Prescription without Laboratory Diagnosis: an investigation into Rural Credit System in Arsi Zone, Oromiya, Ethiopia

Adem Kedir Geleto
Haramaya University, email: ademkg@yahoo.com, ademkg@gmail.com

Abstract
Government of Ethiopia makes different attempts to improve the livelihoods of its people. One of these attempts is the establishment of credit and saving unions in different parts of the country. Arsi zone of Oromiya National Regional State is one of the areas in which the credit and saving unions operate. This study was undertaken in 2011/12 with general objective of assessing the status of rural poverty in the zone. It covers 443 households randomly selected from five districts of the 25 districts of the zone. Assessing the impact of rural credit on household poverty was one of the specific objectives of the study. It was found that 300(67.7%) of the households frequently failed to cover their financial requirements and 204 (68%) of them used credit as coping strategy for financial shortages. Surprisingly, only 33 (16.2%) households took credit from formal institutions. Focus group discussions made with credit takers and credit providers revealed that the formal credit is interest based and requires group collateral. Religious background of the households forbid participation in interest based credit and no one is interested to form group with the poorest of the poor. Even among those who took the formal credit, about 94% faced food shortages very frequently ending in using the credit for covering food shortfalls rather than participating in some productive investments. On top of these, most of the credit takers are illiterate who lack marketing know-how and entrepreneurial skills. All these show that there are a lot of mismatches between the demand for credit and the supply of credit in the study area. The credit provision, therefore, looks like prescription without laboratory diagnosis. It is thus recommended that the credit system should be redesigned taking into consideration the social, cultural and economic conditions of the people.
Keywords: Credit, interest, religion, poverty

Introduction

Ethiopia is considered as one of the poorest countries in the world in many indicators. African Development Bank (2010) report indicates that Ethiopia stood 40th by GNI per capita in 2008; 29th by life expectancy at birth; 25th by infant mortality; and 29th by gross capital formation as compared to the 53 African countries. The UNDP (2010) Human Development Report also shows that Ethiopia ranked 157th out of 169 countries scoring human development index of 0.328 in 2010. The maternal mortality ratio (2003-2008) of the country is 720 and only 6% of the births were attended by skilled health personnel. The same report indicates that poverty head count (2003-2008) based on multidimensional measures was 90% with 64.7% intensity of deprivation. CSA (2011) also shows that more than 96% of rural households live in houses with floor made up of mud; 59.3% cook in the house in which they live; and 71% have only one sleeping room. It indicates also that 62% of rural people in Ethiopia travel for more than 30 minutes to fetch drinking water. The same study indicates that 58% of female and 44% male in Ethiopia have no education and 77.8% of women and 69.1% men in Ethiopia had no access to mass media.

All these indicate that different poverty reduction works are required of the government and its people. Rural micro credit provisions and formation of credit and saving unions at regional levels is one of the attempts that have been made by the Ethiopian government to reduce poverty. Micro credit is a small amount of money loaned to a client by a bank or other institution (Letif *et al.,* 2011). Micro credit is a system where people in poor countries can borrow small amounts of money at low rates of interest even if they have little or no collateral. It works through small banks, which lend money to local people so that they can start businesses and earn their living. Microfinance refers to loans, savings, insurance, transfer services, micro credit loans and other financial products targeted at low-income clients. Micro credit and micro finance have changed the lives of people and revitalized communities in the world's poorest as well as the richest countries, according to Letif *et al.* (2011). They claim also that micro credit has been changing the lives of people and revitalizing communities worldwide for centuries. Micro credit caters commercial needs of poor for enabling them to raise their income levels and improve standards of living. They found also that micro credit has positive impact on alleviating poverty in Pakistan mentioning the evidence that 40% of the beneficiaries opened shops/small provision stores, followed by investment in poultry, embroidery and livestock. Access and efficient provision of micro credit can enable the poor to smooth their consumption, better manage their risks, gradually build their assets, develop their micro enterprises, enhance their income earning capacity, and enjoy an improved quality of life (Durrani et al., 2011). Micro-credit contributes to mitigating a number of factors that contribute to vulnerability, whereas the impact on income-poverty is a function of borrowing beyond a certain loan threshold and to a certain extent contingent on how poor the household is to start with (Zaman, 1999).

