

SAVING AND CREDIT COOPERATIVE SOCIETIES IN ETHIOPIA: A QUEST FOR COMPREHENSIVE LAWS

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Abstract

Formal cooperatives were introduced in Ethiopia by employees of the Ethiopian Road Authority and Ethiopian Airlines in early 1950. Since then, saving and credit cooperatives are one of the most common kinds of cooperatives in Ethiopia. However, saving and credit cooperatives cannot be considered champions in facilitating access to finance for people, mainly due to lack of innovation, networking among themselves, limited product varieties offered to their members, and lack of a comprehensive legal framework that supports their development. Well thought-out laws that provide the required confidence for members and other stakeholders are vital for the development of cooperatives in the country. However, in Ethiopia, there are no laws that have been specifically developed to regulate saving and credit cooperatives, other than a general mention in the cooperative laws that focus on other forms of cooperatives. Ethiopian cooperative laws do not provide detailed provisions in relation to saving and credit cooperatives. This article argues that Ethiopia should introduce a legal framework that provides clear guidelines on important issues that are currently left unaddressed by the Cooperative Societies Proclamation No. 985/2016 to maximize the financial, social and economic benefits from saving and credit cooperatives. Ethiopia is one of the poorest countries in the world with alarming rate of financial exclusion. Access to finance is critically limited in the country and only a few privileged get access to credits from formal sources. The majority of the people get loans from the informal credit markets at exorbitant interest rates. Saving and credit cooperatives therefore, with appropriate legal and policy frameworks, can be part of the solution to curb the problem of financial exclusion of the majority of the people.

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1. A Brief Historical Background of Cooperatives and Credit

According to Holyoake, the history of cooperatives goes back to Minnos of Greece. Holyoake stated that the idea of cooperatives had been forgotten for centuries until it was recognized later as a new concept in Thomas More's *Utopia*. He mentioned that:²

“the cooperative idea is no new-fangled conception which needs to apologize for its novelty. It has an ancient pedigree, and though long intervals have occurred when the principle appeared to be dead yet, like the grains of wheat found in the coffins of Egyptian mummies, it has possessed vitality and power of germination after thousands of years.”

We can see from the quote provided above that the values and principles of cooperatives have been part of human social history for centuries though these values and principles were dented for long time in some part of the world for different reasons. In Africa, cooperation has been the founding social and economic philosophy in most societies and continues to play a vital role. African traditions have had cooperation as their main ingredient for centuries. The *Iddir* and *Eqqub* in Ethiopia, *Stokvel* in South Africa, *Osusu* in Nigeria are traditional cooperative institutions that are providing critical institutional framework for interdependence and mutual co-existence. These traditional cooperative institutions play a vital role to mitigate the damage from natural and human-made calamities. However, these institutions are not recognized and supported by proper policies and laws. The traditional social and economic structure was neglected by policy makers for so long and therefore they are not able to develop and evolve in a natural and orderly manner without losing their intrinsic values and principles to catch the dynamic social and economic problems of the people.³ In many African countries, borrowed laws and policies that thwart the function of these traditional intuitions have been imposed.

Modern cooperative enterprises with new structure and model were reinvigorated in the 19th century. Cooperatives emerged mainly as a response to the capitalist companies (investor-controlled) that focus rather on financial interests of their members than the well-being of community, users and workers. The companies that had started to work for the development of the local communities with supervision and control of trade chambers and manufacturing unions moved from their original philosophy and became monopolistic and profit maximizers that undermined the general interest of the society⁴. The cooperative

² Holyoake, George Jacob (1903) *The Co- Operatives Movement to-day*. Methuen & Co, London. (Re)Published in 2012 by Forgotten Books. Page 95.

³ Wanyama, F., Develtere, P., and Pollet, I. (2009) Reinventing the wheel? African Cooperatives in A liberalized economic environment. *Annals of public and cooperative economics*. Volume 80/ 3. P. 361-392.

⁴ Supra note 1, Holyoake, George Jacob (1903). Page 95.

movement therefore was intended to challenge this selfish interest of investor-owned companies and to offer an alternative ownership and enterprise model to the community. It was supported by intellectuals and thinkers like John Stuart Mill, Alfred Marshal, Leon Walras, George Holyaoke and Robert Owen⁵.

It should be, however, noted that cooperatives are not just a reaction to change in the society, rather they are part of the transformation process in the society. Brett Fairbairn provided that “they are neither the causes of basic transformations in the society nor an oppositional reaction to such changes: rather, they are attempts by people to steer and guide, to influence development, and shape their own futures within a changing world.”⁶ Economic and social changes have forced disadvantaged groups to find a system that mitigates burdens of new economic developments. Cooperatives are a practical response to help the working class and farmers benefit from their own labor and creativities by sharing their labor, generating capital and sharing benefits. The idea of cooperative movement has allowed farmers to challenge the urban centered price determination process that denied farmers their right to fairly benefit from their own production. Workers also get the opportunity to challenge the policy that allow manufacturers and monopolists to determine both the wage of labor and the price for goods that the workers consume that makes life a mounting challenge⁷.

