

Uncertainties in the Enforcement of Loan Agreements in the Informal Credit Markets in Ethiopia

Gebreyesus Abegaz Yimer *

Abstract

Credits from informal credit markets are commonly used by those who have limited access to formal financial institutions. There is no comprehensive legal framework that deals with informal credit markets in Ethiopia. The lack of clear, effective and enforceable legal framework to regulate transactions in the informal credit markets has created uncertainty on the applicable laws. Legal contentions on the formation of valid loan contracts and in relation to interest rates have caused ambiguities and inconsistent patterns of interpretation among courts, legal professionals and parties who are involved in the informal credit markets as borrower or lender. This article examines how the provisions of the Civil Code that regulate contract of loan are used and interpreted by courts and contracting parties. Thirty court cases are used to examine how courts apply the provisions of the Civil Code in their decisions in loan related cases in the context of informal credit markets.

Key terms

Contract of loan · Enforcement of contract · Access to finance · Informal credit markets · Oral evidence · Parol evidence rules

DOI <http://dx.doi.org/10.4314/mlr.v13i3.6>

This article is licensed under a Creative Commons Attribution-NonCommercial-NoDerivs (CC BY-NC-ND)

Suggested citation:

Yimer, Gebreyesus Abegaz (2019), 'Uncertainties in the Enforcement of Loan Agreements in the Informal Credit Markets in Ethiopia', *Mizan Law Review*, Vol. 13, No. 3, pp. 472-494.

* Gebreyesus Abegaz Yimer, (Mekelle University). I acknowledge the support of Dr. Elias Nour and Professor Wim Decock (Ku Leuven) in conducting this research. The two unanimous reviewers also deserve an acknowledgement for the valuable comments. The research is funded by the Global Minds Program, KU Leuven, Belgium. You may contact the author at gebreyesusyimer@gmail.com

Introduction

Only about 22 % of Ethiopia's population has transaction accounts in the regulated financial institutions.¹ 56% of the adult population uses the informal credit market for saving, borrowing and insurance services.² Very few individuals are able to secure loan from regulated financial institutions whereas loans from the informal credit markets have proved to be very common in the society.³ The National Inclusive Finance Strategy recognizes that the informal credit market is the main source of credit for small and medium enterprises.⁴

Generally, the informal credit market plays a vital role in the financial landscape of Ethiopia in saving mobilization, in providing loans both for smoothing consumption and for business activities.⁵ This dominant role of the informal credit market in the financial sector of the country is expected to continue in the coming years. The target set by the National Financial Inclusion Strategy for 2020 is to increase saving in formal financial institutions to 40% and to increase bank account holdings to 60%. Therefore the informal credit market will continue to be an integral part of the financial sector in Ethiopia.

The Second Growth and Transformation Plan (GTP2) provides that increasing access to finance and increasing domestic saving are among the main objectives of the plan to transform the economy from agricultural led economy into industry-led economy. The document provides that "During the GTP 2 period, the financial sector will be strengthened with the aim of establishing accessible, efficient and competitive financial system".⁶ This shows that the government recognizes the importance of access to finance to bring the required social and economic transformation the country is aspiring to.

The effort to provide accessible, affordable, diversified and productive financial services to the people cannot be achieved without the formulation and implementation of a policy and strategy that give due attention to the informal credit markets. Inclusive finance can be achieved only when it becomes possible to transform the existing informal credit markets into eligible actors with the

¹ The National Bank of Ethiopia (2017), *National Financial inclusion Strategy*. Available at <https://www.nbe.gov.et/pdf/service/Ethiopian%20National%20Financial%20Inclusion%20Strategy.pdf>. Accessed on 13.11.2018.

² Ibid.

³ Ibid.

⁴ Ibid.

⁵ A. Beza & S. Rao (2017), 'Financial Inclusion in Ethiopia', *International Journal of Economics and Finance*, Volume 9(4), pp. 191-2001.

⁶ National Planning Commission (2015/6), *Growth and Transformation Plan II, Federal Democratic Republic of Ethiopia*. Available at: https://europa.eu/capacity4dev/resilience_ethiopia/document/growth-and-transformation-plan-ii-gtp-ii-201516-201920. Accessed on 23/3./2018.

appropriate policy and legal framework. A legal system that supports an inclusive finance system requires understanding the source and nature of the informal credit markets that are currently prevalent in the country. The sources of informal credit markets in Ethiopia are highlighted in the first section of this article. The second section examines contract of loan under the Civil Code and relates the issues with the informal credit market. The third section examines the application of these laws by courts.

1. Sources of Informal Credits in Ethiopia

There are three main sources of informal credit market in Ethiopia. Credits from friends and families, credits from moneylenders and credits from traditional financial institutions like Eqqub and Iddir. In this research, the focus will be on the first two sources of the informal credit market as credits from traditional financial institutions have different features and they deserve to be discussed independently in a separate publication.

1.1 Loans from families and friends

In its simplest form, credit is assumed to be among one of the oldest forms of socio-economic interactions. Lending and borrowing are among the most common forms of social interdependence that are necessitated by the natural inclination of human beings to use their future income to satisfy their current needs. History tells us that loans in different forms were common in all major ancient civilizations.⁷

Ethiopia is one of the oldest nations that has a long history of trading at local and cross-border levels.⁸ There is sufficient evidence that the kingdom of Aksum, one of the oldest kingdoms in the history of Ethiopia, had mint coins and established a trade relation with the Arabian Peninsula, Egypt, Greece, the Roman Empire and with many other ancient kingdoms.⁹ While the inscriptions on the coins that were used during the reign of King Endybis (227-235) were in Greek language, later coins, for example, from the fifth century onward used Ge'ez.

Coins represent exchange for money that is an advanced stage of exchange from barter. And, needless to say, money as a medium of exchange and a store

⁷ S. Homer & R. Sylla (2005), *A History of Interest Rates*. 4th Ed. New Jersey, John Wiley & Sons Inc.

⁸ R. Rena (2007), 'Historical Development of Money and Banking in Eritrea from the Axumite Kingdom to the Present', *African and Asian Studies*, Volume 6, pp. 135-153.

⁹ J. Phillips (1977), 'Punt and Aksum: Egypt and the Horn of Africa', *Journal of African History*, Volume 38, pp. 423-457. Accessed on 20/ 9/2019; S. Munro-Hya (1982), 'The Foreign Trade of the Aksumite Port of Adulis', *Archaeological Research in Africa*, Volume 17(1), pp. 107-125. Accessed on 26/04/2019.

of value facilitates loan. Inhabitants of Ethiopia therefore, made use of loan as an important social and economic transaction at least during the first years of the establishment of the Aksum Kingdom.¹⁰ Since then, loan from families and friends is the main source of credit for the majority of Ethiopians.¹¹

Beza and Rao reported that 43% of adults included in their field research are confident that they would secure a loan from family and friends.¹² The finding of Beza and Rao is not a surprise to anyone who is familiar with Ethiopian society as small-scale loan in different forms including food items such as Injera (Ethiopian bread that is made from Teff) is very common in Ethiopia. Providing a loan is considered as a moral and religious obligation of friends and relatives in Ethiopia. Providing free loan is one of those possible ways to help friends and relatives. Fikadu Gelaw provided important data on the frequency of loans from families and friends. He found that¹³

of the total of 243 respondents, 39.9% reported that they had lent money to a total of 113 relatives and neighbours.... While about 70% of the loans had been fully recovered, the remaining 30% of the loans were still partially or fully outstanding. Regarding these outstanding loans, 18.8% of the lenders believed they would not recover the loans, particularly since about 94% of the loans were offered without any collateral and the transaction was based on trust. ...