Similar study by Enisan (2012) shows that many of the beneficiaries of microcredit in Ondo State of Nigeria utilized their loans to procure durable equipment needed in their small scale enterprises and show that loan empowerment has a significant positive effect on beneficiaries' welfare. He concluded also that access to credit allowed the beneficiaries take advantage of economic opportunities by providing a fundamental basis for planning and expanding business activities. What makes the beneficiaries in Enisan's (2012) study unique is that most beneficiaries of micro credit loans are educated young. Cuong *et al*. (2007) also found that micro-credit decreased the head count of poverty for its participants by almost four percentage points and decreased the poverty gap index and the poverty-severity index by almost twenty percent. They did not deny also that only one third of loans reach households who are actually poor.

Contrary to the above findings, Fitri (2006) in his study on Indonesia found that credit programs both formal and informal have not had a positive impact on poverty alleviation. The reason he gave for the failure are unmet demand between the formal financial institutions as the credit providers and the small farmers as the credit recipients in the case of formal credit and being small in size of the loan in the case of informal credit. He emphasized also that informal credit schemes were favoured by the majority of the rural population due to their flexibility and adaptation to local cultures and values.

An attempt to analyze the impact of credit, therefore, requires the investigation into not only the credit scheme but also the local culture and the values of the people. The problems that are discussed in this paper in fact arose from field observations of the study whose objective was assessing the status of rural poverty in Arsi Zone of Oromiya National Regional State. Taking credit was one of the poverty coping strategies used by the rural households as identified by the study on the one hand and there is a great mismatch between the demand and supply of the credit, especially the formal one. The main objective of this paper is, therefore, to discuss on such issues and give possible policy directions to solve the problem.

Methodology

As it has been mentioned in the background above, the study was undertaken with the general objectives of identifying the determinants, consequences and coping strategies of rural poverty in the zone. It covers 443 households randomly selected 13 rural *kebeles* selected from five districts of the 25 districts of Arsi zone. The districts are Digelu-Tijo (highland), Diksis (highland), Sude (midland), Dodota (lowland) and Ziway Dugda (lowland). Data collection was undertaken during June-July 2011 with personal interview of the household heads. Households were asked if they had faced financial shortages and the strategies they used to cope up with the shortages. Those who responded that they used credit were asked about the effects of the credit on their livelihoods. Focus Group Discussions (FGD) were also held in one of the districts after hearing the responses of the households. One of the FGD was with credit providers while the other is with credit takers. The credit takers consist of both male and female members. The methods of data analysis used for the particular discussions in this paper are only descriptive statistics.

Results and Discussions

It was found that 300(67.7%) of the households frequently failed to cover their financial requirements and 204 (68%) of them used credit as coping strategy for financial shortages. Surprisingly, only 33 (16.2%) households took credit from formal institutions. Table 1 also gives the detail of the households' poverty statuses and the number of beneficiaries of the formal credit among the poor. In this case too, the number of households that benefited from the formal credits is far below the number of poor indentified with the given poverty indicators.

Focus group discussions made with credit takers and credit providers revealed that the formal credit is interest based and requires group collateral. Religious background of the households forbid participation in interest based credit and no one is interested to form group with the poorest of the poor as they will be required to pay the money if anyone of the members fails to pay or disappear. According to CSA (2007) about 60% of Arsi Zone's population is Muslim, the figure being about 90% in some districts of the zone. Even if these people are governed by the laws of the Ethiopian government they do also obey the commands of their religion. Islam permits trade and credit but does not allow interest based financial transactions. Interest-based credit is considered as consuming peoples' money unjustly (Quran sura-4, 161) and considered as sin in different verses of Quran (2:275; 3:130; 30:39). The Islamic Shariah does not object profit-taking and payment for the use of an asset as long as both lender and borrower share the investment risk together (Hesse *et al*., 2008). The people are taught this well either in their local language or in Arabic translated by the Imams. The economic foundation of the prohibition is also well explained in the Hadiths of the Prophet.

