Adverse selection and moral hazard in group-based lending

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Chapter 3 Eritrean Financial Institutions

3.1 Introduction

This chapter investigates the Eritrean financial intermediaries. The aim is to see whether these institutions have the necessary competence and facilities to perform the role of facilitating Eritrean economic growth.

Eritrea became independent from Ethiopia in the recent past (in 1993) and has inherited an obsolete monetary and financial system. Obviously, the time-span during which we investigate the impact of the financial system on Eritrean economy is short. Nevertheless, we feel that looking at the policy of these institutions and at how they are doing in promoting the credit needs of the Eritrean poor will help us understand the limitations of the sector.

Contemporary Eritrean formal financial sector can be characterized as small, state-owned, underdeveloped and providing rudimentary banking and other financial services to the economy. The majority of the Eritrean poor does not have any access to these institutions. This is because the Eritrean poor are unable to provide collateral, they have no documented credit history from the formal financial sector and they lack accounting records. Moreover, the Eritrean informal financial market cannot meet the credit needs of the poor because of the sectors inherent limitations.

It seemed that the government of Eritrea recognized the shortcomings of the Eritrean financial sector and therefore they launched microfinance programs early on, which provide financial services to the poor. It is behind this background that the microfinance institutions have started to become active in Eritrea.

This chapter is divided into three sections. Section 3.2 deals with the historical development of the banking system in Eritrea; section 3.3 provides a comparative overview of the Eritrean formal financial sector; and section 3.4 describes the Eritrean formal financial institutions. This section also introduces the types of banks in Eritrea. Section 3.5 briefly describes the informal credit sector, and section 3.6 concludes.

3.2 Historical development of the banking system in Eritrea

The formal financial sector, especially the banking business in Eritrea, emerged with the rise of the Italian colonial rule. In 1920 some Italian private banks, such as Banco di Napoli, Banco Nazionale del Lavoro, Banco di Italia, and Banco di Roma, were operating in Eritrea. Unfortunately, the formal financial sector was not developed further during the British military administration and thereafter. In 1941, with the coming of the British military administration Banco Nazionale Del Lavoro and Banco di Italia were closed, and Barclay Bank opened a branch in Eritrea. Both this bank and the East African Shilling, the currency that was introduced by the British administration, survived until 1952.

With the emergence of the political federation of Eritrea with Ethiopia in 1952, the State Bank of Ethiopia opened branch offices in Eritrea. Until the end of 1962, the bank acted as a central bank and it played the supervisory role for the other financial institutions in Ethiopia and Eritrea; at the same time it was involved in commercial banking activities. From the beginning of 1963, a new banking law issued by Ethiopian authorities split the functions of the State Bank of Ethiopia into two separated entities. The new National Bank of Ethiopia played the role of central bank, and the Commercial Bank of Ethiopia dealt with commercial activities. Simultaneously, the 1963 banking law made it possible for other commercial banks to work in Ethiopia. The biggest of these was the Addis Abeba Bank, which opened branches in Eritrea. During the early 1950s and the late 1960s, there was an economic boost in Eritrea. A lot of small firms that produced consumer goods started to emerge and flourished. A stock market was established and banks facilitated share-dealing activities, both as dealers and as providers of funds for share purchases.

The Agricultural and Industrial Development Bank (AIDB) was set up in 1970, replacing two development banks, which were active in Ethiopia since the 1960s. AIDB provided short-, medium- and long-term loans to the agricultural and industrial sector. The bank also opened branches in Eritrea.

Thus, before the fall of the imperial government of Ethiopia in 1974, Eritrea had four branches of commercial banks, namely Banco di Roma, Banco di Napoli, Addis Abeba Bank, and Commercial Bank of Ethiopia. In addition to this, there were branches of the Central Bank of Ethiopia, AIDB, and several small mortgaging and insurance companies.