People turn to credit to satisfy multifaceted socio-economic interests. In the rural part of Ethiopia, farmers depend on loans from families and neighbours to satisfy their basic needs and obtain important agricultural inputs such as seeds, farming animals, animal feed and fertilizers.¹⁴ It is also very common to seek loans to cover expenses for wedding and memorial services for relatives.¹⁵ In urban areas, individuals borrow mainly for starting new business or to refinance their business, for consumption particularly to buy household goods, to cover health expenses and to cover cost of social events.¹⁶

¹⁰ Rena (2007), *supra* note 8.

¹¹ A. Kedir & G. Ibrahim (2011), 'Household-Level Credit Constraints in Urban Ethiopia', *Ethiopian Journal of Economics*, Vol. 20(1), pp. 1-24. This research indicated that 75% of the informal credits are from friends and families.

¹² Beza & Rao (2017), *supra* note 5.

¹³ F. Mersha (2019), 'MFI Characteristics and Loan Preferences of Farmers: Household-level evidence from rural Ethiopia', *African Journal of Agricultural and Resource Economics*, Vol 14 No. 2, pp. 137-151.

¹⁴ E. Alvi & S. Dendir (2007), 'Private Transfers, Informal Loans and Risk Sharing among Poor Urban Households in Ethiopia', *Journal of Development Studies*, Volume 48(8), pp. 1325-1343.

¹⁵ Kedir & Ibrahim (2011), *supra* note 11.

¹⁶ Alvi & Dendir (2007), *supra* note 14.

Loans from friends and families can be provided in kind or in cash. Most fungible goods such as cereals, seeds, consumable goods and money can be borrowed as far as there is a socially accepted measurement of quantity and quality.¹⁷ Usually the loan is provided for less than one year and the amount is small in quantity. In rural areas borrowers are expected to pay their loans in the next harvest season.¹⁸ Loans from families and friends are, in most cases, interest free and are meant to support those who need help.¹⁹ However, sometimes interests may be collected from those loans. The interest rates imposed on loans vary depending on the relationship of the parties. The local custom and practice is also a relevant factor to determine interest rates.²⁰

Article 2472 of the Civil Code of Ethiopia prohibits courts from admitting oral evidence to prove loans that exceed five hundred Ethiopian Birr. However, as common practice shows, credits among families and friends are based on pre-existing relationships and lenders use soft information.²¹ Contract of loan would be formed in accordance to the local customs and usages without giving much attention to the official laws.²² Many people in practice depend only on oral agreements and they do not reduce their agreements into a written contract. As Beru states:²³

The ancient customary law of loans was applied concurrently and it still works in most parts of the country. In the Ethiopian custom, the word of a man is worth millions. The saying ‘let the offspring be lost (or die) rather than one's word (promise)’ has been the guiding principle for people to engage in monetary transactions. To this day, one would still witness such practices around the Merkato (the largest open -air market in Africa) and in neighborhoods where no form of paper is signed when such transactions are carried out.

Loans from friends and families are commonly unsecured transactions. Sometimes the parties may even conceal the existence of the loan from third parties to protect the dignity and goodwill of the borrower. However, it is also evident that sometimes creditors do not like to depend only on the

¹⁷ M. Caudell, T. Rotolo & M. Girma (2015), ‘Informal Lending Networks in Rural Ethiopia’, *Social Networks*, Volume 40, pp.32-42.

¹⁸ Ibid.

¹⁹ Ibid.

²⁰ P. Brietzke (1974), ‘Private Law in Ethiopia’, *Journal of African Law*, Volume 18(2), pp. 149-167.

²¹ A. Fanta (2015), ‘Viability of Pro-SME Financing Schemes: A Developing Country Perspective’, *Corporate Ownership & Control*, Volume 12(2), pp. 169-179.

²² Ibid,

²³ T. Beru (2013), ‘Ethiopian Legal System- Past and Present’, *International Journal of Legal Information*, Volume 41, pp. 335-388, (346).

trustworthiness of the borrower and they may require additional guarantee. The creditor may require the borrower to adduce a guarantee either by calling someone who is more known and reliable to the creditor as a guarantor or by providing a real security.

The use of a guarantor in social as well as in economic interactions is very common in Ethiopia. Real security is also known in Ethiopian tradition. The kind of real security that is commonly practiced in Ethiopia is similar with antichresis²⁴ (*woledagid*). The possession of the land would be transferred to the creditor who will have the right to collect and enjoy the fruits until the debt is paid.²⁵

An important recent development in urban areas among traders is using a bank cheque as a security for loans in the informal credit markets. Post-dated cheque with maturity date that corresponds with the due date of the loan is becoming very common as a security device in the informal credit market.²⁶ The use of cheque as a mechanism to access short term credit relates with the gaps in the Commercial Code provisions thereby reflecting the need of small businesses.²⁷ The official laws have failed to provide efficient and effective solutions for the failure of payment for credit in small business transactions and this has obliged traders to use post-dated cheque as security for the repayment of the loans.

1.2 Loans from moneylenders

There is a paucity of research on private money lending activities in Ethiopia. Providing loans for interest is generally considered as an immoral practice, to say the least, in the society. This negative perception towards moneylenders may relate with the fact that Christianity (Ethiopian Orthodox Church) and Islam have significantly influenced the values, norms and practices of the society in Ethiopia. A significant part of the society also strongly believes that providing money with interest brings bad fortune to the moneylender. For this reason, moneylenders usually try to remain secretive. However, it is an open

²⁴ Article 3117 of the Civil Code defines antichresis as “a contract whereby the debtor undertakes to deliver an immovable to his creditor as a security for the performance of his obligations.”

²⁵ K. Segers, J. Dessein, P. Develtere, J. Deckers, M. Haile *et al.* (2010), ‘The Role of Farmers and Informal Institutions in Microcredit Programs in Tigray, Northern Ethiopia’, *Perspectives on Global Development and Technology*, Volume 9(3), pp. 520-544.

²⁶ Report by Ministry of Justice, Commercial Code Revision Council, on March 24-25, 2016.

