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Rural financial services and effects of microfinance on agricultural productivity and on poverty

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D9 Rural Financial Services and effects of microfinance on agricultural productivity, and poverty

K.M. Zahidul Islam, Shimelles Tenaw

Abstract:

Access to rural financial services has a potential to make a difference in agricultural productivity, food security, and poverty reduction. However, an efficient, sustainable and widely accessible rural financial system remains as a stumbling block as a major development challenge in most of the developing countries.

This paper assesses the structure of the rural financial services and the role of financial institutions from the view point of their success in improving the rural population's livelihoods in Bangladesh and Ethiopia with emphasis on Amhara National Regional State in north-west part of the country. The aim is to highlight some key-issues which could be drawn to the attention of the Finnish development cooperation authority for possible action and consideration. The paper also highlights the contributions of micro credit and cooperatives to come out of the deeply rooted poverty trap and its significant contribution to agricultural productivity.

Keywords: Rural Financial Services, Microfinance, co-operatives, Agricultural Productivity, Poverty, Bangladesh, Ethiopia

1. Introduction

Rural financial services is about providing financial services- secure savings, credit, financial transactions, money transfer services for remittance and insurance-in rural areas. The ability of rural households to make long term investments to ensure time-patterned income flow is shaped by an economy's financial services. Despite the rapid development of financial services, a majority of smallholders around the world especially third world countries remain without access to financial services that they need to improve their livelihoods. Despite the significant demand for financial services in rural areas, institutions offering financial services-such as banks, credit unions, cooperatives, Microfinance Institutions (MFIs) or insurance companies-are typically reluctant to serve in rural areas due to precarious nature of agricultural production. As a result, the majority of the developing world's resource scarce poor households are bereft of financial access to the formal financial system. Tapped with this lack of access, households, farmers as well as small rural entrepreneurs rely on costly source of accessing financial services especially through informal sources. Most loans from informal sources especially from money lenders are too expensive to be profitable, and debt can lead permanent dependency of borrowers on money lenders and thereby entangle in the vicious cycle of poverty.

Thus the overall financial sector development can be viewed as an important catalyst for economic growth and development for three reasons (Inter-American Development Bank, 2001). First, financial sector development ensures to accelerate the economic growth thorough efficient intermediation and risk management. Countries with developed financial markets with greater financial depth have high economic growth than the countries with less developed financial markets. Second, lack of adequate financial services hinder the formation of new enterprises and the modernization of existing one. Third, improved financial intermediation could directly reduce vulnerability and alleviate poverty. Microfinance as a tool of rural financial services has clear impact on poverty by positively affecting the household economic development, ensuring Income Generating Activities (IGA), sources of income, reducing vulnerability, housing tenure, enterprise growth.

1.1 Rural financial market for growth and poverty alleviation

Rural financial market facilities the economic growth and rural poverty reduction through smooth financial intermediation. Financial intermediaries help to mobilize funds, channel them from surplus units to the deficit units, creates money, and smoothen the payment system. The efficient provision of loans, deposits, payments, and insurance service encourages rural entrepreneurship and help to rural economy to grow (World Bank, 2003). Presence of financial services helps to rural economy to grow and reduce the poverty. Access to working capital can substantially accelerate the adaptation of modern agricultural technologies and production and thereby improving the ability of the rural sector to meet the subsistence need of the poor. It also helps to produce the surplus in primary and intermediary products required for urban consumption, export, and avoid environmental degradation (World Bank, 2003).

1.2 Characteristics of Rural Financial market and constraints:

Many impediments make rural households to access financial services. In general both the users and providers of financial services face some common obstacles in getting and providing financial services like:

1. **High transaction costs:** This is due to the underdevelopment of rural infrastructure, inadequate communication and information technology and the remoteness of the local areas. Moreover, small average loans and small saving further compound this problem of higher transaction costs.
2. **Higher risks:** Credit risk in rural areas are higher since the incomes of the rural households depend and seasonality of agriculture that is being susceptible to natural disasters (such as flood, drought, plant diseases, fluctuating weather). The covariant risk (in prices and yields) is high in the agricultural sector. Rural households mostly depend one or two sources of income and thereby increasing the risks of financial intermediation. Many households are either entirely lack collateral or do not have the legal title to land.
3. **Social Factors:** In most developing countries illiteracy rate is higher especially in rural areas. Poorly educated households find it increasingly difficult to assess the credit risk and profitability of loans and savings. On the other hand, financial institutions willing to work in rural areas may lack motivated and trained staffs to work in rural areas. This leads to poor institutional capacity among rural financial institutions especially in developing countries.

Country-level constraints inhibiting rural financial market include:
(a) unsound macroeconomic management
(b) restrictive agricultural or financial policies (particularly interest rate controls)
(c) insufficient institutional capacity within rural financial institutions to achieve high levels of outreach in a sustainable manner
(d) under deloped legal systems, pariculraly with respect to marketable property
(e) inadequate regulation and supervision of financial intermediaries
(f) Poor governance, corruption and other political factors.

According to World Bank (2003), the most common factors inhibiting the rural financial markets include:

- Weak institutional capacity of Rural Microfinance Institutions (MFIs) due to poor governance and operating systems and low skills of management staffs;
- Low business and financial skills of potential clients especially in Latin American and Caribbean Countries;
- Policy constraints on financial and agricultural markets that limit profitability of both RFMIs and their clients (especially in the Africa, South Asia, and East Asia and Pacific Regions);
- Inadequate physical and financial infrastructure to penetrate rural areas (specially in Africa);
- Dominance of state-owned banks operating on non-commercial principles (especially in the East Asia and Pacific and the Middle East and North Africa Regions).

IFAD Experience in Bangladesh**: Constraints of Financial services for small and marginal farmers**

These are the main client group for crop-based agricultural development, and play a major role in the economic development of the country. They are also termed as Neo-Poor (tomorrow's poor) who possess between 0.5-1.5 acres of land. Particular problems faced by this "Neo-poor" include:

a. lack of access to either formal bank credit or Ngo micro-credit
b. reliance on agriculture as the principal source of income
c. greater vulnerability of crop agriculture to natural disasters
d. seasonal pattern of cash flows, making the typical weekly repayment loan model less appropriate
e. declining real prices for staple crops
f. poor access to technical support services relative to larger farmers
g. Declining farm size as land is fragmented between children on the death of the owner.

2. Bangladesh

2.1 Structure of Rural Finance

In Bangladesh, formal financial institutions like government and private commercial banks, State-owned agricultural or rural development bank (for example, BRDP in Bangladesh), savings and loan cooperatives, microfinance banks, leasing, housing and consumer finance companies can offer a wide range of financial products. In between stand financial Non-government Organizations (NGOs), self-help groups, small cooperatives and credit unions. Formal services such as microfinance cannot replace loans form friends, relatives, friends, and moneylenders but they do complement them and enable the liquidity constrained rural population to access a wider range of financial services. Microfinance emerged as a noble substitute for informal credit and is considered to be a powerful instrument for poverty alleviation among people who are economically active but financially constrained (Murdoch and Haley, 2002).