The fall of the imperial government led to a major change in Ethiopian economic policy. The new military government declared Ethiopia a socialist state. The nationalization of all large corporations was one of the instruments to establish this centralized control.[1] As far as ownership of financial institutions was concerned, there were hardly any important changes, since the existing private commercial banks[2] were relatively small. They were nationalized and merged into the Commercial Bank of Ethiopia. The new Ethiopian government merely shifted from owning *most* of the banking system to owning it *completely*.

The Housing and Saving Bank (HSB) was created in 1975 after a merger between two small mortgaging companies established in 1962.

Nationalization also took place in the insurance industry, leading to the amalgamation of the subsector into the Ethiopian Insurance Corporation. The AIDB continued without having changed much. The practice of banking did change fundamentally though. The state-owned public enterprises became the larger customers of the banks and the banks were instructed to lend to them in support of the government's development plans.

[1] The Derg (the then military government, 1974-1991) nationalized practically all economic activities and subsequently introduced a central planning system to run the economy.
[2] The nationalized banks were Banco di Roma, Banco di Napoli, Addis Abeba Bank, and AIDB, and all mortgage banks and insurance companies.

Summarizing, with the arrival of the military government banks were merged into four specialized nationwide banks: commercial (Commercial Bank of Ethiopia), mortgage (Housing and Saving Bank), insurance (Ethiopian Insurance corporation), and development banking (AIDB).

Until 1991, the formal financial sector in Eritrea consisted of branches of the consolidated state-owned financial institutions mentioned above. Independent Eritrea inherited a financial sector that was solely geared to serve a centrally planned economy, which is characterized by extensive interest rate controls, centralized decision making (in which the provincial branches had an implementation role only), and bureaucratic interference guided by socialist ideology. Banks' lending policies were especially guided by national objectives.

The financial institutions Eritrea inherited from the Ethiopian occupation were the Ethiopian National Bank, the Commercial Bank of Ethiopia, the Agricultural and Industrial Development Bank, the Housing and Saving Bank, and the Ethiopian Insurance Corporation. In the past ten years the government of Eritrea has tried to revitalize and restructure the formal financial sector in line with its liberal economic policy. This liberal economic policy was manifested in the 1994 macro-economic policy issued by the government (GOE, 1994). Among other things, the macro-economic policy aims at the establishment of an efficient, outward-looking, private sector-led market economy, with the government playing a proactive role to stimulate private economic activities.

At present, the financial sector of Eritrea has a central bank, Bank of Eritrea (BOE); and two commercial banks, i.e. the Commercial Bank of Eritrea (CBE) and the Housing and Commerce Bank of Eritrea (HCBE). Also, it has one development bank, the Eritrean Development and Investment Bank (EDIB), and one insurance company, the National Insurance Corporation of Eritrea (NICE). With the exception of HCBE the government owns all financial institutions. From 1998 the government issued licenses to firms to set up foreign exchange bureaus. The main function of these bureaus is to purchase and sell foreign currencies.

Although the BOE enacted a comprehensive Bank and Financial Institutions Act, which in principle permits the licensing of private financial institutions, including the establishment of foreign banks, up till now no other local or foreign private financial institution has been allowed to work in Eritrea (with the exception of the foreign exchange bureaus).

3.3 A comparative overview of the Eritrean formal financial institutions

As discussed in chapter 2, the existence of developed financial intermediaries may help economies to show sustained economic growth and development. In this subsection, we discuss the position of the Eritrean financial sector and its performance in relation to financial institutions of other developing and developed countries.

We use a measure to calculate the size of the financial intermediaries; this measure is equal to the liquid liabilities of the financial system (M2) divided by GDP. M2 consists of the amount of currency in circulation plus demand, time and saving deposits held by the public at the central bank and commercial banks. A higher ratio indicates that the country's financial sector is more developed, larger in size and that it provides more financial services to the economy (King and Levine, 1993).

Table 3-1 presents the M2 to GDP ratio of some developing and developed countries for the 1993-1998 period. The table shows that the ratio for Eritrea is very low, indicating that the country's financial sector is still at its infancy stage. This means that the financial sector is still small and that financial intermediation and provision of services is underdeveloped.