²⁷ P. Brietzke (1974), *supra* note 20, p.172.

secret that the practice of money lending with interest is a common practice in the country.²⁸

The negative perception towards collecting interests from loans motivates the lender and the borrower to design different covers (or simulation) for their transactions rather than mentioning interest rates expressly in the contract. In rural areas, moneylenders provide a loan for farmers during planting seasons and they would require in return that the borrower shall vend his harvests to the lender.²⁹ The price for the goods is to be determined at the time the borrower takes the loan. Under such agreements, the contract of loan also becomes a contract of sale of future harvest of the borrower but with a price that is much lower than the actual price of the goods at the time of delivery. Such contract resembles sales contract on its face; however, careful reference to the terms of the contract reveals that it is a contract of loan although the simulation is latent. Such moneylenders therefore disguise moneylending as a contract of sale.³⁰

In urban and semi-urban areas, moneylenders also use different covers to conceal the payment of interests for loans. Most moneylenders are also traders, and they use the trade relationship that they have with the borrower to cover the moneylending activity. The borrower would be provided with goods without a need for immediate payment of the price, so that he/she effects payment after the goods are sold.³¹ The trader who provides the goods would therefore include

²⁸ A. Gnamu (2014), *Conquest and Resistance in Ethiopia Empire, from 1988-1974: The case of Arsi Oromo*. Leiden, Brill, p. 285. The Controversy in lending with interest is not limited only to Ethiopia. Usury is one of the most discussed concepts in social science. For detailed discussion on moral, theological and legal issues in relation to usury see. Noonan, Jr. (1957), *The Scholastic Analysis of Usury*, Harvard University press, Cambridge, Massachusetts.

²⁹ A. Gashayie & M. Singh (2016), 'Development of Financial Sector in Ethiopia: Literature Review', *Journal of Economics and Sustainable Development*, Volume 7(7), pp. 9-20.

³⁰ World Bank (2011), *Costing Adaptation through Local Institutions Village Survey Results: Ethiopia*. The World Bank, Social development Department, p. 30. Available at <http://siteresources.worldbank.org/EXTSOCIALDEVELOPMENT/Resources/244362-1232059926563/5747581-1239131985528/5999762-1242914244952/CALI_Ethiopia_Web2.pdf>. This research states that "There are few interest-free lending activities (in cash and in kind) among the households in the area. However, most credit is obtained from local moneylenders who offer arrangements to exchange cash for crop harvest at about 500 percent interest. In a focus group discussion in Hardibo, it was mentioned that 'there are moneylenders in the area who provide farmers a credit of Br 1 to be repaid in 1Kg grain (equivalent to Br 5-7) during the harvest season. The arrangement is called Yekitel.' Some better-off households may also be involved in buying crops from the farmers at a cheap price during the harvest season and selling it back to them at a very high price later during the slack period." Accessed on 12/2/2018.

³¹ Gashayie & Singh (2016), *supra* note 29.

the interest for the loan given in the form of mercantile goods in the calculation of the price. It is very difficult to find an explicit mentioning of the interest rates in such kind of contracts and to know the interest rate charged by the supplier.

Adding up expected interests with the principal is also a very common strategy that moneylenders use to conceal payment of interest.³² Moneylenders may put as a condition that the debtor should sign a contract that shows he has taken higher amount of money as a principal than what he has actually taken from the moneylender. Under such contracts, the interest rate will not be mentioned in the written contract. On its face, the contract seems as if it were an interest free loan. According to Article 2005 of the Ethiopian Civil Code, a written contract ‘shall be conclusive evidence, as between the parties who signed it’; and the content of the contract cannot be contradicted by oral evidence, such as witness testimony, thereby rendering it impossible for the debtor to challenge the amount of the principal loan in courts of law.

2. Contract of Loan under the Civil Code

2.1 General contract laws

The Ethiopian Civil Code embraces the principle of freedom of contract and it guarantees contracting parties a right to freely determine the nature of their contract and the form of the contract that they would like to use. The Civil Code provides general principles of contract under Book IV, Title XII. Most provisions in the Civil Code are gap filling and permissive provisions (suppletive laws) that can be modified or replaced by the agreement of contracting parties.³³ The Civil Code sets general principles that require the object of the contract to be sufficiently defined, possible, lawful and morally acceptable.³⁴ As long as these mandatory requirements under the Civil Code are fulfilled, the terms of contract articulated by parties in their contract would be considered as a law and shall be enforceable in court of law.³⁵ Furthermore, the Civil Code provides that courts should interpret contracts considering the

³² T. Kibrom (2016, ሕዳር: ስበይቲ: ሽማግሌ ብማዕረ ዘብከዩ ገበያ ሀራግ ሰባ ምዕራብ (*Tigrigna*). Research paper series of the Justice Bureau of the Regional State of Tigray. Unpublished.

³³ For additional explanation on Ethiopian contract laws, see, G. Krezeczunowicz, (1983), *Formation and Effect of Contracts in Ethiopian Law*, Addis Ababa University Press, Addis Ababa; M. Ayalew (2010), ‘Ethiopian Law of Contract’ in J. Herbots (ed). *International Encyclopaedia of Laws: Contracts*, Kluwer Law International, p 43. Available at <https://www.academia.edu/447187/Ethiopian_Law_of_Contracts> Accessed on 3/2/2019.

³⁴ The Civil Code of Ethiopia, Proclamation No 165/1960. Articles 1678, 1711-1718.

³⁵ Id., Article 1731.

expected good faith that should exist between contracting parties according to business practice.³⁶

With regard to form requirements, Article 1681 of the Civil Code provides that contracts can be made orally, in writing, by signs normally in use or by a conduct. Article 1719 provides that “unless otherwise provided, no special form shall be required and a contract shall be valid where the parties agree.” However, certain formal requirements are introduced by the Civil Code whenever it is felt that there are strong policy justifications to do so. A contract of loan for an amount above Birr 500 is not one of these transactions envisaged under Article 1719. Article 2472 does not require contract of loan that exceeds Birr 500 to be made in writing; it only provides that the contract cannot be proved by oral testimony or by presumption. The Civil Code provides that a contract of loan that exceeds Birr 500 cannot be proved by oral evidence or by presumption of the court. Therefore written evidence is required to prove a loan that exceeds Birr 500 when it is contested by the other party. In the following sections we will discuss the special provisions that regulate contract of loan.

2.2 Contract of loan as a special contract

The Civil Code provides a definition of loan as follows:³⁷

The loan of money and other fungibles is a contract whereby a party, the lender, undertakes to deliver to the other party, the borrower, a certain quantity of money or other fungible things and to transfer to him the ownership thereof on the condition that the borrower will return to him as much of the same kind and quality.

The definition indicates that not only money but also other fungible things can be given in a loan as far as they can be quantified and measured. Another important element in the given definition is the fact that ownership of goods should be transferred to the debtor for contract of loan to be formed. Therefore, agreements that do not include transfer of ownership are not considered as contracts of loan. We can also infer from the definition that the borrower has the obligation to return not exactly the same thing but of the same kind and quality as much as it is possible. This implies that the lender cannot require the payment to be made in things that are identical with the things that she has provided.

With regard to formal requirements, the Civil Code requires that loans that exceed 500 Ethiopian Birr shall be proved by adducing written evidence. When the loan amount is greater than Birr 500, the existence of the agreement can be proved in court of law by written evidence, a confession made in court or by

³⁶ Id., Article 1732.