The birth-place of modern credit co-operatives is in Germany. The father of the idea of modern urban credit co-operatives is Hermann Schulze-Delitzsch who founded the first urban credit cooperative in Germany.⁸ The main motive was to provide alternative sources of credit for the marginalized and small operators who were by then dependent on usurers. Schulze-Delitzsch then established the Volksbanken (peoples bank) based on the principle of self-help with the objective of helping the community to establish their own bank as cooperatives.⁹

In 1949, the first rural cooperative bank was started by Friedrich Wilhelm Raiffeisen. Credit unions were mainly motivated by religious reasons to avoid usury in the community. Rural cooperative banks were limited to specific territories and provided credit only to their members. Rural credit cooperatives were rapidly accepted by peasantry and they became common in many parts of Germany. In 1876 the credit

⁵ Zamagni, V. (2017). A worldwide historical perspective on co-operatives and their evolution. In Michie, J., Blasi, R. and Borzaga, C. (2017) *The Oxford Handbook of Mutual, Co- operative, and Co-owned Business*. Oxford University Press. Page 99.

⁶ Fairbairn, B. (2004) *History of Cooperatives*; in Merrett, C and Walzer, N. (Ed), (2004). *Cooperatives and Local Developments: Theory and Application for the 21 Century*. ME Sharpe. Page 23.

⁷ Ibid.

⁸ Goglio, S. and Kalmi, P. (2017). Credit unions and cooperative banks across the world. In Michie, J., Blasi, R. and Borzaga, C. (2017). *The Oxford Handbook of Mutual, Co-operative, and Co-owned Business*. Oxford University Press. Page 147

⁹ Ibid

unions networked and formed the Raiffeisen bank of Germany.¹⁰ It is also important here to mention the building societies that first appear in Britain. The first building society was founded by Richard Ketley in 1775. The building societies collected contributions from members, and built houses for their members. Building societies became common in many western countries in different forms and structures. Saving and credit unions were also involved in the housing sector and some of the building societies also transformed into standard banks following the liberalization of the financial industry around 1980s.¹¹

2. Cooperatives in Ethiopia

2.1. The development of cooperatives

Ethiopia is home to different cultures and languages. The different languages and cultures however share some common features. Institutions and cultures that coordinate labour and resources for mutual benefits of the people are among the most common traditional institutions one finds across the different cultures and ethnic groups in Ethiopia. The different associations and social groupings coordinate social and economic activities that enable the community to use the available resources in a more efficient and effective manner. In a society that uses domestic animals for farming, it is important to organize how the community can use the available animals in the community in effective way without causing harm to the wellbeing of animals. The coordination is also important with regard to human labor as the labor market is undeveloped and limited only in urban areas. Therefore, cooperatives in different forms have existed in Ethiopia from time immemorial. However, cooperatives that are similar to those widely known in the west emerged in Ethiopia in 1950.¹² Ethiopian Road Authority and Ethiopian Airlines employees are considered as pioneers of saving and credit cooperatives with western-style structure and management. The saving and credit cooperatives were established even before Ethiopia enacted a law to regulate cooperatives. Ethiopia enacted the first law that regulated cooperatives in 1960. The 1960 decree 44/1960 dealt with agricultural cooperatives and intended to encourage cash crop producing farmers. In 1966 a new cooperative society law was announced with more broad and comprehensive provisions that are intended to promote cooperatives as a main engine of the economy. The proclamation also established an office to organize registration and establishment of cooperatives and to provide trainings and technical support for cooperatives. The new law encouraged the establishment of different cooperatives including credit unions, consumer associations and small-scale producers organized as cooperatives. In 1974 around 149 cooperatives were registered by the agency. Most of the cooperatives at that time were organized as

¹⁰ Ibid.

¹¹ Supra note 5, Fairbairn, page 23

¹² Mojo, D., Degefa, T., & Fischer, C. (2017). The Development of Agricultural Cooperatives in Ethiopia: History and a Framework for Future Trajectory. *Ethiopian Journal of the Social Sciences and Humanities*. Volume 13(1). P.44-77. Available at <https://www.ajol.info/index.php/ejossah>.

multipurpose cooperatives.¹³ With regard to agricultural cooperatives, however, only large-scale producers and rich farmers organized as cooperatives. Most small-scale peasants remained neglected and they were dependent on subsistence farming.¹⁴

After the military backed socialist government came into power, it banned all cooperatives that were established during the previous government except the credit unions.¹⁵ The new government then introduced its own version of the cooperative movement based on the Marxist ideology. Proclamation No. 71/1975 was enacted to establish peasant associations throughout the country. The peasant associations were formed with government support and control. In most cases, cooperatives were established without the free will of the farmers. Those cooperative associations were established mainly as a means to achieve the Marxist policy.¹⁶ The government enacted Proclamation No 138/1978. The main objectives were to organize small scale industries, service providers and farmers in government-controlled cooperatives and to provide critical support to them to increase production and productivity in the country. Credit unions were also included in the proclamation as one form of cooperatives but detailed provisions that are required for credit unions to operate efficiently with the required scale and structure were missing. The cooperative Proclamation also provided legal protection and support for housing cooperatives that were intended to solve the problem of housing for urban dwellers¹⁷.

The cooperative structure and governance approach were highly politicized and greatly limited the freedom of members to control the cooperative and had no control of their production and marketing strategy. They were required to supply their products only to government agencies on fixed price below the market price.¹⁸ Principles of cooperatives, such as voluntary membership, democratic control, autonomy and independence, were undermined. The disregard for basic principles of cooperative organizations cultivated an antipathy to the cooperative movement. Therefore, when in 1990 the government introduced a new law that gave members freedom to decide on the fate of the cooperative as associations, most cooperatives decided to dissolve the cooperative enterprises.¹⁹

¹³ Ibid.