Similarly, we can also examine the level of financial development of a country by measuring the amount of credit allocated to the private sector and is equal to the ratio of loans to the private enterprises to total domestic loans issued. The allocation of financial resources to the private sector may be highly related to the provision of services of the financial intermediaries. Financial institutions that simply forward financial resources to the public sector will not be able to play an intermediating role (King, and Levine, 1993, Levine 1997).

Table 3-1 M2 to GDP ratios of various countries, 1993-1998

		1993	1994	1995	1996	1997	1998
1	AUSTRALIA	0.57	0.60	0.60	0.64	0.64	0.67
2	USA	0.60	0.57	0.57	0.58	0.58	0.60
3.	KOREA	0.40	0.41	0.41	0.43	0.45	0.48
4.	ITALY	0.54	0.51	0.47	0.45	0.47	0.47
5.	SWEDEN	0.49	0.45	0.43	0.46	0.46	0.45
6.	CHILE	0.40	0.37	0.39	0.39	0.40	0.42
7.	BRAZIL	0.73	0.38	0.28	0.24	0.28	0.28
8.	TOGO	0.32	0.30	0.36	0.25	0.23	0.24
9.	SENEGAL	0.22	0.23	0.22	0.24	0.23	0.23
10.	ETHIOPIA	0.28	0.32	0.28	0.25	0.25	0.21
11.	TANZANIA	0.24	0.25	0.25	0.22	0.20	0.18
12.	GHANA	0.17	0.19	0.18	0.16	0.19	N/A
13.	NIGERIA	0.21	0.22	0.16	0.13	0.15	0.18
14.	MALAWI	0.22	0.26	0.19	0.16	0.14	0.17
15.	KENYA	0.17	0.16	0.15	0.15	0.14	0.13
16.	CAMEROON	0.17	0.18	0.15	0.12	0.13	0.13
17.	SUDAN	0.12	0.24	0.14	0.11	0.10	N/A
18.	ERITREA	0.02	0.01	0.01	0.01	0.01	0.01

Source: IMF (2000)

Table 3-2 presents the ratio of a number of developed and less developed countries. Countries that have developed financial intermediaries are expected to have a higher ratio. As expected, this ratio is low for Eritrea. The two Eritrean commercial banks forward a large part of their assets to the public sector (IMF, 2000) in the form of loans. Whether this is a sign of government sponsored financial repression or whether it means that the banks are concentrating their business on the public sector because of other reasons needs to be further investigated. Yet, as we will see later on the CBE is not forwarding its loans to the small business sector because of its conservative credit policies. Similarly, other neighboring countries, like the Sudan, Ethiopia and Tanzania, also show low ratios. This indicates that financial institutions in these countries are not playing the role as efficiently as they should be.

In conclusion, we can say that the Eritrean financial sector is small, underdeveloped and offers only a limited range of financial services to the public (IMF, 2000). The sector is dominated by three commercial banks.

Table 3-2 Ratio of loans to the private sector to total domestic loans of various countries, 1993-1998