³⁷ Id., Article 2471.

oath taken in court.³⁸ The same requirements apply to prove payment of loans that exceed Birr 500.

What is not clear from the words of the Civil Code is whether the written evidence requirement is only limited to loans provided in money or whether this requirement also applies to loans provided in the form of other fungible things. Careful reading of the provisions indicates that written evidence requirements are limited only to loans that are provided in money. The phrase “where the sum lent exceeds five hundred” implies that this article is limited to loans provided in money and not to other fungible things”. Therefore, loans provided in kind can be proved using any evidence available including witness testimony even though the estimated value is greater than Birr 500. For example, In *Yusuf Siradj vs. Nesira Abdusemed*³⁹, the Oromia Supreme Court reversed the decision of a lower court reasoning that loans provided in kind can be proved by oral testimony and the written evidence requirement of the law is limited only to loans provided in money. This author concurs with this decision.

The general contract provisions of Civil Code also provide formality requirements that a written contract has to fulfil. Accordingly, a written contract has to be signed by contracting parties and it must be attested by two witnesses.⁴⁰ The Code also provides that a written instrument of contract is conclusive, and witness testimony or presumption cannot be submitted against such instruments.⁴¹ The question is whether the requirements provided for the formation of a written contract are also applicable for loan contracts that need to be proved in court of law by written evidence.

There is a difference between a form requirement that is needed for formation of a valid contract (*ad validatatem*) and qualifying the kind of proof that should be adduced to make your case (*ad probationem*) in court of law. With regard to loan, it can be argued that the form requirement for the formation of a valid loan contract is not a *sine qua non* condition under Ethiopian laws. The Civil Code requires a written evidence to prove a contract of loan (*ad probationem*) in court of law but it does not require a written contract for formation of a valid contract of loan.

It is imperative to note here that the requirements provided in the general contract regarding the formalities that should be fulfilled for formation of valid written contracts are not relevant to Article 2472 of the Civil Code because the provision states what kind of evidence can be accepted in court of law and it

³⁸ Id., Article 2472.

³⁹ *Yesuf Siraj vs. Nesira Abdusemed*, Oromia Supreme Court, East Bench, File No.: 250190, Decided on: 15/3/2009 (Ethiopian Calendar)

⁴⁰ Civil Code, Article 1727.

⁴¹ Id., Articles 2005 and 2006(2).

does not relate the validity for the existence of a contract of loan with written form as a *sine qua non* condition. Moreover, there is no any other provision in the Civil Code that renders the existence of a valid contract of loan (*ad validatum*) to be dependent upon written form.

2.3 The regulation of interest rates in informal credit markets

The Civil Code provides that unless the contracting parties provide otherwise, interest will not be paid for loans. The Code sets 9% as a default rate.⁴² The Civil Code also provides that the maximum legal interest rate is 12% annually. According to the Civil Code, interest rates shall be reduced into 9% by courts whenever parties stipulate in their contract for payment of more than 12%.⁴³

An interesting question that deserves the attention of our courts in relation to the maximum legal interest rate –stipulated in the Civil Code– is whether it is still binding and applicable notwithstanding the liberalization of interest rates for financial institutions by the National Bank of Ethiopia (NBE). Following the fall of the socialist military government, Ethiopia has embarked on gradual liberalization of the financial sector and as part of this liberalization process, private banks have joined the Ethiopian financial market after 17 years of exclusive dominance of government owned banks.⁴⁴ NBE was mandated to regulate the banking industry.⁴⁵ Among others, the right to determine the legal interest rate is bestowed on NBE by law.⁴⁶

However, the National Bank of Ethiopia has given commercial banks a right to determine interest rates freely based on market principles. The only legal interest rate provided by the directive is a minimum saving interest rate.⁴⁷ However, NBE remains silent with regard to the applicable interest rate for credits from informal sources. The lack of a directive or a guideline issued by NBE to regulate interest rates in relation to informal credit markets has casted doubt as to whether the legal interest rate provided in the Civil Code is still valid or whether it is repealed by Proclamation No. 591/2008. Two different views, highlighted below, indicate the issues involved in this regard.

⁴² Id., Article 2479.

⁴³ Id., Article 2479.

⁴⁴ A. Geda (2006), 'The Structure and Performance of Ethiopia's Financial Sector in the Pre- and Post-Reform Period with a Special Focus on Banking', *Research Paper*, UNU-WIDER, United Nations University (UNU), No.112. Available at <<https://link.springer.com/chapter/10.1057/97802305940128>>. Accessed on 2.3.2019.

⁴⁵ The National Bank of Ethiopia Establishment (as Amended) Proclamation No. 591/2008.

⁴⁶ Id, Article, 5(4).

⁴⁷ The Interest Rate Directive, No. NBE/INT/12/2017. National Bank of Ethiopia, Addis Ababa, Ethiopia.

2.3.1 Views in support of the application of the Civil Code's interest rate ceiling for informal credit markets

According to the first view, the maximum legal interest rate that is provided in the Civil Code remains valid and applicable to informal credit markets as far as the National Bank of Ethiopia has not introduced a new applicable interest rate to replace the provisions of the Civil Code. This view seems to be implicitly accepted by the office of the Federal Attorney General and other regional attorney offices as it can be inferred from various official documents of these offices and from criminal charges filed by these offices in relation to usury.⁴⁸

The Cassation Division of the Federal Supreme Court cited the provisions of the Civil Code in its decision in *Fantaye Fiseha vs. Dejene Marye* to nullify a 5% interest rate per month that was agreed by parties.⁴⁹ The Court explained that according to the provisions of the Civil Code, the maximum interest rate to be paid for loan is 12% per annum and an agreement to pay an interest rate that exceeds 12% is invalid. The court did not make reference to the bank laws and did not deliver any argument how the provision of the Civil Code in relation to interest rate are still relevant and applicable. Surprisingly, the court declared that the lender would not be paid any interest because the rate in the contract had exceeded 12%. This is clearly not what the provisions of the Civil Code provide for. The Civil Code provides that any agreement that provides for an interest rate that exceeds 12% would be reduced into 9%.⁵⁰ Therefore, in this case, if we apply the provisions of the Civil Code, the court should have allowed the lender to collect 9% interest rate from the time the loan was provided.

⁴⁸ The 2017 Report of the Regional Justice Bureau of Tigray indicates that *usury* is one of the most serious crimes that the region should focus on. In *Kedamay Weyane Wereda Court* 150 usury cases were filed in 2017. The government-owned television and other government owned media also frequently announce that usury is one of the crimes that should be addressed and controlled. See also G. Yimer (2017), 'Case Comment on Cassation Division's Decision on File No 80119', *Mizan Law Review*, Volume 11(1), pp. 248-294.

⁴⁹ *Fantaye Fiseha vs. Dejene Marye*, Federal Supreme Court, Cassation Division, File No. 102711. *Federal Supreme Court Decisions*, Volume 17, p. 117.