¹⁴ Bernard, T., G.T. Abate and S. Lemma. (2013). *Agricultural Cooperatives in Ethiopia: Results of the 2012 ATA Baseline Survey*. Washington (DC): International Food Policy Res. Available at <http://ebrary.ifpri.org/cdm/ref/collection/p15738coll2/id/127690>.

¹⁵ Tefera, D., Bijman, J., & Slingerland, M. (2017). *Agricultural Co-operatives in Ethiopia: Evolution, Functions and Impact*. *Journal of International Development*, Volume 29. Available at <https://onlinelibrary.wiley.com/doi/epdf/10.1002/jid.3240>. Page, 44-77.

¹⁶ Ibid.

¹⁷ Supra note 14, Tefera, Bijman, & Slingerland, Page, 44-77.

¹⁸ Holmberg, S.R. (2011). *Solving the Coffee Paradox: Understanding Ethiopia's Coffee Cooperatives through Elinor Ostrom's Theory of the Commons* (Dissertation). Amherst: University of Massachusetts. Citing Dessalegn, Rahmato (1984). *Agrarian Reform in Ethiopia*. Uppsala: Scandinavian Institute of African Studies.

¹⁹ Ibid, page, 103.

Generally, during 17 years of the socialist reign, the potential of cooperative associations to transform the economic and social conditions of their members and the community at large was limited due to the political instability that dragged the country into civil war and the stagnant agrarian economy that remained unchanged.

Following the fall of the socialist government and the coming into power of EPRDF (Ethiopian People's Revolutionary Democratic Front), most cooperatives, especially the peasant associations were dismantled and destroyed.²⁰ Sadly, cooperatives were considered as manifestations of the failed socialist government and they were destroyed and their property was embezzled and robbed. Some of the managers of these cooperative were also jailed. Here, it is important to note two things: (1) The EPRDF is generally a result of the Marxist orientated student movement and it is very difficult to repudiate its leftist Marxist inclination; therefore it is somewhat incoherent that it dismantled the cooperatives that in principle should have been considered to be tools to enhance the social and economic wellbeing of the farmers; (2) It underlined the fact that cooperatives cannot become successful without full consent of their members. The members and the leaders of the cooperatives not only failed to protect the property of these cooperatives but also they were active in taking the property of the cooperatives as they failed to consider the property of the cooperatives to be of their own.²¹ It is good to take note here that the traditional associations like Iddir survived all the three governments and they are still functioning without any serious problem. It clearly implies that the traditional institutions are true people's cooperatives that can effectively prevail social and political shocks. Therefore, connecting the new cooperative movement with these traditional institutions may provide the required glue to members to cooperate in the real sense of cooperation.

The new government lately came to understand the advantages of cooperatives to facilitate development in the country. The government then introduced a new proclamation that focused only on agricultural cooperatives, disregarding all other forms of cooperatives. The agricultural cooperative society Proclamation No. 85/1994 was introduced to organize agricultural cooperatives. However, after four years a new cooperative Proclamation No. 147/1998 was introduced to embrace other forms of cooperatives. The 1998 proclamation allowed different forms of cooperatives by different interest groups. At this time, a special team was also established under the Prime Minister's Office to organize and provide policy and technical support for cooperatives in the country.²² The government became aware of the importance of cooperatives for economic growth, job creation, equitable distribution of income, and to improve the saving culture in the society. The government then established a cooperative commission

²⁰ Supra note 18, Holmberg. Page 93.

²¹ Ibid.

²² Ibid.

(now agency) under Proclamation No. 274/2002 at federal level and all regions have also established regional cooperative agencies by law.

The Federal Cooperative Agency is mandated under the laws to organize, support, regulate and to develop a policy and legal framework for cooperative societies at federal level.²³ Interestingly, one of the duties of the commission was to conduct research on traditional financial institutions and to produce a policy document on how these institutions would be transferred into modern cooperatives. The Proclamation under article 5(4) articulates that one of the responsibilities of the commission is to “Undertake research and study to promote traditional and local self-help associations to modern cooperative societies, it shall make known and disseminate the results of the study and follows up the implementation thereof.”

2.2. Proclamation No. 985/2016/ and Cooperatives

In 2016 a new cooperative societies law was proclaimed to further enhance the legal framework for cooperatives.²⁴ In the next section, this article discusses the main features of the proclamation that is currently the applicable law.

The Proclamation provides a working definition for cooperatives as follows:²⁵

“cooperative society” means an autonomous association having legal personality and democratically controlled by persons united voluntarily to meet their common economic, social and cultural needs and other aspirations, which could not be addressed individually, through an enterprise jointly owned and operated on the basis cooperative principles”

The definition is broad enough to bring under its wings all associations that operate based on cooperative principles. The definition indicates that cooperatives can be formed to promote common social, economic and cultural interests. The definition understandably avoids political interest as ground of cooperation for the purpose of the proclamation. The definition also indicates that the cooperatives shall be formed based on free will of its members. The definition provides a vague requirement of “having a legal personality” in the definition. The definition is meant to identify or to qualify the associations that can be given a legal personality as cooperative enterprises. Therefore, requiring legal personality as a condition to be

²³ Cooperatives' Commission Establishment Proclamation, No. 274/2002, *Federal Negarit Gaeta*, No 21. Regional states have their own laws that regulate cooperative societies and there are also cooperative agencies in each region that coordinate the development of cooperatives in regional states.