The economic foundation of the prohibition of interest based credit is based on the fact that the basic concept of Islam is that wealth should not be hoarded or wasted, it should be put to productive use so that the owner, the society and the less privileged may share the benefits. It follows that it is not permissible to leave money idle and charge interest or profit from the mere use of the money by another party without regard to risks, or profits that may generate. Usurers only seek profit, or interest without risks, according to the hadith. This is contrary to the foundation of Islamic economy which is based on equity and equilibrium (Sahih Muslim Book 10). Another hadith also reports that Allah's Apostle (Muhammad, PBUH) used to invoke Allah in the prayer saying, "O Allah, I seek refuge with you from all sins, and from being in debt.", giving the reason saying that, if a person is in debt, he tells lies when he speaks, and breaks his promises when he promises (Bukhari hadith book 41).

All these show that being in debt in not encouraged in general and involving in interest based transactions is forbidden in Islam. It is obvious, then, that no believer wants to commit sin and hence people are not interested in taking interest based loans. One of the factors hindering the people from taking formal credits, when in fact they badly need money and they are poor in many measures, is that their religion does not allow taking. This is obviously one of the reasons in the study area. This is again in agreement with Temesgen (2012) finding in Somali National Regional State which states that religion restricts households from seeking formal saving and credit services which are linked with interest earning or payments (more than 99% of the households in his study area are Muslim). Even the Grameen Bank Concept that literature on microcredit appreciate states that Micro-credit is a small amount of loan given to the poor to develop their standard of living and its is based and trust and collateral free (Shukran and Rahman, 2011).

Even among those who took the formal credit, about 94% faced food shortages very frequently ending in using the credit for covering food shortfalls rather than participating in some productive investments. There were also some who used the money to furnish their houses but failed to pay back the loan as they did not have any other financial sources. Houses in the rural areas are also not sold. Some few also complain that some of their friends migrated to other areas selling their lands after to pay the loan (how far this is true in fact cannot be proved). On top of these, most of the credit takers are illiterate who lack marketing know-how and entrepreneurial skills. All these show that there are a lot of mismatches between the demand for credit and the supply of credit in the study area.

Results of our FGD and informal discussions also show that the credit provision was not based on the detail study of the household characteristics and interests. There are also many formal credit providers but none of them share information and hence some credits takers take from two or more sources and fail to pay back. This may be in line with what Pitamber (2003) states that the microfinance institutions lack clear implementation mechanisms to achieve the poverty reduction aims of the credits. Lack of participation of the beneficiaries in the design of the credit programs, the inability of certain commonly used indicators of success/failure of micro-credit in measuring the non-quantifiable impact of the programmes on the clients, the micro size of the loan and the small returns from the use of the loan are some of the factors that may hinder the process of poverty reduction. Pitamber (2003) argues also that it is a misconception that an MFI always targets the ultimate poorest of the poor, the landless, the assetless, and the destitute, because, for an MFI such a client profile will not ensure returns and increase profits, and it is precisely such a beneficiary profile that is unattractive and unlikely to become a potential client.

Our discussion with the credit providers on the other hand show that the beneficiaries deposit some percentage of the loan as compulsory saving and they are given orientations on how to use. They argue also that interest based credit is not forbidden. My personal observation from the discussions is that the intention of the credit providers is good to help the poor but the relationship between them and the beneficiaries is like the traditional teacher-student relationship. The teacher decides what to teach and how to teach but the student accepts everything. They confirmed to us also that their credit is based on group- collateral and by implication excludes the poorest of the poor.

Table 1: Distributions of household by poverty status and formal credit use

Poverty Type	Number of Poor (A)	Number of poor beneficiaries of formal credit (B)	Difference (A-B)
Income	353	32	321
Food	337	28	309
Housing	264	25	239
Clothing	173	14	159
Education	364	30	334
Health	120	9	111
Information	244	19	225

Source: Adem (2013)

This paper does not argue that credit does not help poverty alleviation, but argues that the credit provision in the study area did not take the need, the culture, religion and other important characteristics of the society. It is prescription from the credit providers in the form of "take this in this way as I know for you". We can, therefore, conclude that the credit provision in the study in particular and in the country in general looks like prescription without laboratory diagnosis. It is thus recommended that the credit system should be redesigned taking into consideration the social, cultural and economic conditions of the people. Putting in other words, the credit should be non-interest bearing and avoid (group) collateral if it is meant for rural poverty reduction in the areas where most of the households are Muslim and where the poor has no collateral to take the credit. Households should be requested and supported to prepare their proposals/business plans before taking the credit if their intention is for running small businesses on the one hand, and the government has to design the credit system that fits the interests of the households if the purposes of taking credits are different from running businesses. Then, only the government's poverty alleviation/reduction effort will be fruitful. Learning the experiences of other countries may also help in this regard.

