.0 (1981-90)
Ghana	1.05 (1981-88)
Kenya	5.6 (1981-90)
Malawi	5.5 (1981-89)
Nigeria	6.0 (1981-90)
Sierra Leone	7.9 (1981-90)
Zaire	3.3 (1981-89)
Zambia	13.9 (1981-90)
Zimbabwe *	12.4 (1981-90)
Average	7.6

Source: Calculated from Easterly, et al (1994), Table A1, pp. 530-531.
* We could not find such data for the other Sub-Saharan African countries.

(B) Low income countries

Country	Percent (period)
Burkino Faso	4.0 (1984-89)
Ethiopia	15.0 (1981-90)
Ghana	1.05 (1981-88)
Kenya	5.6 (1981-90)
Malawi	5.5 (1981-89)
Nigeria	6.0 (1981-90)
Sierra Leone	7.9 (1981-90)
Zaire	3.3 (1981-89)
Zambia	13.9 (1981-90)
Indonesia	1.93 (1981-90)
Bangladesh	10.0 (1981-90)
Pakistan	6.7 (1981-90)
Sri Lanka	10.34 (1981-90)
Honduras	8.59 (1981-90)
average (only for those with data)	7.13

Source: Calculated from Easterly, et al (1994), Table A1, pp. 530-531.
* We could not find such data for the other low-income countries.