²⁴ Cooperative Society's Proclamation No 985/2016. *Federal NegaritGazeta*, No 7, P. 9436, Ethiopia, Addis Ababa. For legislative history of cooperatives in Ethiopia and for history of cooperatives see; Mojo, D., Degefa, T., & Fischer, C. (2017). The Development of Agricultural Cooperatives in Ethiopia: History and a Framework for Future Trajectory. *Ethiopian Journal of the Social Sciences and Humanities*. Volume 13(1). P.44-77. Available at <https://www.ajol.info/index.php/ejossah>; Supra note 14, Tefera, Bijman, & Slingerland. .

²⁵ Article 2(1).

recognized as cooperative societies is confusing. Article 11 of the proclamation clearly shows that legal personality is to be bestowed by the regional or federal cooperative agency once the enterprise has been registered. It provides that “any cooperative society registered in pursuance of Article 10 of this Proclamation shall have juridical personality from the date of its registration.” Therefore, the phrase “having legal personality” in the definition seems somehow used to exclude traditional institutions like *Eqqub* and *Iddir* from its scope.

Another important point that should be noted in the definition is the use of ‘person’. Under article 1(24) it is provided that the definition of person includes both natural person and juridical person. Therefore, when we read the definition of cooperative societies as provided in the proclamation together with the definition of persons provided under article 2(24) it appears as if judicial entities were also allowed to form cooperatives under the proclamation. The bare reading of article 2(1) and article 2(24) seems to suggest that investor-owned business entities such as shareholding companies, private limited companies and partnerships can be organized as cooperative societies or cooperative unions. It is however obvious that this is not the intention of the legislature. We can also infer from the change of terminology from persons to individuals when the Proclamation refers to members of primary cooperatives. The law provides that primary cooperatives can be established “by individuals who live or work or are engaged in specific profession within a given area; and by number of members not less than fifty.”²⁶ Article 24 makes it unequivocally clear that only natural persons can be members of a cooperative society. Therefore, only natural persons are allowed to form primary cooperatives and juridical persons cannot become members of cooperatives. The definition provided under the proclamation that includes both juridical and natural persons seems to be enunciated having in mind secondary cooperatives that can be established by cooperatives. Cooperative unions, cooperative societies federations and cooperative societies league can be established by primary cooperatives, but not by natural persons directly. Therefore, the intention of the proclamation is that natural persons can form primary cooperatives and only legally recognized cooperatives (juridical persons) can form cooperative unions, federations and leagues.

The Proclamation interestingly under Article 5 provides general principles of cooperatives, including democratic control, one member one vote, contribution for community, providing education and training and autonomy and independence. The Proclamation also recognizes that profits shall be divided according to share value.²⁷ Article 6 provides that self-help, self-responsibility, promoting culture of democracy, equality, equity and solidarity are the values that cooperatives should adhere to achieve. The Proclamation lists honesty, openness, accountability, participatory, social responsibility and caring for others as ethical

²⁶ Article 1(2) of the same Proclamation.

²⁷ Article 5(3).

values under Article 7. The legal effect of these values is not so clear. However, these values shall be considered by members in drafting the bylaws and other internal guidelines and manuals. The values shall be also relied by arbitrators and courts in adjudicating disputes between members or between members and the management or the board of the cooperative society.

The proclamation should be applauded for including a dispute resolution mechanism that can help cooperatives to avoid the slow and inefficient litigation in courts.²⁸ The Proclamation provides that parties shall try to solve their dispute by reconciliation as primary method of dispute resolution. The Proclamation however provides neither detailed rules on how the reconciliation shall be organized nor an institutional framework to facilitate reconciliation. Cooperatives therefore shall include more elaborated rules in their bylaws in the use of reconciliation to solve disputes. The reconciliation may become more effective if it is designed based on the norms and the practice that are used in the traditional institutions like *Eqqub* and *Iddir*.

The Proclamation provides that disputes that cannot be solved by reconciliation should be adjudicated by arbitration. Arbitration can be established by disputant parties. Each party in the dispute elects an arbitrator and the two arbitrators elect the chair of the arbitration tribunal. The law also provides that the arbitration tribunal shall make its decision as per the civil procedure code and they have the same power and mandate as a civil court. Article 65 provides that “[T]he Arbitrators shall have the same power, with regard to the cases provided ... as a Civil Court for the summoning of witnesses, production of evidence, the issuing of orders or for the taking of any other legal measures.” It is surprising here to note that the law does not require the arbitrators to be lawyers. It is very common to set as a requirement by the law that at least one of the arbitrators should be a trained lawyer in order to apply procedural laws and other laws of the nation that are relevant to the case at hand. The role of lawyers in the development of cooperatives has been crucial, as we learn from history.²⁹

It is commendable that the Proclamation tried to introduce amicable dispute resolution mechanism to solve disputes that arise in the government and management of cooperatives. However, there are serious substantive and procedural limitations in the Proclamation that need to be amended so that cooperatives may benefit from amicable dispute resolution mechanisms as it is intended by the legislator.

²⁸ See Part nine, Articles 61-67.

²⁹ Lawyers assisted cooperatives in Europe, in the USA and in Canada to get legal recognition and to find legal coverage and recognition. The Rochdale Society of Equitable Pioneers was for example, getting critical legal advice and supervision from Edward Vansittart Neale. See Holyoake, George Jacob(1903) *The Co- Operatives Movement To-day*. Methuen & Co, London. (Re)Published in 2012 by Forgotten Books. Page 95.