		1993	1994	1995	1996	1997	1998
1.	KOREA	0.98	0.99	0.99	1.00	0.98	0.94
2.	SWITZERLAND	0.92	0.92	0.92	0.91	0.92	0.94
3.	AUSTRALIA	0.87	0.88	0.89	0.88	0.92	0.92
4.	SWEDEN	0.87	0.85	0.87	0.87	0.89	0.88
5.	USA	0.81	0.82	0.83	0.83	0.83	0.85
6.	ARGENTINA	0.70	0.76	0.71	0.71	0.72	0.73
7.	NIGERIA	0.31	0.32	0.42	0.68	0.64	0.71
8.	IVORY COAST	0.62	0.65	0.66	0.65	0.67	0.66
9.	KENYA	0.63	0.54	0.59	0.62	0.64	0.59
10.	BRAZIL	0.55	0.80	0.80	0.70	0.67	0.58
11.	INDIA	0.49	0.51	0.52	52.0	0.53	0.51
12.	MALAWI	0.38	0.43	0.47	0.46	0.46	0.48
13.	ETHIOPIA	0.12	0.16	0.26	0.38	0.44	0.44
14.	NIGER	0.83	0.73	0.51	0.48	0.32	0.44
15.	GHANA	0.23	0.29	0.27	0.33	0.32	0.38
16.	CHAD	0.34	0.30	0.39	0.33	0.32	0.36
17.	TANZANIA	0.33	0.35	0.29	0.20	0.28	0.35
18.	SUDAN	0.21	0.28	0.28	0.32	0.34	0.31
19.	ERITREA	0,39	0.41	0.14	0.29	0.29	0.27

Source: IMF (2000)

3.4 A description of the Eritrean formal financial sector

3.4.1 Bank of Eritrea

When Eritrea became independent, a new central bank, the BOE, was established to replace the former branch office of the Central Bank of Ethiopia. However, until 1997 Eritrea was in a de facto currency union with Ethiopia, which limited its scope for an independent monetary policy. Thus, monetary management by the bank was largely restricted to aspects of interest rate, reserve requirement regulation and banking supervision. In 1997 Eritrea introduced its own currency, the Nakfa, and the BOE became the central bank. The enactment of the BOE's proclamation (GOE, 1997) and financial institutions' proclamation (GOE,

1997) substantially transformed the role of the bank. Immediately after its enactment the bank took steps to improve its regulatory and supervisory capacity. To these ends, the bank imposed regulations on legal reserve requirements and prepared drafts of a number of regulations to establish a money market, including credit facilities and the issuance of treasury bills. Other specific tasks of this central bank include (GOE, 1997):

- to issue, manage and retire the legal tender currency of Eritrea;
- to implement measures designed to influence money supply and credit availability, interest rates and exchange rates;
- to manage and account for the foreign exchange reserves of Eritrea and to issue regulations in respect to foreign exchange;
- to license and supervise financial institutions in Eritrea;
- to act as lender of last resort for depository institutions in Eritrea.

Despite the introduction of the above proclamations and good intentions of the bank management, the bank is not fulfilling its supervisory, regulatory and monitoring role the way it should. A reason for this could be that the bank has been faced with a severe shortage of trained, skilled and experienced permanent staff (Seghid, 2001).

In order to achieve the objective of price stability the bank has a mandate[3] to use three monetary instruments, namely open market operations, the discount rate, and required reserves. The open market operation is not used in Eritrea, because both money and capital markets are non-existent. At the moment, the bank also does not have a discount program. Thus, required reserves are the only tool currently used by the bank. At present the bank demands that commercial banks set aside 20 per cent of their deposits as reserves.

3.4.2 The Commercial Bank of Eritrea

The Commercial Bank of Eritrea is the largest commercial bank in the country, chartered by the government to accomplish a wide range of banking activities that include handling demand, saving and time deposit accounts, and forwarding credit. Moreover, it provides international trade transaction services. At present the bank has 15 branches in major towns throughout the country. The government appoints the board of directors.

Since 1991 the CBE demand deposit account has drastically increased.[4] In 1998 demand deposit account was 58 per cent of total deposits of the bank and the percentage of saving deposit account was 41.5 per cent, while the share of time deposit was only between 0.2 to 1.4 per cent.

The CBE is entrusted with a wide range of financial activities such as stimulating agricultural production; export promotion, rural development and encouraging and financing working capital requirements of the industrial sector. Interest rates on loans and deposits are fixed.[5] Different sectors are charged different interest rates. The current maximum interest rate on loans ranges from 8 to 12 per cent per annum. The current interest rate on saving deposits is 4 per cent, while it ranges from 4 to 6.5 per cent for time deposits.