According to Ledegerwood,

> "Formal financial institutions are defined as those that are subject not only to general laws and regulations but also to specific banking regulations and supervision. Semi-formal institutions are those that are formal in the sense being registered entities subject to all relevant general laws, including commercial laws, but informal insofar as they are, with few exceptions, not under bank regulation and supervision. Informal providers (generally not referred to as institutions) are those to which neither special bank law or nor general commercial law applies, and whose operations are also informal so that disputes arising from contract with them often cannot be settled by recourse to the legal system"(Ledgerwood, 1999).

Microfinance (MF) has become a buzzword among the development practioners. The term'microfinance' means providing very poor families with very small loans (microcredit) to help them engage in productive activities or develops their tiny businesses (The Microfinance Gateway, 2008). According to the Consultative Group to Assist the Poor (CGAP), microfinance is the supply of loans, savings and other basic financial services to the poor, including working capital loans, consumer credit, pensions, insurance and money transfer services. Similarly, Hossain (2002) defines MF as, the practice of offering small, collateral-free loans to members of cooperatives who otherwise would not have access to the capital necessary to begin small business or other income generating activities. The term'microfinance' is often used in a much narrower sense, referring principally to microcredit delivered through NGOs for tiny informal business of micro-entrepreneurs (Christen et al., 2003). The term microfinance institution now refers wide range of organizations dedicated to providing these services like NGOs, credit unions, cooperatives, private commercial banks and parts of the state-owned banks, and non-bank financial institutions.

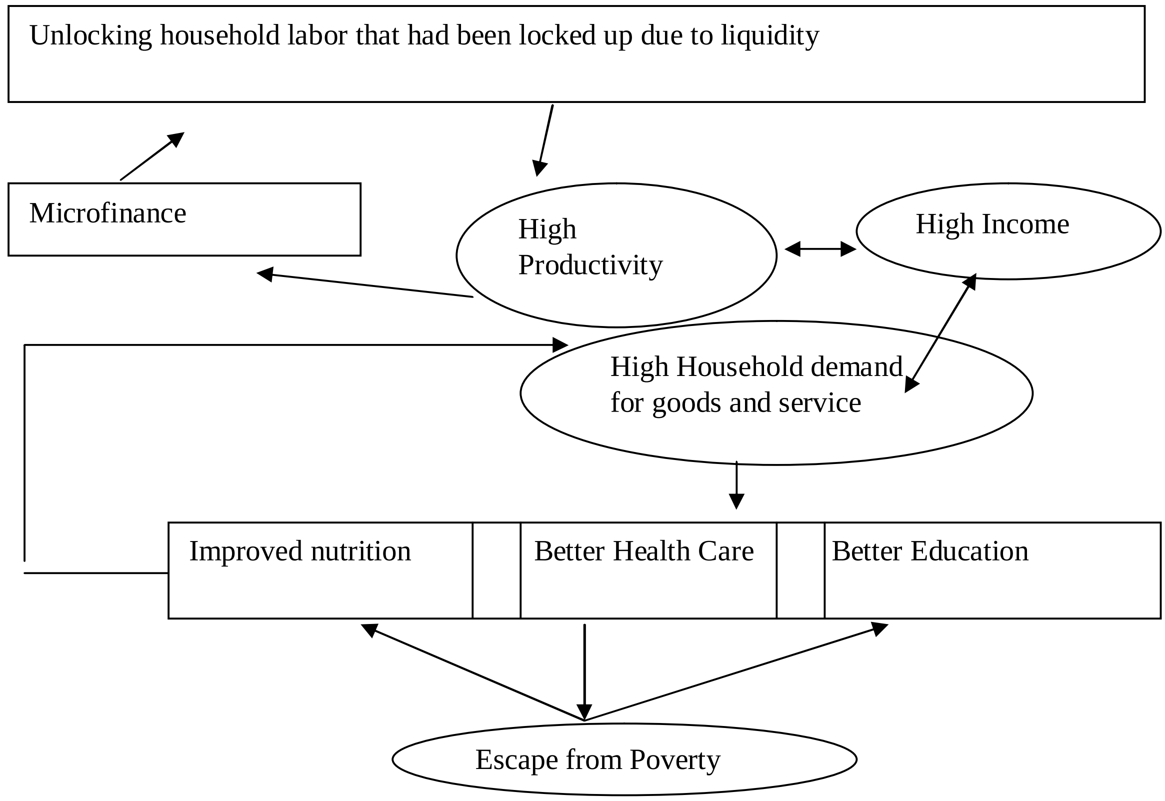

Figure 1: Impact of Microfinance on agricultural productivity and on poverty

Source: (Kiiru, J. ?)

Economists argue that to break the vicious cycle of poverty there need to be some outside force that will intervene in some point of the cycle to improve demand for goods and services. This could be done by MFIs through injecting liquidity to the liquidity constrained households and thereby unlocking the productivity of the households. Figure-1 portrays this promise of MFIs.

2.2 The role of micro-finance for smoothing income and consumption: A conceptual framework

Micro-finance plays an important role in income and consumption smoothing. In a nutshell, improved access to financial services can have two principal effects on household outcomes. First, it can raise the expected value of income and therefore of consumption and future investment and asset accumulation. This is the traditional and often sole argument for provision of services by micro-finance institutions. Second, it can decrease the variances of income and consumption. For the food-insecure poor, it is particularly important to reduce the down-side risk of falling below minimum levels of disposable income for consumption of food and other basic needs.

In Bangladesh, informal credit sources such as local money lenders and wealthier community members often charge interest rates that are prohibitively high. As a result, the landless poor in rural Bangladesh often face severe liquidity constraints that affect their economic well being. More specifically, the inability to access credit at reasonable rates of interest limits their opportunities to rise above poverty by restricting their labor use, income and productivity. It can be hypothesized that micro credit is expected to have a positive impact on the levels of consumption, employment, and productivity of the landless and near landless poor in rural Bangladesh. The process through which access to financial services influences income generation and consumption smoothing and the accumulation of physical, human, and social capital in future periods is depicted through the linkage of boxes. Each of the boxes indicates a subcomponent in the overall process.