⁵⁰ Article 2479 of the Civil Code, titled '2. Rate of interest' provides:

- (1) The parties may not stipulate a rate of interest exceeding twelve per cent per annum.
 - (2) Where it has been agreed that the loan will bear interest but a higher rate has not been fixed in writing, the borrower shall owe interest at the rate of nine per cent per annum.
 - (3) The borrower shall also owe interest at the rate of nine per cent per annum where a rate exceeding twelve per cent per annum has been agreed in writing.
-

In *Deresu Alemu vs. Mulisa Worku*⁵¹ the Cassation Division of the Federal Supreme Court invalidated a contractual term that required a borrower to pay 100% of the loan as a penalty (in addition to the loan). The Court annulled the decisions of the lower courts that validated the penalty clause. The Court reasoned that to require the borrower to pay double of the principal as penalty for delay violates the provisions of the Civil Code that sets the interest rate at 12%. The special provisions that regulate loan agreements expressly provide that any agreement that requires the borrower to pay more than the legal interest rate or the agreed interest rate as penalty for delay is unenforceable in court of law. According to the Civil Code:

Where the borrower is late in returning the thing lent or in paying the interest due by him, he shall pay legal interest in accordance with the provisions of the Title of this Code relating to ‘Contracts in General’ (Art. 1790-1805).⁵² Any provision increasing the liability of the borrower shall be of no effect.⁵³

The two decisions by the Cassation Division of the Federal Supreme Court and the decision of lower courts show that Ethiopian courts are taking it for granted that the provisions of the Civil Code are still applicable and relevant in relation to private loans or for loans in the informal credit markets. Ethiopian courts have indeed failed to take into consideration basic issues and realities that should be considered in the determination of interest rates vis-à-vis the freedom allowed to formal financial institutions by the National Bank of Ethiopia.

In one case, however, the Cassation Division of the Federal Supreme Court has implicitly suggested that the provisions of the Civil Code that put a limitation on the amount of interest rate are not binding at least on saving and credit cooperatives.⁵⁴ The court stated that saving and credit cooperatives can freely decide the applicable interest rate in their internal rules. It cited the provision of the Civil Code that provides “agreements freely made are considered as a law between parties” to give effect to the terms of the contract that provide for 18% interest rate. However, the court did not expressly declare that the provisions of the Civil Code that regulate interest rate are repealed for loans obtained from saving and credit cooperatives or other loans. It is to be noted that the Cooperative Society Proclamation allows cooperatives to freely decide the lending interest rate and the borrowing interest rate.⁵⁵

⁵¹ *Deresul Alemu vs. Mulisa Werku*, Federal Supreme Court Cassation Division, File No. 43372, *Federal Supreme Court Decisions*, Volume, 8, p. 361.

⁵² Article 2489(1) of the Civil Code.

⁵³ *Id.*, Article 2489(2).

⁵⁴ *Metekel Development Association vs. Kess Kalayu Kiros*, File No. 62162, Federal Supreme Court, Cassation Division, *Federal Supreme Court Decisions*, Volume 13, p. 186.

⁵⁵ Cooperative Society’s Proclamation No. 985/2016, Article 48(2)

2.3.2 Views against the application of the Civil Code's interest rate ceiling for informal credit markets

The second view is that the maximum legal interest rate in the Civil Code is not applicable anymore for both formal and informal credit markets. According to this view, the law has given the National Bank of Ethiopia (NBE) the right to regulate interest rates not only for formal financial institutions but also for loans in the informal credit markets. Supporters of this view argue that the provisions of the Civil Code that deal with interest rates are repealed tacitly by Proclamation No. 591/2008, and the inaction of the NBE does not bring them back to life.⁵⁶

The argument that the provisions of the Civil Code that regulate interest rates are not any more applicable can be supported by Articles 4 and 5(4) of the National Bank of Ethiopia establishment Proclamation. Article 4 provides that “The purpose of the National Bank of Ethiopia is to maintain stable rate of price and exchange rate, to foster a healthy financial system and to undertake such other related activities as are conducive to rapid economic development of Ethiopia”.⁵⁷ Likewise, Article 5(4) provides that the Bank regulates and determines the supply and availability of money and credit as well as the applicable interest rates and other charges.

These provisions of the Proclamation clearly show that the mandate of the NBE is broader than regulating the banking industry and the provisions clearly indicate that the NBE has a legal mandate to decide legal interest rates for credits both in the formal and in the informal credit markets. The NBE can issue yearly or quarterly maximum and minimum interest rates that bind all creditors in the informal credit markets. Furthermore these provisions suggest that no other government office or agency can issue a law to regulate interest rates in Ethiopia. The NBE is expressly mandated to regulate price and exchange rates to promote healthy and stable economic growth. It is clear that the law entrusts the NBE with the mandate to regulate interest rates for all purposes including loans in the informal credit markets. Therefore, had the NBE found it important to determine a maximum legal interest rate it would have determined it based on the current financial and economic situation of the country. The lack of

⁵⁶ Yimer (2017), *supra* note 48; In *Abdulkadir Juwar vs. Ambasel Trading PLC*, the Federal Supreme Court, the Cassation Bench approved 14% interest to be paid for delay in the payment of a price for supply of sesame seeds as it was stipulated in the contract. Article 2489 of the Civil Code expressly provides that only a legal interest shall be paid as a damage for delay in payment of loan or interest. Therefore, the Cassation Court by endorsing 14% interest rate as a damage for a delayed payment for the supplied sesame seeds seems to impliedly disregard the Civil Code provisions that provide 12% as the maximum legal rate in Ethiopia.

⁵⁷ The National Bank of Ethiopia Establishment (as Amended) Proclamation No. 591/2008.

maximum legal interest rate determined by the NBE which is applicable to creditors and borrowers in the informal credit market should be interpreted as intentional inaction to allow the interest rates to be determined by market forces.

The fact that the formal financial institutions are given the discretion to determine interest rates also implies that the National Bank of Ethiopia has no interest to intervene in the regulation of interest rates, at least for the time being. Interest rate, in a free market economy, is to be determined by the opportunity cost of the money, the inflation rate, the premium of the risk, the cost of administration and monopolistic profit.⁵⁸ The literature on informal credit market generally concede that when the market is left free to determine the applicable interest rate, the interest rate in the informal credit market is usually higher than the interest rate in formal credit markets.⁵⁹ High risk of lending in the informal credit markets,⁶⁰ lack of collaterals, unscrupulous creditors' selfish motives,⁶¹ are some of the reasons mentioned by researchers for higher interest rates in the informal credit markets.⁶²

In addition to the arguments that rely on the interpretation of the intention of the laws that provide broad power to the National Bank of Ethiopia –as discussed in the preceding paragraphs– there is also a strong practical reason that make the application of the Civil Code's provisions (that determine the maximum interest rate) irrational and discriminatory. The interest rates that are provided in the Civil Code remained unchanged for the last six decades while the financial and economic situations on the ground have fundamentally changed. Therefore, the legal interest rate in the Civil Code does not consider the current high inflation rate in the economy that usually ranges between 10-12% during the last 10 years. It does not also consider the big devaluation of Ethiopian currency following the liberalization of the economy.