The first limitation that needs to be rectified is in relation to appeal from arbitration decisions. The Proclamation allows parties to appeal to formal courts whenever they disagree with the outcome of the arbitration decision. Article 67 provides that

“any person who has grievance on the decisions given by the Arbitrators pursuant to article 65 of this proclamation may lodge appeal to the Regular Courts if the issue is at regional level to Regional Court which have jurisdiction, if it is at federal level to the Federal High Court” and sub 2 of the same article further provides that “Without prejudice to the provisions of article 61 and 62 of this proclamation, if parties do not agree on conciliation or arbitration they can bring the issue to regular court which has jurisdiction.”

This contradicts with the provisions of the Civil Procedure Code that limits appeal from arbitration tribunals to only specific grounds of appeal. The general intention of arbitration is also to avoid lengthy and costly legal litigation. Therefore, to allow parties to appeal to formal courts without any limitation negates the very reason that arbitration is required for. The Proclamation generally failed to provide the required clarity for the dispute resolution mechanisms to achieve their objectives. It has failed to make clear the distinction between *shimglina* and arbitration.³⁰

What could have been better in this regard is to introduce institutional arbitration by establishing an independent and neutral arbitration institution or special tribunal that adjudicates disputes using multilevel dispute resolution mechanism. Establishing special tribunals may provide the following advantages. It can include experts who understand the cooperative principles and values in the arbitration tribunal, it can be accessible and uncomplicated, and it can make its verdicts within a reasonable period. Generally, institutional arbitration would help to solve disputes efficiently and effectively. Furthermore, the tribunals may creatively integrate the traditional dispute resolution methods and techniques with modern business practices to come up with fair, equitable and rational procedures that in the long term help to create a smooth and predictable dispute resolution mechanism that avoids or reduces disputes among members, the management and the workers. Well defined dispute settlement mechanisms help the cooperative enterprise to become more stable and reliable institution so that creditors and other business partners will be confident in their dealing with the enterprise.

³⁰ For further reading on the issue see Petros, F. (2009) Underlying distinctions between ADR, Shimglina and arbitration: a critical analysis, Mizan Law Review vol. 3, no. 1, pp. 105-133. Addis Ababa: St. Mary's University.

3. Saving and Credit Cooperatives and the Law in Ethiopia

Saving and credit cooperatives are considered one of the most sustainable and effective cooperatives in the history of cooperatives in Ethiopia.³¹ The number of saving and credit cooperatives have been rapidly growing in the last 10 years in Ethiopia. According to the Federal Cooperative Agency report 2018, 20,591 cooperative societies and 128 cooperative unions are registered in the country. They have collected 12 billion Birr in savings. They have 4 billion Birr as capital and have provided more than 8 billion Birr as credit to their members.³²

There is no specific law that regulates saving and credit cooperatives in Ethiopia other than Proclamation No. 985/2016 that gives very little attention for saving and credit cooperatives. Hereunder the article discusses some of the provisions that are relevant to the topic.

3.1. Formation of Saving and Credit Cooperatives

The proclamation defines a saving and credit cooperative society as a “society established to provide saving, credit and loan – life insurance services to its members.”³³ The objectives of cooperative societies are, according to the Proclamation, to enhance saving culture of the society, to provide loan to its members, to encourage investment and development and to minimize and share risks in the society.³⁴ The Proclamation provides that the minimum number of members to establish a cooperative society is fifty.³⁵ The Proclamation provides that cooperatives can be established by individuals who live or work in the same area and by professionals who are engaged in the same profession.³⁶

The requirement to live or work in the same area is very vague as the expressions ‘living in the same area’ and ‘working in the same area’ are not defined by the Proclamation and the terms are not also used in the Civil Code that regulate the personal laws. Furthermore, the requirement of working in the same area or living in the same area would make it more difficult for individuals who would like to come together and establish saving and credit cooperatives. The Proclamation seems to follow the Raiffeisen approach that was developed and applied in Germany for rural credit unions. However, for urban residents the Schulze-Delitzsch Volksbanken (people’s bank) approach seemed more appropriate at the time.³⁷ To require

³¹ Supra note 14, Tefera, Bijman, & Slingerland, Pages 431-453.

³² Report of the Federal Cooperative Commission, available at <http://www.fca.gov.et/>. The report on the website is not updated. The author contacted in person the official who is in charge of organizing and supporting credit and saving unions in the Agency and the official provided the latest report of 2018.

³³ Cooperative Society’s Proclamation No 985/2016. *Federal Negarit Gazeta*, No 7, P. 9436, Ethiopia, Addis Ababa. Article 1(70)

³⁴ See Article 4, Cooperative Society’s Proclamation No 985/2016.

³⁵ Article 7(2) of the Cooperative Society’s Proclamation. The Proclamation has given the authority discretion to decide on the number of members considering the nature of the work.

³⁶ Ibid.