The loans portfolio, on the other hand, mainly consists of short-term loans, which the bank considers as less risky. As table 3-A1 shows (see the appendix at the end of this chapter), the bank's loans are adapted towards domestic trade and services, and larger state-owned and private manufacturing firms, which are considered to be relatively low-risk customers.

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[3] Proclamation NO. 93/1997 allows the bank to make use of these monetary instruments.

[4] There could be many reasons for this phenomenon. After the independence a lot of people who were living in the Diaspora started to come back with their savings and began to deposit their money with the bank until they invested it in the economy. But the overall reason could be that people who had lost confidence in the Ethiopian government's socialist economic policy and preferred to keep their savings in actual currency might have started to deposit their capital in the CBE after the independence.

[5] The interest rate is fixed and determined by the Bank of Eritrea (Eritrean central bank). In the past ten years there was not much fluctuation in the interest rate offered by the bank.

Collateral requirements for loans by the CBE amount to 100 per cent, thereby limiting the ability of investors to capitalize on business opportunities. Agricultural loans by CBE were about 5 per cent of the total credit in 1993 (World Bank, 1994). The average loan forwarded to the agricultural sector for the last seven years amounts to only 7 per cent and it was available mainly to large commercial farmers.

The CBE does not usually lend to small entrepreneurs, to people in the informal sector and to small-scale farmers, since they are considered to be high-risk borrowers. Moreover, the high cost of borrowing and the difficulties of having appropriate collateral have inhibited these microentrepreneurs from applying for credit at this institution. Indeed, the low productivity and lack of collateral in these subsectors make them not a very appealing client for the CBE.

Although the bank still dominates the banking business in the country with more than 90 per cent of the countries deposits and 80 per cent claims on the private sector, it is not making any profit on its main business (Von Eije et al, 2003). The reason for this is that the bank is suffering from chronic excess liquidity (CBE, 1998). In 1998, only 29 per cent of its deposits was forwarded as loans and advances to costumers. Hence, the bank cannot raise enough income to pay depositors, and its return on assets (ROA) and return on equity (ROE) were only 0.6 and 21 per cent respectively (Haile, 1999). The income of the bank comes from other sources: mainly from foreign currency transactions and banking service charges (CBE, 1998).

3.4.3 Housing and Commerce Bank of Eritrea

The Housing and Commerce Bank of Eritrea is a relatively small bank. Its predecessor was the Housing and Saving Bank of Ethiopia. This was a mortgage bank that forwarded loans for construction purposes only. In 1994, the Housing Bank of Eritrea was established and it took over all the assets and liabilities from the Housing and Saving Bank of Ethiopia. By 1996 the Housing Bank of Eritrea decided to expand its services by transforming itself from a strictly mortgage bank into a fully fledged commercial bank that included all areas of commercial and international banking. It then adopted its present name of Housing and Commerce Bank of Eritrea (HCBE) to reflect the change.

The main objectives and functions of the bank include accepting demand, saving and time deposits; providing long-term loans for construction or for acquiring residential housing, buildings, infrastructure, and community facilities; and providing short-term loans for maintenance, repairs of dwellings, buildings, infrastructures, and community facilities. In addition, as table 3-A2 indicates, the bank is also involved in providing short-term loans to other sectors of the economy. Notwithstanding its claim that it is a full-fledged bank, the bank is still mainly a mortgage bank. As the table indicates the lion's share of the bank's assets consists of loans for construction purposes; other sectors obtain insignificant amounts of money. Like the CBE, HCBE provides loans against collateral. As a result of this collateral-based loan procedure, the majority of poor people, who have no collateral at all, are likely to be excluded from getting loans from this bank.

Table 3-A3 compares the amount of demand saving and time deposits of the two commercial banks. As we observe, the CBE is the dominant bank in terms of deposits and loans in Eritrea.