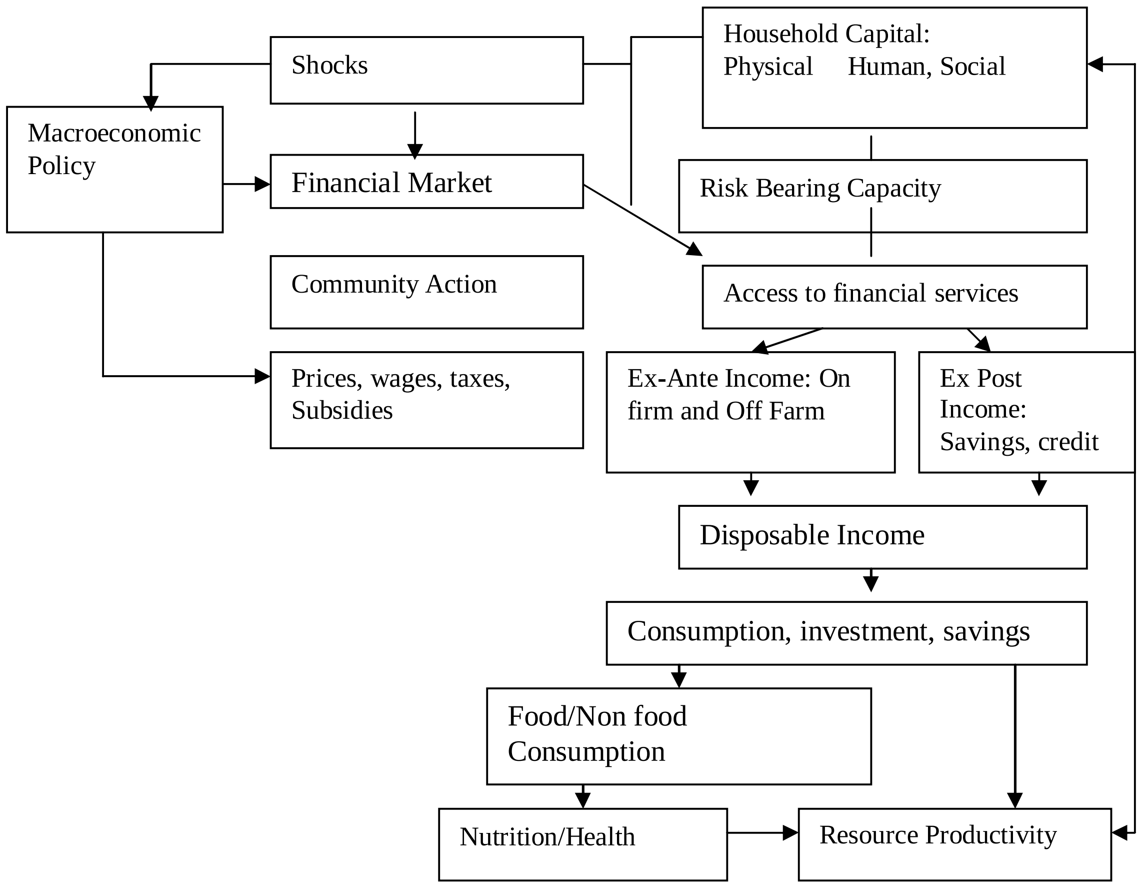

Fig 2: Access to Financial Services and its effects on Income and Consumption smoothing. [Adopted from Conference on Social Protection and Poverty (IFPRI): The Role of Microfinance for Income and Consumption Smoothing].

Access of small and marginal farmers to micro credit can significantly help them to avoid sliding down the poverty ladder. Providers of micro credit have not generally addressed the credit need of small and marginal farmers because of their priority of funding to the poor and because of some perceived problems which include, among others, (a) risk of invest in agriculture; (b) seasonality of agricultural production; (c) poor loan repayment performance of agricultural lending; and (d) technical nature of agriculture production system.

This small note shows that the perceived problems of lending in agriculture sector targeting small and marginal farmers are not real and argues that micro credit providers should extend their priority area of lending to cover small and marginal farmers – the tomorrow's poor – who like the poor, have a right to credit. The norms and disciplines of micro credit which, among others, include weekly meetings and weekly savings need not be compromised for such lending. Only the repayment schedule will require some adjustments and that again not in all cases. The supply of micro credit to small and marginal farmers needs to be supported by the provision of extension services and marketing and storage facilities. These services can be provided by micro credit institutions themselves and also by the relevant government departments. As suggested by Yunus (2004), 'we can put to agriculture micro credit a label, say 'small farmer's micro credit' and formulate right policies and design appropriate methodologies for 'small farmers' micro credit'.

2.3 Impact of Microfinance on Poverty Alleviation:

2.3.1 Poverty and Poverty Alleviation

To explore the impact of microfinance on poverty alleviation let us first know what constitutes 'poverty'. At the UN's World Summit on Social development, the ' Copenhagen Declaration' described poverty as ' A condition characterized by sever deprivation of basic human needs, including food, safe drinking water, sanitation facilities, health shelter, education and information'. The Scottish Poverty Information Unit defines poverty as ' People live in poverty when they are denied an income sufficient for their material needs and when these circumstances exclude them from taking art in activities which are an accepted part of daily life in that society. On the other hand, according to World Bank,' the most commonly used way to measure poverty is based on incomes. A person is considered poor if his/ her income level falls below some minimum level necessary to meet basic needs. The minimum level is usually called 'poverty line'. What is necessary to satisfy basic needs varies across time and place and each country uses lines which are appropriate to its level of development, societal norms and values. The most commonly used measure of poverty is the so-called head-count index which measures percentage of people living below the poverty line. Two other measures, the poverty gap index (Proportionate Poverty Gap), and the Squared Poverty Gap Index (Weighted Poverty GAP) measures respectively the distance of the income of the poor from the poverty line, and the poverty gap weighted by changes in the distribution of income among the poor.

For Bangladesh, the poverty line is measured with reference to the cost of basic needs methods. This method takes a normative consumption bundle of food items recommended for the average Bangladesh population that that gives a per capita daily energy intake of 2112 kcal. and protein intake of 58gm. The required minimum expenditure of food items is estimated by valuing them at prices prevailing in the reference year. An additional 40% allowance is then made for income needed to satisfy non-food basic needs.

2.3.2 Linkage between microfinance and poverty alleviation

The foremost objective of MFIs is to alleviate poverty. It is widely believed that microfinance prorgrammes will raise incomes and broaden financial markets by providing credit, among other services, to small scale entrepreneurs (Aghionand Morduch, 2000). In view of the above, many countries in Africa, Asia, and Latin America have included microfinance as a policy variables to eradicate the poverty (Hossain and Rahman, 2001). So, microfinance is a tool used to improve the quality of life of people with limited access to permanent financing. There is an almost global consensus now that microfinance to the poor be viewed to achieve equitable and sustainable gains for economic and social development in the twenty-first century (Mayoux, 1999).

Microcredit in Bangladesh: A Case Study on Poverty Alleviation

Life is now meaningful Nabiron, abondoned housewife of abandoned housewife of Gopalgonj village in Mohammadpur Upazila, Magura district. She now belongs to the group of women in the are who are better off by selling bamboo fish traps (an instrument in catching fish). Fortune smiled on her, a mother of three sons, when the Association for Social Advancement (ASA), a major Non Government Organization(NGO), came to her rescue by training and microcredit. ASA offered her a loan of Taka 9,000 (Bangladeshi currency) in 2001. She made good use of the loan and set up a bamboo-based cottage industry on her father's land.

She started making bamboo fish traps, locally called *dohar*. She used to make fish trap at a cost of Taka and sold it at Taka 12 and thereby making a profit of 100%. Every Saturday, she supplied he product to the wholesaler at the rate of Taka 1200 per 100 traps. The wholesaler sold her product in the adjoining districts of Faridpur and Rajbari. "Now I earn Taka 3000-4000 each month and my children are attending school" a smiling Nabiron said. With the profit last year she built a house with a tin roof.

According to locals, once upon a time Telipukur and surrounding villages were famous for their cottage industries. But due to a shortage of capital and lack of customers, bamboo based cottage industries collapsed, they added. However, ASA intitiatives brought back the lost glory of the villages. At present, 31 women at Telipukur village are involved in manufacturing bamboo traps.

Nilupha, another woman in the village was living in extreme povery three years back. Her rickshaw-puller (a mannaul driven carriage carrying people) husband could not feed his family of seven with meagre income. About two years back, Jagoroni Chakra, another NGO, brought Nilupha good fortune. Jagoroni Chakra provided her with a micro credit of Taka 8000. With the credit she also started manufacturing *dohar*. Now her monthly earnings have risen to Taka 4,000 per month. This year, she had her eldest daughter married the man of her choice using her savings.