³⁷ Goglio, S. and Kalmi, P. (2017). Credit unions and cooperative banks across the world: in Michie, C, Blasi, R. and Borzaga, C.(2017) *The Oxford Handbook of Mutual, Co-operative, and Co-owned Business*. Oxford University Press. Pages 145-156.

working in the same office or living in certain location as a necessary condition for the formation of saving and credit cooperatives may hinder the effectiveness of saving and credit cooperatives in urban areas. It is also useful to note here that the requirement of living in the same area or working in the same place makes it difficult for individuals who work in the informal economy and for small and medium enterprises to organize credit and saving cooperatives. The requirement to work in one sector or to live in similar place also makes it difficult for traditional financial institutions like *Eqqub* to reorganize themselves as saving and credit cooperatives, if they need so. *Eqqub* members commonly come from different professions and places. It is very common to find civil servants, traders, and teachers in one *Eqqub*. The diversification of members is vital in *Eqqubs*, as diversified members have diversified financial interests that complement each other. Some members in *Eqqub* are interested in using *Eqqubs* for saving while others are interested in quick access to credits that makes *Eqqubs* relevant for both of them.³⁸

Nowadays some saving and credit cooperatives that are not based in a certain organization follow an open membership policy that violates the law that requires cooperatives to recruit their members from specific area or specific profession. So far, they are openly operating with members who are from different areas and from different professions and the regulators turn a blind eye on these cooperatives. Therefore, it seems that there is a consensus among stakeholders that the law which demands members of cooperatives to share living area or profession is not meant to be implemented in practice.

3.2. The Governance of Saving and Credit Cooperatives in Ethiopia

Corporate governance can be defined as “the mechanism for internal control system that makes up the structure through which the objectives are defined, the means to reach the goals are determined and the results are controlled. It involves a set of relationships among the shareholders, the board of directors, the managers, and other stakeholders”³⁹ In relation to saving and credit cooperatives, the main challenges in relation to governance relate with the following points:⁴⁰

- a. Loss of interest by members in the governance of the union as the process becomes complex and technical;
- b. Possible conflict between cooperative philosophy and the interest of members;

³⁸ The South African Cooperative Bank Act No 40/2007 provides that “a co-operative registered as a co-operative bank in terms of this Act whose members— (a) are of similar occupation or profession or who are employed by a common employer or who are employed within the same business district; or (b) have common membership in an association or organisation, including a business, religious, social, co-operative, labour or educational group; or (c) reside within the same defined community or geographical area.” It seems that a similar approach may help to integrate the traditional institutions with modern cooperatives.

³⁹ Amha, W and Alemu, T (2014). Household Saving Behavior and Saving Mobilization in Ethiopia, EIFTRI, Addis Ababa, Pages 152-153.

⁴⁰ Ibid.

- c. The risk that the board becomes independent from members' control;
- d. Growing agency problem;
- e. Weakening of democratic control;
- f. Mission drift by excluding the poorest; and
- g. Entry barrier for new cooperative banks due to regulation.

The Proclamation has tried to address some of the concerns in the governance of cooperatives.

It requires that the founders should deposit money in a bank that is enough to cover one year's administrative costs of the cooperative and one fifth of the subscribed amount shall be paid up and the remaining paid in the coming four years.⁴¹ This strategy is to avoid cooperatives that come and vanish without carrying out any meaningful activity for their members and society. However, the Proclamation provides nothing in relation to how much credit can be allowed to a member, how they deal with unpaid loan, how many loans they can get from other sources and how they cooperate with other institutions like banks and microfinance institutions. It can be said that these issues shall be regulated by the by-laws. However, considering the delicate nature of the transaction in the saving and credit cooperatives, it would have been better to introduce a separate proclamation or regulation with the required details. Saving and credit cooperatives require a more elaborated and detailed regulation than what is generally provided in Proclamation No 985/2016.

The cooperative law allows cooperatives to issue special shares for non-members with special privileges. Therefore, credit unions can allow non-members to own special shares. The law also allows cooperatives to decide freely the lending interest rate and the borrowing interest rate.⁴² The law allows a member to control 10% of the shares. Therefore, this clearly shows that credit unions deserve special regulation that provides the required prudent supervision as well as provide them with the opportunity to grow further to become important players in the financial sector of the country. The cooperative Proclamation under Article 10 indicates that special regulation with specific and detailed provisions will be enacted by the Council of Ministers. However, so far, the Council has not taken any action.

3.3. Financial Services that Saving and Credit Cooperative Provide

The main function of saving and credit cooperatives is provided under Article 21(9). They are mandated to collect savings, to provide credits and loan- life insurance to their members. Saving and credit cooperatives are not allowed to make credits to nonmembers and to collect saving from non-members. However, cooperatives can provide loans to other cooperatives.⁴³ It is important to note here that

⁴¹ Articles 21 and 27(2) of the Proclamation.

⁴² Article 48(2).

⁴³ Article 48.

cooperatives that are not specifically established as saving and credit cooperative societies can also provide credit to their members and they can also provide loan to other cooperatives.

Cooperative societies are allowed to receive revolving funds from development partners to serve their members and also nonmembers.⁴⁴ The mandate to receive funds from development partners is open to all cooperatives and it is not limited only to saving and credit cooperatives. What is interesting with regard to revolving funds is the fact that the law puts no limitation on the source of the fund. Therefore, funds from foreign sources or from international development actors can also be eligible to finance the society via cooperatives. The cooperative societies may collect payment as service charges and interests from the revolving funds they provide for beneficiaries according to the contract they agreed with the fund providing partner.