3.4.4 Eritrean Development and Investment Bank

Before independence there was a branch bank of the Agricultural and Industrial Development Bank (AIDB) in Eritrea. This bank was established in 1970 by the Haile Selasie regime to meet the pressing credit needs of the agricultural and industrial sectors of Ethiopia. The bank was a typical development bank – similar to traditional state-sponsored development banks we used to see in other low-income countries in the late 1960s. It was providing short-, medium- and long-term loans to the agricultural and industrial sectors of Ethiopia (Harvey, 1996). Even though about 63 per cent of the loans distributed during the early 1970s was given to the agricultural sector, state-owned farms, large commercial farmers and some cooperatives were the major beneficiaries (Lele, 1975).

Similarly, in the industrial sector the beneficiaries were the larger private and public firms (Lele, 1975). Almost all beneficiaries of these loans were located in central Ethiopia; regions on periphery were ignored. At the end of the day, the bank was facing a lot of overdue loans from state farms and it was almost paralyzed due to liquidity problems.

After Eritrean independence, the bank was practically inoperative for nearly five years and it was not until 1996 that the government formally established the Eritrean Development and Investment Bank (EDIB) as a successor of AIDB. The main objective of EDIB is to promote and accelerate the country's economic development by providing development finance to viable development-oriented projects in the agricultural, industrial and other sectors of the economy. What makes this bank different from its predecessor is that it is supposed to be a self-supporting bank.[6] The proclamation for its establishment allows it to mobilize savings from national and international sources, either private or public. Thus, it needs no grants and government subsidies. Yet, until the middle of 2003 the bank was not mobilizing savings from the Eritrean households and firms. Table 3-A4 shows the bank's sectoral distribution of loans.

As the bank's directives indicate, it forwards loans only to specific sectors of the economy and does not issue loans for merchandising purposes. Loans are more or less equally disbursed between the agriculture, manufacturing, services and mining-construction sectors. Similar to the other state-owned banks in Eritrea, this bank is also collateral-based. It requires borrowers to present legally registered collateral assets for any type of loan they want to acquire. Even though it is still at its infancy stage, its objectives are oriented towards the credit needs of medium and larges industries and commercial farms rather than microentrepreneurs.

[6] The AIDB was sponsored and financed by the Ethiopian government and other donors.

3.4.5 The Eritrean formal financial sector: concluding remarks

At present, the Eritrean banking sector has strong impediments that have to be resolved in order to make this sector an important factor in stimulating Eritrea's economic development. After the independence of 1991 the Eritrean banking sector inherited an obsolete monetary and financial system from the Ethiopian marxist government. Between 1974 and 1991 the military government of Ethiopia nationalized the banking sector and converted it into an appendage of the state administration. In this system, bankers were transformed into civil servants and bureaucrats, devoid of any sense of customer service and fast and efficient performance (Tsegai, 1999). It is this type of archaic organizational structure and banking behavior the Eritrean banking system is trying to leave behind. Existing banking practices in Eritrea could be characterized as low-technology, semi-manual operations. The conversion from manual to computerized banking operations is at its infant stage, and this is posing the most serious impediment to progress in banking services in Eritrea. Since the sector is not adequately connected to global telecommunications services efforts to computerize it are less valuable (Tsegai, 1999). Thus, the renovation of existing national telecommunication system could positively influence the banking sector in terms of its international banking activities and relations. Still, a lot has to be done before Eritrea will have (realized) modern banking practices.

At present, Eritrea is facing an acute shortage of skilled and professionally trained bankers to meet the growing needs of the economy (Tsegai, 1999). Until recently, there was no Eritrean banking college or other training center to educate skilled bankers. Although nowadays there is one training center that is run by the Ministry of Education, this center still lacks the necessary staff and other important facilities to train competent bankers.

To conclude, the financial sector of Eritrea can be characterized as a system that is still at a lower level of financial intermediation, providing narrow range of both financial institutions and instruments. It is a challenge for the government and the Bank of Eritrea to promote the expansion and diversification of the range of financial assets, and to improve the quality of banking services available in the country.