References

1. Adem Kedir Geleto, 2013. Determinants, Consequences and Coping Strategies of Rural Poverty in Arsi Zone, Oromiya, Ethiopia; PhD Dissertation, Haramaya University
2. African Development Bank, 2010. *ADB Statistics Pocketbook*, Economic and Social Statistics Division of ADB.
3. Central Statistical Agency (CSA), 2007, Ethiopian Population and Housing Census, Provisional Result for 2007, CSA, Addis Ababa.
4. Central Statistical Agency (CSA), 2012. Ethiopia Demographic and Health Survey 2011.
5. Coung, N.V.; Bigman, D.; Berg, M.V. and Thiu, V. 2007. Impact of Micro-credit on Poverty and Inequality: The Case of the Vietnam Bank for Social Policies.
6. Enisan, A.A., 2012. Impact of Microfinance on Poverty Alleviation in Ondo State, Nigeria, Australian Journal of Business and Management Research, 2(9):31-37.
7. Fitri, R., 2006. Informal Finance and Poverty Alleviation: A Grassroots Study of Small Farmers' Credit in West Sumatra, Indonesia, A Thesis presented in fulfillment of the requirements for the Degree of Doctor of Philosophy in Development Studies at Massey University, Palmerstone North, New Zealand.
8. Hadith Bukhari, BK. 41: Loans, Payment of Loans, Freezing of Property, Bankruptcy
9. Hesse, H; Jobst, A.A and Sole, J., 2008. Trends and Challenges in Islamic Finance, *World Economics*, 9(2): 175-194.
10. Latif, A.; Nazar, M.S.; Mehmood, T.; Shaik, F.M and Shay, A.A., 2011. Sustainability of Micro Credit System in Pakistan and Its Impact on Poverty Alleviation, Journal of Sustainable Development, 4 (4):160-165.
11. Pitamber, S., 2003. Factors Impeding the Poverty Reduction Capacity of Micro-Credit: Some Field Observations from Malawi and Ethiopia, the African Development Bank.
12. Sahih Muslim (Book 10), the book of Transactions
13. Shukran, Kh. And Rahman, F. 2011. A Grameen Bank Concept: Micro-credit and Poverty Alleviation Program in Bangladesh, International Conference on Emerging Trends in Computer and Image Processing (ICETCIP2011), Bangkok.
14. Temesgen Keno, 2012. Outreach Frontiers of Microfinance Service Development in Rural Ethiopia: A Case of Shinile District in Somali National Regional State, Journal of Economics and Sustainable Development, 3(7):40-50.
15. The Quran: Arabic Text with Corresponding English Meanings, Abulqasim Publishing House, 1997, Riyadh
16. United Nations Development Program (UNDP), 2010. Human Development Report 2010: The Real Wealth of Nations: Pathways to Human Development, United Nations Development Program.
17. Zaman, H. (1999). Assessing the Poverty and Vulnerability Impact of Micro-Credit in Bangladesh: A Case Study of BRAC, downloaded from www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/ on September 09, 2013.

The IISTE is a pioneer in the Open-Access hosting service and academic event management. The aim of the firm is Accelerating Global Knowledge Sharing.

More information about the firm can be found on the homepage:
http://www.iiste.org

CALL FOR JOURNAL PAPERS

There are more than 30 peer-reviewed academic journals hosted under the hosting platform.

Prospective authors of journals can find the submission instruction on the following page: http://www.iiste.org/journals/ All the journals articles are available online to the readers all over the world without financial, legal, or technical barriers other than those inseparable from gaining access to the internet itself. Paper version of the journals is also available upon request of readers and authors.

MORE RESOURCES

Book publication information: http://www.iiste.org/book/

IISTE Knowledge Sharing Partners

EBSCO, Index Copernicus, Ulrich's Periodicals Directory, JournalTOCS, PKP Open Archives Harvester, Bielefeld Academic Search Engine, Elektronische Zeitschriftenbibliothek EZB, Open J-Gate, OCLC WorldCat, Universe Digtial Library , NewJour, Google Scholar