Saving and credit cooperatives are allowed to use collaterals for credits and they are empowered to decide the applicable interest rate by their by-laws.⁴⁵ Cooperatives have also a right to be paid in priority to other creditors except for debts owed to the government.⁴⁶ The privilege to be paid in priority is an important addition to the advantages that are given to cooperatives by the law. A right to be paid in priority may be the most appealing incentive for traditional financial institutions to restructure themselves as cooperatives as they are currently facing a problem of not getting adequate share from insolvent debtors who also owe debts to banks and microfinance institutes. Article 40 of the Proclamation provides that the share in cooperatives is exempted from possible court attachment to satisfy a member's personal creditors. However, the shares can be set off for debts a member owes to the cooperative society. Cooperatives are exempted from income tax, and are entitled to get access to land free from auction and they are exempted from court fees in all litigation in which they are involved.

3.4. Arguments for Specific and Comprehensive Laws

Saving and credit cooperatives can play an irreplaceable role for the development of the financial sector and to improve financial inclusion in Ethiopia.⁴⁷ Saving and credit cooperatives help to enhance equitable and accessible financial service for the segment of the society that is excluded from the financial sector. Saving and credit cooperatives however need to be supported with the required prudent supervision and legal framework to avoid a disaster for their members and for the society at large. In Ethiopia it seems that so far, they are not given the required attention by the relevant authorities and they are cornered by policy makers. The central bank that regulates banks, microfinance institutions and insurance has not

⁴⁴ Article 23 (C).

⁴⁵ Article 49.

⁴⁶ Article 40.

⁴⁷ Supra note 40, Amha and Alemu. Page, 69.

enacted any directive or any law in relation to saving and credit cooperatives and they are left to be dealt by the cooperative agency which lacks the required experience, expertise and understanding of the financial system and the banking system of the country.

Saving and credit cooperatives, like other cooperatives, can form credit unions and federation of cooperatives to benefit from scale. That means they can become big enterprises that can attract a lot of savings from their members and attract additional finance from non-members using special shares and loans from other sources. Therefore, the way they are established, controlled, administered and structured are important issues that we need to make sure that they play a positive role in enhancing financial inclusion in the country. The Proclamation that is intended to regulate all kinds of cooperatives has a very limited capacity to provide the required framework for saving and credit cooperatives to develop further and to provide the required service to their members and to the community at large. Therefore, credit unions deserve special laws and attention. To leave them full control and regulation by the cooperative agency is imprudent for two reasons: (1) It creates a risk for depositors and for members as it may be easily abused by the management of federation; and (2) it denies cooperatives the opportunity to scale up and become cooperative banks that provide a multitude of services to their members and to the society at large. In Ethiopia there is currently no legal framework that allows cooperatives to scale up to operate as cooperative banks which allows them to serve non-members. To force them to become just another commercial bank and change their identity is not the right thing.⁴⁸ The lack of diversified banking ownership system can be considered as a limitation in the sustainable and healthy growth of the financial sector for the following reasons:

1. Access to credit is one of the most restricted services in developing countries and the situation is not different in Ethiopia. Credit from banks is inaccessible for most people in Ethiopia not least for those who are unfamiliar with the complex bureaucracy and stringent security requirements of banks. Only 21% of the population has access to banking business in Ethiopia and it is assumed that most of those who have access to banking business may not be qualified to get an advance or loans from the banks.⁴⁹ It is also important to note that even when some applicants are lucky enough to get credit from banks the amount of credit is commonly less than what they need to avoid dependency on the informal market. Therefore, as the credit from banks will not be accessible or insufficient to start business, entrepreneurs in many cases partially or totally depend on the informal credit market.

⁴⁸ The Oromia Cooperative Bank is established by cooperative enterprises in Oromia as main shareholders. However, as they were not allowed to maintain their identity as cooperative banks, they changed their structure to become investor-owned commercial banks by drifting from their cooperative identity. Had it not been for the poor legal framework, they could have emerged as the first true cooperative banks in the country. Now they only maintain the name cooperative, but they are just investor-owned banks.

⁴⁹ The Ethiopian National Bank, Financial Inclusion Strategy, 2018.

Supporting and promoting credit unions is among the best strategies to improve access to finance in developing countries. “Legislative intervention to support the operation of the mutual model in deprived areas may be necessary to help combat this growing problem of financial exclusion.”⁵⁰ Therefore, allowing credit unions to form a small scale bank that is owned and controlled by its members provides a good alternative to credit consumers.⁵¹

2. The agricultural cooperatives that are playing a significant role in importing and distributing fertilizers and improved seeds for farmers are also facing a growing challenge to get financing from commercial banks. Cooperatives have a limited financial power to distribute fertilizers both to members and non-members. Cooperatives then depend on government owned commercial banks or microfinance institutions to get the fund they need to distribute fertilizers for farmers. Commonly, the government owned commercial banks of Ethiopia provide credit to cooperatives directly or sometimes they provide funds to microfinance institutions that are affiliated with regional governments. Regional governments provide guarantees to the commercial banks. Therefore they can provide credit to cooperatives. This long and complicated process makes credit expensive for households. Cooperatives also take the difficult and risky job of collecting the loan from farmers but without any proportional reward for their contribution. Therefore, establishing cooperative banks may solve this problem. Cooperative banks, based on the principle of “cooperation among cooperatives”, can work effectively with agricultural cooperatives to solve the problem. The cooperative banks will benefit from the special privileges that are given to cooperative enterprises and they can use this advantage to provide affordable credit and insurance services to other cooperatives. They can be supervised jointly by the Cooperative Agency and by the National Bank to assure they play a positive role in the development of the banking system and also for the development of cooperatives in the country.
3. The third argument to provide a framework for cooperative banks in Ethiopia is based on the need to diversify the banking ownership structure in Ethiopia. Investor-owned share company is the only model of ownership that is allowed to operate as bank or as a microfinance institution in Ethiopia.⁵² However, especially after the recent financial crisis many finance experts and lawyers are asking if the investor owned model is the best model for the financial sector.⁵³ At least currently there is a

⁵⁰ Adams, Z. and Deakin, S. (2017). Enterprise Form, Participation and Performance in Mutuals and Co-operatives. In Michie, J., Blasi, R. and Borzaga, C. (2017). *The Oxford Handbook of Mutual, Co-operative, and Co-owned Business*. Oxford University Press. Page 242.