3.5 The informal financial sector in Eritrea

The Eritrean modern sector is small and restricted to urban centers only. As the majority of its population depends on subsistence agriculture, the lack of significant monetized economic activity has been its defining characteristic. The daily monetized economic activities mainly take place outside the realm of activities of the few financial institutions that are currently available (Tsegai, 1999).

The other financial alternative to the poor is the informal financial sector. Informal credit is widely used in African countries (Aryeetey, 1995). The informal financial sector encompasses all financial transactions that occur beyond the functional scope of various commercial banking and other formal financial institution regulations. People in neighboring countries such as Ethiopia, Kenya and the Sudan have been acquiring large amounts of loans from informal sources (Adugna and Heidhues, 2000; Alila, 1992; Kevane, 1993). Similarly, even though few systematic studies in informal financial markets have been carried out in Eritrea, preliminary evidence suggests that the poor in Eritrea also acquire their loans from informal financial sources (World Bank, 1994). According to this World Bank report there is an informal financial sector in Eritrea that engages in all kinds of credit and saving mechanisms. These informal sources of credit include relatives, friends, local moneylenders, retails and suppliers, and ROSCAs.

Although the role of informal financial markets in the provision of credit to the poor cannot be neglected, informal financial markets are subject to certain limitations. As discussed in chapter 2, informal financial markets are not always good vehicles for long-term investments and do not contribute to the integration of markets in an economy (Tang, 1995).

3.6 Conclusion

As discussed in section 2, theoretical and empirical works have confirmed that the development of the financial sector and economic growth are positively correlated. A country's economic growth and private sector development will depend on the financial sector for the mobilization of savings, capital accumulation, diversification of investment risks, and the monitoring of investment projects (Levine, 1997). To deliver these services satisfactorily, the sector itself must be well developed, competitive, and easily accessible to savers and investors throughout the country. In short, the sector must offer a variety of financial products and posses the required quality and mix of skills to ensure the most efficient ways of utilizing financial resources.

The financial sector of contemporary Eritrea can be characterized as small, state-owned, undeveloped and providing rudimentary banking and other financial services to the economy. Not only are there only five financial institutions in the country and each one of them is located only in Asmara and in a few other major towns. The majority of the poor in rural Eritrea do not have any access to these institutions at all. This is mainly because the poor do not have any collateral to offer and banks prefer handling larger loans to geographically concentrated areas.

It seems that the government of Eritrea has recognized the shortcomings of the Eritrean financial sector. Therefore, it early on initiated pilot projects that provide microfinance to the poor. It is against this background that the MFIs have started to work in Eritrea. The next chapter deals with these two Eritrean MFIs.

APPENDIX: Distribution of loans by Eritrean banks

Table 3-A1 Sectoral distribution of CBE loans, 1996-2002 in millions of Nakfas[#]

Sector	1996	1997	1998	1999	2000	2001	2002	Average
Agriculture	102.73	119.65	137.27	170.82	143.84	157.49	225.16	151.00
	(7.11)	(8.10)	(8.20)	(9.35)	(9.90)	(9.61)	(11.71)	(7.57)
Manufacturing	202.13	332.16	358.22	324.88	289.67	363.67	410.37	325.87
	(14.00)	(22.52)	(21.40)	(17.78)	(19.92)	(22.20)	(21.34)	(16.34)
Domestic trade & services*	719.18	589.21	782.93	984.36	686.80	880.48	986.92	804.27
	(49.79)	(39.95)	(46.75)	(53.88)	(47.24)	(53.72)	(51.32)	(40.32)
Export & import	220.23	244.27	275.94	228.90	246.79	169.57	231.33	231.00
	(15.25)	(16.55)	(16.44)	(12.53)	(16.97)	(10.35)	(12.03)	(11.58)
Building & construction	89.54	104.47	43.97	61.83	46.85	39.19	34.80	420.65
	(6.20)	(7.08)	(2.63)	(3.38)	(3.22)	(2.40)	(1.80)	(21.10)
Personal loans	110.24	85.49	76.74	56.26	39.95	28.23	34.40	61.61
	(7.65)	(5.80)	(4.58)	(3.08)	(2.75)	(1.72)	(1.80)	(3.09)
Total loans	1444.05	1475.05	1675.07	1827.05	1453.9	1638.63	1922.98	1994.4