Source: The Daily Star, April 2004. Original Report by Hoosain Seraj, Magura. Reproduced with editing.

2.3.3 Impact on Income and Consumption

There are different ways to measure the impact of microcredit on income and consumption. First there is the borrowers' recall of the "before-after" situation. Using this method in the early1980s, Hossain concluded that both per capita income and household income were positively associated with the amount of credit obtained from Grameen Bank (Hossain, M., 1984). The impact can also be viewed through member perception. On the basis of a survey of 1986 measuring borrower perception, Hossain found that 91 percent of Grameen Bank members improved their economic conditions after joining Grameen Bank (Hossain, M., 1998).

More recent research uses income and consumption as dependent variables for the measurement of microcredit programs' impact. Using this technique, most authors conclude that microcredit institutions can have a positive impact on combating poverty. Khandker takes the lead in this positive evaluation. Together with Chowdbury, he examines the impact of Grameen Bank and BRAC. They find for both institutions that a greater number of loans means a lower incidence of poverty for all program participants. In the Grameen Bank case 76 percent of participants who have taken no loans or only one loan are below the poverty line, compared with only 57 percent of those who have taken five or more loans (Khandker, S. R., 1996). Based on his 1998 research, Khandker comes to the same con clusions (Khandaker, 1999). He estimates that for every 100taka lent to a female member of BRAC, household consumption increases by 18taka. For men, this figure is 11taka. These results indicate that poverty decreases as the borrowed amount (possibly in different instalments) increases. The study further shows that the poverty rate of BRAC members falls by around 15 percent for the moderate poor and by 25 percent for the ultra poor when borrowers have a loan for up to three years. Khandker points out, however, that this rate of poverty reduction appears to decline with duration of membership. For instance, for households that have been members for more than five years, moderate poverty fell by 9 percent and ultra poverty by 18 percent. These figures are considerably lower than for households that had been members for three years or fewer.

Moreover, since the “less than three years” category has a lower average cumulative loan size (3,348taka) compared with the “five years plus” category (6,567 taka), these results suggest that the poverty reduction impact of credit declines with cumulative loan size for BRAC. Khandker and Chowdbury observe the same outcome for Grameen Bank (Khandker and Chowdbury, 1999). Thus the reduction of the level of poverty is variable and declines with the passage of time. His 1998 study reveals that for both Grameen Bank and BRAC, the per capita spending and net worth (assets plus savings/loans outstanding) of the members has increased. Women, however, seem to score better than their male counterparts when it comes to per capita spending (Hossain et al., 2000), while men generally have a higher net worth. Female members of Grameen Bank show better results on this criterion than those of BRAC. It should be noted that many households working in the agricultural sector have to deal with seasonality in consumption. At harvest time, their income reaches a peak. In other periods they have almost nothing. The programs of Grameen Bank and BRAC help to smooth their consumption pattern. Finally, for a program to be successful, it is not only important to alleviate the poverty of its clients but also to achieve a long-term sustainability of the benefits. Khandker and Chowdbury point out that it takes approximately five years for a poor member to work up to above the poverty line (Khandker and Chowdhury, 1996), and it generally takes eight years before the member is able to function independently from the microcredit institution. Consequently, Khandker is convinced that providing microcredit is an effective instrument to reduce poverty and even to overcome it.

2.3.4 Impact on Employment and Productivity

Besides income and consumption, the employment generated by microcredit programs can indicate a reduction of the poverty rate. Rahman and Khandker show that Grameen Bank and BRAC have been successful in expanding the opportunities of self-employment for their members (A. Rahman and S. R. Khandker, 1994). Self employment generates a higher return than wages (Hossain et al., 2000). Still, the average returns are higher in nonagriculture activities compared with those in livestock and agriculture. This finding is strongly correlated with “the fallacy of composition” in the sense that the more people who specialize in the same activities, the lower the return will be. Further, Rahman and Khandker’s paper shows that labor-force participation rates among women have increased compared with those of nonmembers living in control villages. The latter often do not have the necessary credits and other inputs to start up their own enterprises. Finally, Hossain states that the members’ careful choice of projects, cooperation with the staff, and peer pressure also contribute to the two microcredit institutions’ successful fight 19 against poverty.

Not everyone shares the optimism described above. The research of Hulme and Mosley shows that the impact of credit on BRAC 20 members’ monthly incomes has been limited. Particularly when inflation is taken into account, income increases of members are negligible. Hulme and Mosley, however, nuance their statement by acknowledging some success among the wealthier poor. Zaman recognizes that microcredits can contribute to poverty reduction, but only if the poor have achieved a certain economic 21 22 level. Morduch is even more radical in his conclusions. He explicitly attacks Khandker's impact study (1998). He demonstrates that positive results are to a large extent attributable to Khandker's measuring of the income of members who do not belong to the specific target group of Grameen Bank and BRAC. According to Morduch, 30 percent of them would be too rich to be part of the target group. Consequently, with the same data, but after adjustments, he cannot find any proof of an increase in income. The ecoenomic-impact assessment seems to remain a controversial issue on which no consensus has yet been reached.

2.3.5 Impact of Microfinance on Agricultural productivity

Access to finance is a crucial issue in the productivity of agriculture in Bangladesh. If the farmers in Bangladesh are categorised based on land ownership, then we will find that most of the farmers are either marginal farmer or land less farmers producing crop by taking land lease from the affluent people. So, sometimes it is extremely difficult for the marginal farmers to get access to credit as the credits are not collateral free. The lack of deposit facilities force households to rely on inefficient and costly alternatives. The lack of access to medium- and long-term finance inhibits investment by a majority of small and marginal agricultural households in Bangladesh. This inadequate fund of marginal farmers has negative impact on the agricultural productivity of the whole country. In addition capitalists groups are reluctant to invest on agriculture as return from investing is double/triple in other sectors compared to agriculture. Micro credit has been successful in reaching the rural poor with credit for self-employment, supporting women's empowerment and significantly contributing to poverty alleviation. Nevertheless, micro credit has only had a marginal impact in the agriculture sector as microfinance institutions (MFIs), to a great extent, limit their lending to those possessing less than half an acre of land (the functionally landless). Poor farmers' access to agricultural credit remains very limited. They are usually missed by regular credit facilities. As a result marginal and small farmers are frequently termed as “missing middle." (Raman and Husain, 1995).

Alam (1988) made a study to measure the productivity growth of the Grameen Bank members. His study was confined within comparing the agricultural productivity alone. His findings suggest that the small and marginal farmers as a result of participating in the Grameen Bank programs can allocate a higher percentage of their land for the cultivation of high-yielding varieties (HYV) and have improved their agricultural productivity. His studies showed that the users of microfinance caan bring 81.5% of their cultivable land under HYV Boro production compared to 76% of the non-users. Yield of the users of microfinance for HYV Boro was 47.6 maunad per hectare while it was 38.2 for the non-users. Cultivation of HYV requires costly inputs like irrigated water, relatively large doses of fertilizers and pesticides. Before joining the Grameen Bank, they could not afford to apply these expensive inputs to their farms for HYV cultivation due to their low income level. However, joining the Grameen Bank credit programs itself has increased their income and since they work in groups, it is relatively easier for them to obtain HYV inputs at a low average cost. And accordingly, members of all programs in general, have achieved a higher agricultural productivity in terms of per acre yield.