It is also important to note that recent administrative laws use the lending interest rates that prevail in the formal financial institutions as reference point to determine interest rates that apply to default in performance of obligations such as delayed payments or delayed performance; they do not use the provisions of

⁵⁸ A. Bottomley (1975), 'Interest Rate Determination in Underdeveloped Rural Areas', *American Journal of Agricultural Economics*, Volume 57(2), pp. 279-291.

⁵⁹ Ibid

⁶⁰ Ibid

⁶¹ A. Bhaduri, (1977), 'On the Formation of Usurious Interest Rates in Backward Agriculture', *Cambridge Journal of Economics*, Volume 1(4), pp. 341-352.

⁶² D. Germidis (1990), 'Interlinking the Formal and Informal Financial Sectors in Developing Countries', *Saving and Development*, Volume 14(1), pp. 5-22.

the Civil Code.⁶³ In this regard, the Tax Administration Proclamation, for example, provides “the rate of late payment interest shall be the highest commercial lending interest rate that prevailed in Ethiopia during the quarter ... increased by 15%”.⁶⁴ Therefore, to require the informal credit market to be regulated by the legal interest rate that is provided in the Civil Code has no economic and financial rationale.

Trying to use the provisions of the Civil Code as official interest rates to prosecute creditors in the informal credit markets does not protect the borrowers who depend on the informal credit markets. On the contrary, the interest rates in informal credit markets are likely to increase even more because criminal prosecution poses an increased legal risk for creditors that need to be covered by borrowers in the form of higher interest rates (a premium for the increased legal risk). Furthermore, lack of clarity and the possible risk of criminal prosecution drives potential lenders out of the market and only those who incline to take higher risks for higher premium would dominate the informal credit markets.⁶⁵

It is now very common in Ethiopia for a lender to be criminally charged for crime of usury and the borrower to be criminally prosecuted for giving a cheque with insufficient balance. This scenario explains how the lack of comprehensive legal framework for loans in credit markets is entangled with confusion and uncertainty in the informal credit markets. Thus, lack of comprehensive legal and policy approach adversely affects the interest of small and micro businesses that depend on informal credit markets as the only accessible, flexible and quick access to finance.

3. Application of the Provisions of the Civil Code by courts

The Civil Code requires written evidence to prove loans and repayment of loans that exceed Birr 500 unless it is admitted by the debtor. However, the common

⁶³ Land lease proclamations, tax proclamations and procurement proclamations provide that when an interest payment is due to government for whatever reason, the prevailing interest rate in commercial banks should be used.

⁶⁴ Tax Administration Proclamation No. 983/2016, Article 37(2).

⁶⁵ The Criminal Code of the Federal Democratic Republic of Ethiopia, Proclamation No. 414/2004. Article 712 provides that:

1. Whoever, by exploiting a person's reduced circumstances or dependency, material difficulties, or carelessness, inexperience, weak character or mind: (a) lends him money at a rate exceeding the official rate; or (b) obtains a promise or assignment of benefits in property in exchange for pecuniary or other consideration, which is in evident disproportion, shall be punishable, according to the gravity of the case, with simple imprisonment, or with rigorous imprisonment not exceeding five years, and fine.
 2. Whoever, with a similar intent, acquires a usurious claim and sets it up against or assigns it to another, shall be liable to the same punishments.
-

practice is different from this as it is only in few cases that parties use a written contract. Most loan contracts in Ethiopia among family members, relatives, friends, and business partners are not written. Loan contracts are commonly made in writing when they involve higher interest rates that tantamount to usury or when they are made for the purpose of covering up sale of immovable or condominium houses that cannot be sold under the law. Parties use simulated loan contracts to be used as bargaining ground analogous the observations of Cooter *et al* regarding strategic behaviour in relation to pretrial bargaining.⁶⁶ The parties need the contract of loan to use it as a bargaining power to enforce the other party to honour its obligation as per the underground agreement that cannot be enforced in court of law because of some legal restrictions in the particular transaction.

3.1 Contract of loan as a means to enforce other agreements

The cases discussed below explain how loan contracts are used to achieve other covert agreements that cannot be formed legally due to public policy reasons. In *Tadesse Tamirat vs. Eminent Tilahun*⁶⁷, the litigation of the parties in court revealed that the real interest of the parties was to sell a condominium house. However, as condominium houses cannot be sold (subject to exceptional circumstances that are provided by law), the parties agreed that the seller would sign a contract of loan as an assurance that the seller would transfer the house after the conditions for the transfer of the house are fulfilled. When the seller refused to transfer the house as per the covert internal agreement of the parties, the buyer sued the seller for payment of the money stipulated in the contract of loan as he cannot claim specific performance for transfer of ownership of the condominium house. The case was finally settled by agreement of the parties, according to which the seller would transfer the house to the buyer and the buyer will drop the case he had filed for payment of loan.

In *Tesfaye Brhanu and Weynished Lemma vs. Gebeyehu Grma and Hiwot Kasaye*,⁶⁸ the parties used Birr one million loan contract as a cover to an agreement to sell a condominium house by including a term in the contract of loan that requires the borrower to transfer possession and ownership of the condominium house in case of default to pay the loan. The court, however, rejected the agreement stating that the agreement is illegal and unenforceable. In

⁶⁶ R. Cooter *et al* (1982), 'Bargaining in the Shadow of the Law: A Testable Model of Strategic Behavior', *Journal of Legal Studies*, 11(2), p. 225.

⁶⁷ *Tadesse Tamirat vs. Eminent Tilahun*, Dessie First Instance Court, File No. 22235. Date of decision: 10/03/2010 (Ethiopian Calendar)

⁶⁸ *Tesfaye Brhanu and Weynished Lema vs. Gebeyehu Grma and Hiwot Kasaye*, Federal First Instance Court, File No. 199033. Date of decision: 7/6/2010 (Ethiopian Calendar).

a similar arrangement, in *Lubaba Oumer vs. Yamrot Ali*,⁶⁹ the plaintiff sued the defendant for repayment of loaned money. The defendant argued that her contract with the plaintiff is only to sell a house and it was not a loan contract. Witnesses also testified that they knew the loan contract was a cover up to the contract of sale of house and it is not meant to be paid. The court rejected the oral testimony and decided based on the written agreement that it was a contract of loan.

In *Hailu Ayele vs. Getie Akele*,⁷⁰ the plaintiff applied to the First Instance Court of Kombolcha claiming that the defendant and the plaintiff made a contract of loan. He adduced a written contract of loan which indicates a loan of Birr 300,000 was provided to the defendant to be paid within one year. The contract also provided that if the debtor fails to pay as per the agreement, the plot of rural land and two rooms indicated in the contract will be transferred to the plaintiff. The plaintiff then asked the court to order the defendant to pay Birr 300,000 or to order the transfer of the landholding title to the plaintiff.