Source: CBE records on loans and deposits (2003)
Note: number in brackets shows percentage share of a sector
Until to December 1997, in millions of Birr (the official Ethiopian currency)
* Including wholesale and retail trade, hotels and restaurants and transportation and communication

Table 3-A2 Sectoral distributions of HCBE loans, 2001-2002, in millions of Nakfas

	Agriculture	Manufacturing	Domestic trade & services	Export & import	Building & construction	Mortgages	Total loans
2001	0.66	2.90	16.26	9.02	14.79	683.36	726.99
	(0.09)	(0.40)	(2.24)	(1.24)	(2.03))	(94.0)	
2002	0.19	2.99	36.52	14.46	21.70	712.95	788.81
	(0.02)	(0.38)	(4.63)	(1.83)	(2.76)	(90.38)	
Average	0.43	2.95	26.39	11.74	18.25	698.16	757.92
	(0.06)	(0.39)	(3.48)	(1.45)	(2.50)	(92.12)	

Source: HCBE' brochure (2002)
Note: numbers in brackets indicate percentages

Table 3-A3 Depositaccounts of both CBE and HCBE, 1994-1999 in millions of Nakfas

Deposits	1994		1995		1996		1997		1998		1999	
	CBE	HCB	CBE	HCB	CBE	HCB	CBE	HCB	CBE	HCB	CBE	HCB
Demand deposits	1258.4	0.0	1295.8	0.0	1670.9	6.0	1597.9	17.6	1808.7	71.8	2276.6	130.5
	(100)		(100)		(99.6)	(0.4)	(98.9)	(1.1)	(96)	(4)	(94.5)	(5.5)
Saving deposits	1317.9	30.4	1668.3	186.2	1827.4	325.1	2121.1	495.1	2529.4	695.7	2870.8	872.2
	(97.7)	(2.3)	(89.9)	(10.1)	(84.9)	(15.1)	(81.1)	(18.9)	(78.4)	(21.6)	(76.7)	(23.3)
Fixed deposits	318.2	0.0	449.2	31.3	261.3	67.6	186.0	61.5	130.9	31.9	160.5	87.9
	(100)		(93.5)	(7.5)	(79.4)	(20.6)	(75.0)	(25.0)	(80.4)	(19.6)	(64.6)	(35.4)
Foreign deposits	0.0	0.0	0.0	0.0	0.0	0.0	146.7	42.6	141.9	76.3	132.0	97.9
							(77.5)	(22.5)	(65)	(35)	(57.4)	(42.6)
Claims on	328.9	18.5	651	37.8	951.9	85.7	1218.8	261.8	1722.1	351.1	1753.0	417.9
Private sector	94.7	(5.3)	(94.5)	(5.5)	(92)	(8.0)	(82.3)	(17.7)	(83.1)	(16.9)	(80.8)	(19.2)

Source: IMF staff country reports No. 00/55, April 2000
Note: numbers in brackets indicate percentages

Table 3-A4 Sectoral Distribution of EDIB Loans, 2001-2002 in millions of Nakfas

	Agriculture	Manufacturing	Services	Mining & construction	Total
2001	10.03	6.24	6.71	7.96	30.94
	(32.41)	(20.17)	(21.70)	(25.72)	(100)
2002	5.80	13.65	4.04	5.82	29.31
	(20.00)	(46.56)	(13.59)	(19.85)	(100)
Average	7.92	9.96	5.38	6.89	30.15
	(26.27)	(33.04)	(17.84)	(22.85)	

Source: EDIB' brochure (2003)
Note: numbers in brackets show percentage