With the breakthrough of green revolution of agriculture and the necessity of adopting modern technologies during the mid-seventies, the demand for agricultural credit has increased tremendously. The modern agricultural farming technology is highly capital-intensive due to intensive use of modern agricultural inputs such as HYV seeds, synthetic fertilizers, pesticides, modern irrigation facilities and farm implements. Most of the farmers cannot afford such big investment due to scarcity of working capital (Hossain, 1985).

However, the agrarian economy of Bangladesh is mostly dominated by the small and marginal farmers. Small marketed surplus of food grains and its seasonality along with the need for funds for both farming and family consumption creates cash deficit leading to demand for credit in the agricultural sector. Moreover, the MV Boro rice cultivation in the new agricultural systems is highly input intensive. Consequently, farmers are unable to accumulate enough capital to buy the costly inputs needed for Boro rice cultivation. Early studies indicated that to sustain and accelerate technological change in agriculture for adopting improved practices, credit is essential (Hossain, 1986). Similarly Jaim and Rahman (1985) observed that although rich and middle class farmers generate sufficient surplus after maintaining a higher standard of living, they too feel need for credit in certain period, particularly in Boro seasons. Farmers take loan both from informal and formal sources. Due to excessive formalities followed by the nationalized banks, informal compound interest mohazoni system still remains in the rural agriculture. Informal credit sources as local money lenders and wealthier community members often charge interest rates that are prohibitively high. As a result, the landless poor in rural Bangladesh very often face severe liquidity crisis that affect their economic well being as well as productivity. At More specifically, the inability to access credit at reasonable rates of interest limit their opportunities to rise above poverty by restricting their land use for agricultural production, income, and poverty.

Credit are also available from informal sources against advanced sale of crops at prices much below the level prevailing in the market during the harvesting period. Payments for interest charges on such loans constitute a major drain on the current income of the small farmers, which depress their living standard and make the perpetually indebted (Baduri,1973), and in some cases lead to alienation of land which contributes to growing landlessness (Jabber et al., 1981). A recent study indicated that the yield (per hectare) of users of micro credit is 1.21 times higher than the non-users and both the users and non-users displayed inefficiency in major resources uses (Miah et al. 2006).

3. Policy Recommendations:

Problems of rural finance in Bangladesh may be considered as synonymous rural financial problems of cross-country analysis in many regions in the world because of specific socio culturalcircumastances surrounding them. Based on the analysis we suggest following strategic recommendations for rural financial services and poverty alleviation:

(a) To deal with the complexity and risk in agriculture, rural financial service providers have to innovate on their product design; improve their information and risk management strategies, develop price risk management instruments like weather-based risk management products, backing credit with technical services.

(b) Appropriate government policy to ensure marketable land rights (for collateral in obtaining credit) and linking commercial banks with NGOs in providing maximum loans to the farmers. Special care should be taken for the small and marginal farmers who constitute the economic backbone of the country. Since microfinance enables farmhouse hold to smooth their cash flows to access to productivity enhancing techniques, commercial banks may work with microfinance institutions in reducing poverty and hunger, thereby facilitating the achievement of Millennium Development Goals.

(c) To enhance agricultural output performance and alleviate poverty farmers need to increase their farm size; thus, an increase in microcredit is advocated to enable farmers to pay for additional mechanization required by the use of additional land. To reduce risks and unstable production and income, there should be a policy of price stabilization which would help increase income and assets on a sustained basis.

(d) The delivery of microcredit and savings services along may not lead to eradicate poverty for the majority of the poor. So, providing microfinance along with ensuring health education (family planning) services would allow the participants to come out from poverty trap. Moreover, credit should be accompanied by some kind of marketable skill development that poor lack and thereby engage themselves in non-traditional activities which are rewarding indeed like self-employment and employment generating activities.

(e) The rural infrastructure especially road and inland networks need special attention for healthy microfinance operations. Since poor are largely involved in few enterprises, risks would be minimized if they can communicate smoothly with urban market to sell their produces. For microfinance to have its desired intended positive impact on the lives of the poor, rural infrastructural problems should be given high priority in rural development agenda. It is therefore recommended for investments in infrastructural development that may act as a catalyst for broader development.

(f) In general there is wide gap between the supply and demand for rural services and the gap is due to inefficiency. Agricultural sector in Bangladesh is characterized by the adoption of poor technology, dependent on unreliable climate, poor infrastructure, small and fragile market, and precarious income flows that denies the access of many who can demand the rural financial services at the price and terms and conditions at which they are offered. Targeting of the poorest of the poor automatically excludes many potential applications of financial services. Loan term is another severe obstacle that limits the efficiency of microfinance service on the poor who are largely poor and engaged in agricultural and live-stock that need time to produce any result. So, repayment may be modified considering the precarious nature of agricultural and not imposing penalty or excluding from the program due to crop failure.

(g) The interest rate offered to the savers by the microfinance institutions are very minimum (6-8% in Bangladesh) that discourages savings mobilization. Establishing secure and convenient saving programs may allow rural poor households to cope less income stemming from crop failure or natural disaster and thus can come out from poverty.

4. Ethiopia

4.1 Background

In developing countries, where the vast majority of the populations live in rural areas, their future will depend on their ability to develop the rural areas. Agriculture is the main means of livelihood for the rural people. It is also the backbone of national economies, the main source of foreign exchange and by far the most important source of employment, including self-employment. It is in the rural areas where the largest numbers of poor and destitute people are found in many developing countries.

Economic growth has to be the focal concern in any strategy for both rural and national development. The transformation of subsistence and semi-subsistence production systems into market oriented and commercialized production is a precondition for welfare improvements of any significance. In such a transformation process financial services have an important role to play. The transformation of subsistence agriculture to production for the market is a central objective. Improved productivity and output levels will be achieved through the introduction of new production technology. Credit is a prerequisite to gain access to such technology particularly for the small-scale farmers in Africa with little or no capital of their own. Therefore, credit is a strategic component of a package of activities for agricultural development.

On the basis of the above mentioned argument, governments in Africa supported by donors have allocated substantial resources to agricultural credit and implemented large numbers of credit programmes over several decades. Most of these resources have been channelled through government financial institutions or institutions controlled by governments such as cooperatives.

The performance of these credit programmes and the institutions implementing them have been way below expectations since the loans have not reached the intended beneficiaries, and they have often been used for other purposes than those for which they were given. Credit often became a political tool which was used for patronage and vote-buying. Credit institutions failed to enforce loan repayment and to cover operating costs.

The above-mentioned problems facing African countries were widely noted already in the 1990s during the period of economic liberalization process launched in the continent. The Nordic aid donor countries including Finland became concerned with the negative development of rural financial services in Africa and took the initiation to discuss the issue together with experts from concerned international organizations, African officials and researchers representing African and Nordic countries as well as international research institutes.

The first joint Nordic workshop on Rural Financial Services in Africa which was held in Harare Zimbabwe, 1993 discussed a good deal of issues related to the question of subsidy provision, the role of African governments, performance and experience of financial institutions based in Africa and above all the needs of poor people for financial services in the rural areas. The workshop emphasized the need for creating new conditions conducive to financial sector reform and more successful efforts to develop rural financial services.

As a result, valuable proposals to policy guide-lines on rural finance service for use by donor and African countries were produced focussing mainly on enhancement of agricultural productivity and alleviation of poverty with the appropriate use of formal and informal sectors available at grassroot level in Africa.