The defendant admitted the loan and mentioned to the court that he does not have enough money to pay the loan. He added that he has no objection if the land is transferred to the plaintiff as a payment to the loan. The court after examining the rural land administration laws and the Constitution ruled that the land cannot be transferred to the plaintiff. The court reasoned that the part of the contract that provides for transfer of the rural land is illegal and shall therefore be of no effect in court of law. The court therefore simply ordered the defendant to pay the loan but rejected the claim for transfer of the land to the plaintiff.

In *Abas Yimer vs. Muhamd Nur and Sophia Yasin*,⁷¹ the parties used contract of loan to sell rural land with two rooms on it. They made a contract of loan and then they provided in the contract that if the borrower fails to pay the debt on the date specified in the written contract, the lender should automatically become the owner of the land. The lender applied to court requiring the payment of Birr 264,000 or the transfer of the land. The borrower admitted the loan and agreed to give the land as a payment. The court however, rejected the offer to transfer the land stating that it is illegal to do so and ordered the borrower to find another property that can be attached to satisfy the debt of the debtor.

The loan contracts discussed here-above are all supported by a written contract and they fulfil all formal requirements of the Civil Code. Even though

⁶⁹ *Lubaba Oumer vs. Yamrot Ali*, Dessie First Instance Court, File No. 15029. Date of decision: 13/10/2008 (Ethiopian Calendar).

⁷⁰ *Hailu Ayelev Getie Akele*, South Wello Higher Court, File No. 34730. Date of decision 09/05/2010 (Ethiopian Calendar).

⁷¹ *Abas Yimer vs. Muhamd Nur and Sophia Yasin*,⁷¹ South-Wello Higher Court, File No. 33831, Date of decision: 17/04/2010 (Ethiopian Calendar)

the expressed objective of the contracts was loan, their real objective –as later uncovered in court– was meant to cover up sale of land or a condominium house. The parties consult paralegals or lawyers in such cases as they want to make sure that loan contract can be used as deterrent to dishonest land dealers who may hesitate to respect their words later mainly because of substantial increase in land value at the time of transfer of the title to the buyer.

It is also important to note here that the Ethiopian Civil Code embodies strict parole evidence rule under Articles 2005 and 2006 which makes it impossible to contradict the written terms of the contract by other evidence such as witnesses. Courts seem to strictly follow this rule at least in relation to loan contracts, even though parties may later try to challenge the nature of these contracts by invoking absence of intention. Courts in most cases have rejected these testimonies although witnesses may testify that the real intention during the formation of the contract was to use them as incentive for parties to respect the concealed agreement (so that parties respect their promise that they may not be required so by law).

3.2 Decisions of courts that are inconsistent with the Civil Code

In this section we will discuss how various courts implicitly and explicitly fail to apply the provisions of the Civil Code that require contract of loans that exceed Birr 500 to be proved by written evidence or by oath to be given in court of law. There are courts that accept oral testimony and other evidence to prove loans and repayment of loans. These courts do not provide reasons for their decisions and this makes it difficult to understand why they do not apply the provisions of the Civil Code. Sometimes, we can see that the decisions of lower courts are reversed by the court of appeal or by the Supreme Court for not following the provisions of the Civil Code. However, the cases provided hereunder show that it is not possible to make generalized conclusion that lower courts avoid the provisions of the Civil Code while the higher courts follow the provisions of the Civil Code as there are also decisions by higher courts that disregard the provisions of the Civil Code by accepting oral evidence.

In *Gebru Gebremeskel vs. Gebremedhin Reda*,⁷² the Federal Cassation Court decided by majority that bank transfer is sufficient to satisfy the written evidence requirement under Article 2472 of the Civil Code which requires loan more than Birr 500 to be proved with written evidence. The decision of the Cassation Bench in this case seems to support the opinion that the written evidence requirement to prove loans does not need to follow the strict formality requirements (of a special document signed by all parties and attested by witnesses) stipulated under Article 1727 in the Civil Code. However, one judge

⁷² *Gebru Gebremeskel vs. Gebremedhin Reda*, Federal Supreme Court Cassation Bench, File No. 31737, published in *Federal Supreme Court Decisions*, Volume 5, pp-69.

has given a dissenting opinion in this case stating that the bank receipt shall not be considered as a valid contract of loan. The dissenting judge opined that the court should reject the claim for the repayment of the loan because the formality requirements for formation of written contract are not fulfilled. The fact that the judges at the highest court could not have consensus on the interpretation of Article 2472 of the Civil Code indicates the need to settle this issue with a view to providing certainty and predictability in the informal market.

In relation to repayment of loan, the Federal Cassation Court decided in *Mhader Aemro vs. Laek Gebremedhin*⁷³ that the return of a cheque that was given to secure the loan is sufficient evidence to prove the repayment of loan. The lender argued that repayment of loan shall be proved only by a written evidence signed by witnesses and the return of the cheque cannot be taken as valid evidence to show the repayment of loan. The Cassation Bench of the Federal Supreme Court, however, decided that the return of the cheque leads to a strong presumption of repayment. The court also relied on Article 2845 of the Civil Code which provides that a pledged good shall be returned on the execution of the obligation to support its decisions.

Likewise, the Amhara Regional State High Court ruled that giving a bank cheque shall be sufficient to prove contract of loan if it is supported by oral testimony. In *Engdaw Yimer vs. Neka Tibeb*,⁷⁴ Dessie First Instance Court ruled that oral testimony is acceptable to prove whether a loan is usurious or not. In *Hailu Ayele vs. Getye Akele*⁷⁵, the First Instance Court and the Higher Court neglected the formal laws and accepted oral testimony as sole evidence to decide that there is a loan contract of Birr 7,000. In *Husen Irecho vs. Zenebe Guasil*,⁷⁶ a First Instance Court in Oromia Regional State accepted oral evidence as a defence by the borrower to prove that he has paid Birr 4,500 to the creditor.

In *Elias Semie vs. Zenebech Temesgen*,⁷⁷ the Cassation Bench in the Federal Supreme Court decided that when the signature on the contract is denied, the court can rely on witnesses or technical examinations to prove the existence of a contract. However, witnesses can be called only when a written contract is adduced by one party and it was denied by the other party. Regional courts also

⁷³ *MahderAemro vs. Laek Gebremedhin*, Federal Supreme Court Cassation Bench, File No. 41571, *Federal Supreme Court Decisions*, Volume 8, p. 334.

⁷⁴ *Engdaw Yimer vs. Neka Tibeb*, South-Wello Higher Court, File No. 32624, Date of decision: 06/02/2010 (Ethiopian Calendar).

⁷⁵ *Hailu Ayele vs. Getye Akele*, South Wello Higher Court, File No. 011549, Date of decision: 21/08/2010 (Ethiopian Calendar).

⁷⁶ *HusenIrecho vs. ZenebeGuasil*, AdamiTullu District Court, File No. 27616, Date of Decision: 16/6/2009 (Ethiopian Calendar).