⁵¹ Abdula, Kelifa (2009). Can the Rich Finance the Poor in Ethiopia ? A Fresh Look to Address the Challenge in the Microfinance Sector: in Tekie Alemu (ED) (2009). *Proceedings of the 10th Anniversary of AEMFI Ethiopia*, Addis Ababa. Pages 87-108.

⁵² See Microfinance Business Proclamation No 626/ 2009. The Banking Business Proclamation No 592/2008 and the Proclamation to Amend the National Bank of Ethiopia Establishment Proclamation No. 591/2008.

⁵³ Supra note 49, page 238.

consensus that complicated systems like the financial system will be better off if they are required to follow a diversified ownership structure. Adams and Deakin argued that:⁵⁴

“different legal models serve different social and economic needs. It may be desirable for the law to intervene in order to maintain plurality so that the specific needs served by the different models are not left unmet”. They further explained that “the experience of the 2008 financial crisis has lent support to the view that preserving a diversity of ownership structures in a sector of the economy may be necessary pre-requisite to the avoidance of systemic risk.”

To exclude all other ownership modalities and to rely only on the share company model seems to be founded on shaky assumptions that are challenged both theoretically and empirically, especially following the 2008 financial crisis.⁵⁵ Generally, both theoretical arguments and empirical findings decidedly imply that member controlled financial services are more stable and less risk averse than commercial banks.⁵⁶ Bülbül, Schmidt and Schüwer suggested that:⁵⁷

“Most savings and cooperative banks also fared relatively well in the crisis and better than most of their competitors from the ranks of large private banks. This is due to the fact that, by virtue of their institutional design, they have limited incentives to take on greater risks, while their strong local roots and their embeddedness in close networks puts limits on their possibilities to do so.”

Therefore, policy makers in Ethiopia need to give the required attention to introduce cooperative banks or strong credit unions. Cooperative banks will help to reduce the level of financial exclusion in Ethiopia and to increase saving in the country.⁵⁸ Furthermore, cooperative banks or credit unions, as owned and controlled by consumers, will contribute to protect consumer rights in the credit market. Cooperative banks will also help to diversify the ownership structure of banks and thereby may help to avoid a systemic risk in the financial sector.

Conclusion

Cooperative enterprises that are owned by members for members' benefit are considered to be one of the most prominent social innovations that provide alternatives to investor owned enterprises in many countries. Cooperative enterprises are considered as one of the best suitable ownership models to promote

⁵⁴ Supra note 49, page 238.

⁵⁵ Supra note 49, page, 238.

⁵⁶ Supra note 49, page 237.

⁵⁷ Bülbül, D., Schmidt, R., and Schüwer, U (2013). Savings Banks and Cooperative Banks in Europe. White Paper Series No. 5. Center of excellent SAFE Sustainable Architecture for Finance in Europe. Goethe, Available at https://safefrankfurt.de/uploads/media/Schmidt_Buelbuel_Schuewer_Savings_Banks_and_Cooperative_Banks_in_Europe.pdf. Page 17.

⁵⁸ Supra note 38. Amha and Alemu. Page 69.

social welfare and a sustainable development. Credit and saving cooperatives play a dual role in the cooperative based development. They provide affordable saving and credit services for their members and most importantly they provide financing services for other cooperatives based on the principle “cooperation among cooperatives”⁵⁹.

Ethiopia has attempted to use cooperatives to alleviate some of its intricate social and economic problems. However, generally speaking modern cooperative enterprises in Ethiopia have always been the project of the government and have never been the result of a social movement that was initiated and developed by the community and as a result they are sadly kept separate from indigenous institutions.⁶⁰ They regrettably have lost the opportunity to capitalize on what is already known and acceptable by the society. However, one prominent exception can be saving and credit cooperatives. Credit and saving cooperatives are very popular and commonly free from unwarranted government intervention.

Credit and saving cooperatives are regulated by the cooperative Proclamation that gives limited attention to credit and saving cooperatives while it focuses on agricultural cooperatives as its main subject. The lack of a separate legal framework that is developed considering the special nature of credit and saving cooperatives has posed at least two self-evident challenges to the sector. Firstly, the lack of proper prudent supervision by competent entities exposed them to operational and governance risk. The lack of prudent regulation may also erode the confidence of members and other potential partners that is crucial for the development of the sector. The second effect of the lack of well-crafted laws is denying them the opportunity to expand their services to play a significant role in the financial sector without losing their identity as cooperatives. Therefore, enacting specific laws that deal exclusively with credit and saving cooperatives may lead to the creation of cooperative banks. Supervision by the Cooperative Agency and by the National Bank is recommended to improve the accessibility and inclusiveness of the financial sector. The introduction of cooperative banks may also help to diversify the ownership structure of the banking industry.

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⁵⁹ Supra note 50, Abdula, Pages 87-108.

⁶⁰ Ibid.

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