Continued cooperation and dialogue between donor and African countries in the effort to develop the operation of rural financial service systems is vital especially at the present time when the burden of poverty has become increasingly dominant affecting the lives of the rural people in many parts of Africa. In the case of Ethiopia, obviously the community based informal sectors and cooperative societies would respond to this demand.

4.2 Rural financial services in Africa

Onumah, 2003, emphasizes that promoting efficient, sustainable and widely accessible rural financial systems remains a major development challenge in most African countries. With about 73% of Africa's population living in rural areas, and the high incidence of rural poverty, improved rural finance is seen as crucial in achieving pro-poor growth and poverty reduction goals. However, the development of rural financial systems is hampered by the high cost of delivering financial services to small, widely dispersed customers; as well as a difficult financial terrain - characterised by high and covariant risks, missing markets for risk management instruments and lack of suitable collateral.

According to Yaron et al. 1997, attempts to reduce the gap in the provision of rural finance often focus on supply-side interventions, including government and donor-funded targeted credit programme of the 1950-60s, the global failure of which is well cited. Contrary to the expectations of its advocates, liberalisation of financial markets in the 1980s has not succeeded in improving the supply of finance to rural households and enterprises, as formal financial institutions (FFIs) have become more risk averse and reduced their exposure to agriculture and the rural economy. During the 1990s, a number of NGOs converted into full-service micro-finance institutions (MFIs) targeting rural and micro entrepreneurs. However, scepticism is growing about their role in mobilising rural savings and in providing agricultural finance (Murdoch, 2000).

The escalating food deficits in Africa are other aspects that come to the fore in connection to improvement of rural financial services in Africa. Birgegård, 1993, foresaw the situation in sub-Saharan Africa that already in the beginning of the 1990s there was a consensus that sub-Saharan Africa will face alarmingly large food deficits in the near future and beyond. The human, political and economic costs are likely to be very high. The market fails to internalize these costs and to give the right signals to investors in food production. The effective demand for food on the market of increasing numbers of destitute people has an inverse relationship to their nutritional needs. Particularly the starving people in sub-Saharan Africa simply disappear from the market. Even to the extent that a worsening food situation is reflected in increasing producer prices, the production response may be too weak and too slow.

A particularly serious problem is that those in real need will have inadequate purchase power to acquire food even if the market succeeds in stimulating production. In the absence of employment opportunities which provide purchase power, the only solution for food deficit families is to produce their own food. These families are exactly those who are the first to be ignored by the financial market since they possess few resources, have no collateral, and involve high risks and high transaction costs. The numbers of these types of families are plenty in sub-Saharan Africa who will require assistance, including financial services, which are not determined by the market to secure self-sufficiency in food production. Stimulating food production is therefore desirable in sub-Saharan Africa by poor and marginalized rural inhabitants beyond a market stimulated production level.

The informal rural financial service institutions play an important role especially in sub-Sahara Africa as the poor people in general, and women in particular depend almost exclusively on the informal financial market. Therefore, improving the operational status of the informal sectors is one way out of poverty for the rural poor in sub-Saharan Africa.

4.3 The role of cooperatives in rural financial services

By way of introduction formally, a cooperative is defined as an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise. The definition emphasizes the very fact that cooperatives are independent of Government and not owned by anyone other than the members (MacPherson, 1996). On the contrary, informal cooperative are formed at the local level to serve various purposes in rural and urban areas which are found in plenty in several sub-Saharan African countries. A typical example is Ethiopia, where such organizations exist immensely to-date due to their successful achievements.

In general, the aim of cooperative formation is to offer an opportunity for local people to take development into their own hands and make it a meaningful concept at the local level. Cooperatives have arisen, too where the cost of adjustment to economic change has threatened to destroy communities, where local people needed power to control the pace and direction of change in order to preserve what they valued (Kangara, 1995).

The cooperative enterprise is the only form of organization meeting so fully all dimensions of avoiding poverty among the rural people in developing countries. For example, cooperatives give opportunity farmers unable to market their and enjoy economies of scale and acting through their own cooperative organizations small-scale producers, workers and the poor especially in rural areas, access goods, markets and government services more efficiently aimed at improving their livelihoods and undertake other self-help action to improve their communities.

4.4 The challenges of cooperatives in sub-Saharan Africa

Smallholders in sub-Saharan Africa usually face problems with marketing their produce, fulfilling standards and obtaining credits. The transaction costs (costs related to making an economic exchange, i.e. the cost of seeking the information, negotiating the outcome, travelling etc.) for marketing are too big for a single farmer and the effort to build bargaining power are too complicated. Furthermore, the small size of produce is an obstacle for utilizing economics of size. Uncertainty of supply and the small volumes produced by a single poor farmer reduces the interest of private market dealers. One way to overcome these problems is through utilization of farmer controlled cooperatives, sometimes alternatively called producer organizations (Sumelius et al. 2008).

Efficient cooperatives enable smallholders to reach economics of scale in marketing, purchase of inputs and by reducing transaction costs they help smallholders to build bargaining power, to meet the requirements of SPS (Sanitary and Phytosanitary), to process products and to obtain credit. Through farmer marketing cooperatives it is possible to ensure large volumes to be delivered on a regular and timely basis. Cooperatives can offer the institutional framework for collective action in order to supply with technical know-how about financial services. According to ILO (2007), cooperatives provide real economic benefits to farm families through increasing the stability of the farming sector, improving market access for their products and strengthening the farmers' position in the food chain.

Experiences with government controlled cooperatives in sub-Saharan Africa in the 1960s and 1970s were not always successful (The World Bank, 2008). However, where cooperatives have been controlled from member's point of view, they have succeeded well. What are needed in sub-Saharan Africa are cooperatives that are efficiently controlled by their members. Cooperatives which serve the needs of their members offer the possibility to be deployed as instrument for delivery of financial services.

4.5 Cooperatives as a tool for rural financial service activities in sub-Saharan Africa

The semi-formal sector often plays an innovative role on rural financial market services. However, this sector does not have the capacity to replace neither the informal nor the formal rural financial sector. Earlier in this paper, the role of cooperatives in rural financial services in sub-Saharan Africa was mentioned from the informal and formal cooperative activities point of view. In general, cooperatives constitute a border case; in some sub-Saharan African countries, the rural financial service activities of cooperatives are subject to control banking laws, central bank supervision, etc. In these cases the cooperatives would be classified as formal financial institutions. In other countries this is not the case and the cooperatives would be classified as semi-formal financial institutions.

Birgegård, 1993, explains that multi-purpose and agricultural produce marketing cooperatives have been widely used as instruments for delivery of government funded agricultural credit with limited success in many sub-Saharan African countries. A particular problem has been that large credit programmes, which have widely surpassed the capacity of cooperatives to manage, have been pushed on to them. Under strong political pressure to reach lending targets lending has tended to become indiscriminate and loan collection inefficient. Soaring default rates have been the result. Multi-purpose and agricultural marketing cooperatives have the potential to become important providers of rural financial services. In most countries they constitute an organizational framework with extensive geographical coverage and out-reach. Furthermore, the provision of financial services is a logical extension of other services provided by the cooperatives.

The performance record of cooperative credit unions and savings and credit societies suggest that they may have a greater potential to provide financial services than multi-purpose and agricultural marketing cooperatives. Therefore, there are good reasons to consider a support to the expansion of credit union and society activities. A particular challenge is to expand activities of such institutions in rural areas in sub-Saharan Africa and to increase the membership of rural people.

5. Rural financial service policy and development framework in Ethiopia

On dealing with the structure, performance and feature of rural financial services in Ethiopia, two aspects should be taken into consideration that are directly linked to the issue: a) impacts of political changes on the economy and b) the changing structure of agricultural and rural policy.

During the past century, Ethiopia was ruled by three regimes of different administrative and economic policy. For example, when the current Government came into power in 1991, it inherited a weak command of economy characterized by fiscal and current account deficits amounting to 8.7 per cent and 6.9 per cent of GDP respectively, in addition to an external debt burden equivalent to 33 per cent of GDP. It therefore embarked on far-reaching reforms to achieve broad-based economic growth in a stable market economy. Another problem that took place was development in price rising of food. According to the Central Statistical Authority (CSA) food inflation was 23.6 per cent in 2007/08.

Rural households in Ethiopia tend to spend more of their income on food and the recent increase in food prices has meant that poor rural and urban households are finding it more difficult to secure adequate food supplies, particularly as food prices increase faster than the prices of non-food items. In addition to high food prices, the price of agricultural commodities such as fertilizer has more than doubled over the past year. Such high prices are likely to reduce the application of fertilizers with potentially adverse effects on future food production and on agricultural and economic growth.

In Ethiopia, where the agricultural sector greatly influences the rate of economic growth, about 11.7 million smallholder farmers account for approximately 95 per cent of agricultural GDP and 85 per cent of the population. With a total area of about 51.3 million hectares of arable land, Ethiopia has tremendous potential for agricultural development. However, only about 10.6 million hectares of land are currently being cultivated, just over 20 per cent of the total arable land. Nearly 55 per cent of all smallholder farmers operate on one hectare or less (IFAD 2008a). Apparently one of the most serious impediments to sustainable poverty reduction in rural Ethiopia is the strong nexus between land degradation, low agricultural productivity and rural poverty.

Despite all the problems prevalent in the country, provision of financial services in the rural areas is a key-issue of the rural and agricultural development strategy of the present regime. The most significant reforms made in the overall financial system of Ethiopia under the present regime are the reorientation of the financial system to market economy. Reforms since 1991 included comprehensive restructuring of government owned financial institutions and opening the sector for local private equity participation. The formal financial institutions operating in Ethiopia are banks, Monetary Financial Institutions (MFI) and insurers, saving and credit cooperatives (5, 437) and limited contractual saving services. Thus financial institutions in Ethiopia constitute: the Central Bank, 12 banks, 9 insurers, 28 MFI and over 5000 Savings and Credit Co-operatives (SACCOS).

Financial markets in Ethiopia are underdeveloped in such a way that inter-bank local money and foreign exchange market is almost non-existent or inactive. In all, Ethiopian financial systems are thus bank dominated which is not yet easily accessible to large segment of the urban rural population. In particular, problems faced by the small farm landholder living on subsistence farming, the minimum account opening balance (birr 50) set by banks is relatively high. For banks small-scale farmers are considered poor and no access to bank loan (Nana, 2008).

As mentioned above, Ethiopia as a large country of a huge population can not alone manage to provide the necessary financial services for the development of its rural areas. Additional assistance from the international community and aid donor countries is thus necessary. The International Fund for Agricultural Development (IFAD) has developed a lead in rural finance in Ethiopia. The programme launched by IFAD has enabled micro finance institutions, rural savings and credit cooperative societies to increase their client base form about 700,000 to nearly 2 million in five years. It has therefore demonstrated the potential of rural finance for helping a large number of poor people – especially women, accounting for at least 30 per cent of beneficiary households – to cover poverty in a sustainable manner (IFAD, 2008b).

5.1 The role of community based informal cooperatives in rural financial service

The basic problem in providing credit to poor people, as formal credit institutions tend to see it, is the high risks and the high transaction costs. In Ethiopia, where the vast majority of the rural population live in poor conditions, the people have to find a way to survive. Hence, especially among the poorest segments of the rural population, informal financial sectors including informal cooperative societies have become a high priority. Such traditions have existed for a long time, and continue to the present day, primarily because they have been successful in achieving their objectives.

For example, when it comes to farming and crop harvesting, rural farmers use a system known as “Woberra,” “Debo,” or “Wonfel”. This way, farmers living in the same community work together helping neighbouring farm families, turn by turn, during the weeding and harvesting periods, and in cutting wood. All helpers who participate bring along with them the necessary equipment to do the work.

As for money saving, in Ethiopia, it is only 1% of rural households that maintain bank accounts. Thus the informal financial sector is one of the most important sources of rural finance and accounts for about 78% of total agricultural credit (Dejene Aredo, 1993). The major sources of finance in this sector are relatives and friends (66%), and moneylenders (15%). There are a number of commonly found community based indigenous savings and credit groups, which are also widely used by women. One of the Community Based Organizations (CBOs), known as iqqub is an informal, ad-hoc informal type of cooperative society organized by members for the purpose of pooling their savings in accordance with rules established by the group. Members agree to deposit monthly or weekly contributions of a fixed sum with an elected treasurer or, where accessible, in a bank. Lots are drawn weekly or monthly by turns and members in need can purchase the winner's lot by paying a premium.

The other common CBO is an idir which is an informal association whereby savings are made primarily for the purpose of covering the cost of funerals or weddings. A mehaber is an informal, religious association that draws its members from the church to raise money for medical and burial expenses. In this sense, moneylenders are well positioned, with terms and conditions that are quick, simple, convenient and flexible, for most accessible source of funds for the rural poor outside of family and friends, albeit at an annual rate of interest as high as 245% or more.

Therefore, CBOs play a significant role in savings and beneficiary mobilization, and are considered to be effective ways of targeting clients as some of the CBOs are uniquely controlled and owned by women [1].

The above explanation about the operation of informal sectors in Ethiopia shows their importance for the rural people and for community development. Whatever political changes take place at the in the country the informal cooperatives continue to exist in their form of operation. They are actualized as ways to find local solutions to the problems prevalent in the area, such as lack of credit services for the small-scale farmers and increasing poverty in rural areas caused by scarce access to jobs besides farming. Additionally the will of the rural people to maintain the informal sectors in their localities is a true indication of the rural people to manage life within the possibilities available to them.

Taking into account these facts, it can be claimed that cooperative values and principles have an immense to play. The challenge becomes shifting the operation of informal cooperative to formal cooperatives in accordance with the cooperative the cooperative principles and values, a shift that requires the approval and support of the Ethiopian government and also aid donor countries such as Finland as well as the international community (Tenaw, 2007).

[1] Adapted from (http://www.evancarmichael.com/African-Accounts/1665/Microfin) on 02 August 2009

5.3 Micro finance policy and development in Ethiopia

The formal microfinance in Ethiopia started in 1994. In particular, the Licensing and Supervision of Microfinance Institution Proclamation of the government encouraged the spread of Microfinance Institutions(MFI) in both rural and urban areas as it authorized them among other things, to legally accept deposits from the general public (hence diversity sources of funds), to draw and accept drafts, and to manage funds for the micro financing business. Currently there are 23 licensed MFIs reaching about 905,000 credit clients and some saving clients. Considering the potential demand, particularly in rural areas, this only satisfies an insignificant proportion (Gobezie, 2005a).

The origins of MFIs in Ethiopia is largely rooted in their NGO past with a clearly defined mission of rural poverty eradication. With a network of 500 sub-branches and branches, the MFIs have expanded their outreach to many of the regions where the incidence of poverty is highest. As of January 2001, MFIs has made loans to and mobilized savings from about 500,000 clients nationally. Some MFIs have also started to offer other services such as managing pension remittances and money transfer services At least 41% of the MFI clients nationally are women and in the majority from rural households.

As far as MFIs Loans products and delivery mechanisms are concerned it follows the Grameen model with some slight variations. Most of the MFIs have two types of loan products, namely loans for on-farm activities, which are due in four to twelve months, and off-farm investments with more flexible repayments on weekly or monthly basis (IFAD, 2001). On average, 60% of the MFI portfolio represents loans for on-farm investments while income generating activities and petty trading accounted for about 40%. These are two types of savings offered by MFIs, namely compulsory, which acts as collateral and will be withheld by the MFI in case of default, and voluntary savings are the most common and the interest rate on savings is about 6% per annum (Dejene, 1999).

5.4 Rural Financial services in Amhara National Regional State (ANRS) in north-west Ethiopia

The situation of informal rural financial system in ANRS has similarities with the rest of the regions in Ethiopia. The formal Amhara Credit and Saving Institution (ACSI) was established in the Amhara region, and aims to fulfil the gap of formal institutions by meeting the needs of small-scale borrowers in income generation schemes. It was established initiated by the Organization for the Rehabilitation and Development in Amhara (ORDA), an indigenous NGO engaged in development activities in the Amhara region. In a move to depart from the more usual direct provision of relief, the NGO created a department to supply small credit to rural people on a pilot basis. That department grew into a separate institution, and ACSI was licensed as a microfinance share company in April 1997, with the primary mission of improving the economic situation of low income, productive poor people in the Amhara region through increased access to lending and saving services.

ACSI currently delivers four types of financial products: Credit, Savings, Pension Fund Management and Money Transfer. Through its 10 branches and 174 sub-branch field offices, it has reached all Woredas (districts) in the region, and operates in over 2221 Kebeles or Peasant Associations (over 75% of the total). As of February 2005, ACSI had an outreach of over 345,000 active credit clients (with over USD 35 million outstanding loan balance), 35% of them being poor women. With an estimated potential market of about 2.9 million people in the region, ACSI and other smaller MFIS and Saving and Credit Cooperatives (SACCOs) in the region only manage to reach between 10 and 12% of the demand (Gobezie, 2005b).

6. Policy Recommendations

This paper discusses broadly issues concerning the importance and problems of rural financial services from the point of view of agricultural productivity and poverty prevalent mainly in Ethiopia. The Amhara National Regional State in north-west Ethiopia is a focal point of discussion due to its special position as a region where the Finnish development cooperation activity is being implemented currently. On presenting the previous dialogue undergone through intervention of aid donor and recipient countries in sub-Saharan Africa, the aim was to reveal the fact that continued assistance in the rural financial sector to the rural population in sub-Sahara African countries is absolutely vital.

The following suggestions/recommendations have been drawn up with respect to improving the situation of rural financial services generally in developing countries:

a) Financial Sector Reform
In order to make provision of agricultural marketing adequate for the small-scale farmers, it is essential to restructure the financial sector aiming at eliminating financial market distortions, restoring the health of the existing financial institutions.

b) Rural Finance
In order to improve the efficiency of rural financial intermediaries, special assistance programmes should be set up to design better operational procedures to improve staff and management performance to install adequate management information systems for use by the local people.

c) Formal Financial Sector
National private and commercial banks are the main sources of finance for agricultural marketing. Apart from providing short term credit for domestic agricultural marketing, normally these institutions are well specialized in financing export and import marketing activities. In all cases, it will be necessary that banks consider agricultural marketing financing a profitable activity.

Linkage of banks with decentralized rural financial intermediaries is an important mechanism to reduce their information costs to link rural savings mobilization with credit and to facilitate loan supervision and loan recovery.

d) Informal Financial Intermediaries

The role of informal trade finance is significant and governments in developing countries should recognize and support the role of informal financial intermediaries. In general, banks can promote trade finance by providing sufficient overdraft facilities to large traders who then on their turn will provide finance to smaller traders. Banks may also provide marketing loans which can be guaranteed by the government to contracted input dealers or traders.

e) Cooperatives

Grassroot marketing cooperatives which have an active member involvement and present economies of scale in their operations, may be in a position to compete with private traders, provided they have mobilized sufficient own capital and savings and are well managed.

Assistance to cooperatives should aim principally at strengthening the business character of these organizations by providing adequate training marketing, financial management, accounting and auditing. Provision of bank funding to cooperatives should only be increased gradually and be made dependent on proven profitable track records.

f) Role of government

Government have essential role to play in agricultural marketing and financial policy formulation, coordination of marketing and financial operations of the different actors, establishing information systems (production information and market intelligence), required legislation (business laws, bank regulation and supervision, loan collateral requirements, safeguarding of savings, warehouse acts,.), training (in storage and grading techniques, cooperative business operations etc.

The community rooted informal types of cooperative societies have an immense role to play in promoting rural financial services at the local level. Therefore, the government should take the responsibility of shifting the operation of informal cooperatives to formal cooperatives so that they will stand the chance of equal status and financial support.

6.1 Recommendations to Ministry of Foreign Affairs, Department of Development Cooperation

In development cooperation scheme, it should be borne in mind that the basic principle of donor support is partnership. The substance of this partnership should be established through continued dialogue which preferably should be initiated by the recipient country.

The following recommendations are made to the Finnish development cooperation authority to support the development of rural financial services mainly in Ethiopia:

i. Involvement in rural financial services development

Rural financial services are a long-term process. A long-term and a substantial commitment to developing rural financial services in Ethiopia will make Finland as an aid donor country a useful partner. The principal objective of this partnership is to formulate and implement effective and efficient national policies in agricultural marketing and rural finance within the context of the Structural Adjustment Programme (SAPs). In a later stage, through exchange of information of research results and of policy experiences, larger cooperation agreements can be implemented on a regional and sub-regional basis.

ii. Establishing multi-sectoral dialogue

To establish a multi-sectoral and multi-agency policy dialogue with the Ethiopian government, domestic actors and relevant donor/international organizations.

iii. Provision of donor programme

To provide in the Finnish development cooperation aid programmes sufficient resources for the implementation of research, training activities, advisory services and pilot projects.

Concluding Remarks

The research study indicates the vital role of financial services and micro finance in maintaining and improving livelihoods of rural people in Bangladesh and Ethiopia. Local based financial systems created by the local people in rural and urban areas are useful vehicles in promoting self-help and independency since the management and administration policy and rules are in the hands of the initiators. Agricultural sector in Bangladesh and Ethiopia are characterized by the adoption of poor technology, dependent on unreliable climate, poor infrastructure, small and fragile market, and precarious income flows that denies the access of many rural households. So, efforts can be made to develop the rural financial systems of these countries to ensure its smooth operations and thereby contributing to agricultural productivity and tackling the poverty. The transmission of knowledge and experience gained from the operations of such institution like Grameen Bank in Bangladesh can be replicated in several developing countries including Ethiopia.

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