⁷⁷ *Elias Semie vs. ZenebechTemesgen*, Federal Supreme Court, Cassation Bench, File No. 114553, *Federal Supreme Court Decisions*, Volume 20, p. 221.

allow witnesses to be heard when the parties disown the written contract. In *Abrha Berhe vs. Brnesh Hluf*,⁷⁸ the Cassation Court decided that when the signature in the loan contract is disowned and when technical examination is not possible, it is possible to use oral testimony of the witnesses who signed in the same contract to prove that the contract was signed by the borrower.

The cases provided in the next paragraph show some decisions both by higher courts and by first instance courts in which the provisions of the Civil Code are not totally neglected. This shows that there is no general consensus among judges in Ethiopia on how to deal with loan cases that are not supported with written evidence. Moreover, we can infer from the following decisions that there is no consensus among judges whether the written evidence should follow the formality requirements set in the general contract, or whether any written evidence is acceptable to prove loans.

In *Leteyesus G/ Egziahber vs. Teklay*,⁷⁹ the Supreme Court of Tigray revised the decision of the First Instance Court stating that a loan that exceeds Birr 500 shall only be proved by written evidence and the lower courts erred to accept oral evidence to decide there was a loan. Likewise, in *Shamble Gebrekidan Berhe vs. Gebrehiwot Teklu*,⁸⁰ Tigray Supreme Court ruled that bank transfer shall not be considered as written evidence to prove a loan contract. The Tigray Supreme Court also interpreted the provisions of the Civil Code strictly that it ruled in *Priest Mebrhatu Fantahun vs. Tafere Asmlash and Shtay Tadesse*⁸¹ that a contract of loan that is not signed by the lender is void even if it is signed by the borrower and by two witnesses. This decision clearly implies that Tigray Supreme Court interprets Article 2472 of the Civil Code as a formality requirement that should be made in accordance with 1727 of the Civil Code.

In some of the decisions that strictly follow the provisions of the Civil Code without any consideration for equity and fairness of the decisions, we can notice that it results into partially admitting the testimony of the debtor when it is against his interest whilst rejecting his words when it benefits him. In *Roman Grmay vs. Yemane Gebreyohans*,⁸² for example, the court accepted the testimony of the borrower as admission and ordered him to pay a loan. However, the court rejected the testimony of the borrower who claimed that he

⁷⁸ *Abrha Berhe vs. Brnesh Hluf*, Federal Supreme Court Cassation Bench, File No. 71927, *Federal Supreme Court Decisions*, Volume 13, page 215.

⁷⁹ *Mrs. Leteyesus G/ Egziahber vs. Mr. Teklay, Kedamay Weyane* First Instance Court, File No. 77488, Date of decision: 22/06/2008 (Ethiopian Calendar).

⁸⁰ *Shamble Gebrekidan Brhe vs Gebrehiwot Teklu*, Tigray Supreme Court, File No. 81209, Date of decision: 17.09. 2008 (Ethiopian Calendar).

⁸¹ *Priest Mebrhatu Fantahun vs. Mr. Tafere Asmlash and Mr. Shtay Tadesse*, Supreme Court of Tigray, File No. 67252, Date of decision: 16/04/2007 (Ethiopian Calendar).

⁸² *Roman Grmay vs. Yemane Gebreyohanes*, Federal First Instance Court, File No. 251772.

has paid 50 per cent of the loan. In this case, the lender adduced no written evidence and not even other oral evidence; and the court rendered decision purely based on the admission of the borrower but rejecting the defence of the borrower that he has partly paid the loan. In *Gebire Tesfay vs. Gete Bewketu*,⁸³ Dessie First Instance Court decided that payment of loan that exceeds Birr 500 shall be proved only by written evidence, and the Court of Appeal confirmed the decision.

Courts seem to pursue a similar pattern in interpreting that a written loan contract is also sufficient evidence to prove the actual payment of the money provided in the contract of loan without a need for additional receipt or payment certificate. In *Asegedech Zergaw vs. Ayele Ndanae*⁸⁴ the Federal Cassation Court decided that a loan contract that is duly signed by the parties implies the actual transfer of the money from the lender to the borrower. In this case, the borrower argued that she signed the contract only based on the promise that the lender would give her the money. She stated that the money was not actually given to her. The court rejected her claim that the money was not actually given to her and stated that she could not have signed the contract of loan without taking the money. The court decided that a signed contract of loan is conclusive evidence to prove the existence of the loan and the actual delivery of the money. Lower courts also seem to follow this decision. In *Dagne Geleta vs. Sindew Ejigu*,⁸⁵ Amhara Regional State Supreme court decided that if a debtor has signed a contract of loan, then the assumption is that he has actually taken the money.

4. Conclusions

Credit from families and friends are important sources of credit in Ethiopia. Credits from friends and families are commonly made orally and without taking the caution required by the law. It can be assumed that most of the borrowers pay lenders back without a need for courts to intervene to enforce the contract. However, in some cases, lenders may require the help of courts to be paid back. As discussed in this article, court decisions are not consistent and predictable when it comes to contracts of loan. Sometimes, courts require plaintiffs to adduce written evidence attested by two witness whereas in some cases courts accept oral evidence to prove loans that exceed Birr 500. Another source of uncertainty is that in civil cases, various courts refuse to accept any oral evidence that contradicts the content of the written evidence and they strictly

⁸³ *Gebir Tesfay vs. Gete Bewketu*, Dessie First Instance Court, File No. 21490, Date of decision: 22/09/2010 (Ethiopian Calendar).

⁸⁴ *Asegedech Zergaw vs. Ayele Ndanae*, Federal Supreme Court Cassation Bench, File No. 59882, *Federal Supreme Court Decisions*, Volume 12, Page 157.

⁸⁵ *Dagne Geleta vs. Sindew Ejigu*, Amhara Regional State Supreme Court in File No. 03/8786, Date of decision: 03/02/2010 (Ethiopian Calendar).

apply Articles 2005 and 2006 of the Civil Code; but there are courts that accept oral evidence that contradicts the written evidence when the case is referred from civil bench to criminal bench. It may be possible for the civil bench to admit evidence that is dropped by the criminal bench but for the criminal bench to accept evidence dropped by civil bench is difficult to justify by any means.

Another source of uncertainty emanates from the lack of clarity on the applicable official interest rate that is applicable in the informal credit market. Contract of loan is governed by two different legal regimes in Ethiopia. Loans from formal financial institutions are regulated by the newly enacted special laws. On the other hand, loans from informal credit markets have not been given meaningful attention by lawmakers. In effect, courts apply the Civil Code for transactions in informal credit markets. Thus, there is lack of certainty, predictability and clarity on how the provisions of the Civil Code relate with the new banking laws.

Various cassation court decisions are indicative of the negative perceptions that are predominant in Ethiopian courts that seem to despise the whole concept of collecting interests from loans in the informal credit markets. Although the reasons for such inclination of the courts need further research, it may be argued that the religious and moral values of the judges play a big role in the way they interpret the provisions of the Civil Code rather than rational, legal, financial and economic arguments.

Effective, clear and enforceable legal remedy for breach of contractual obligations is a significant variable that lenders take into consideration in their decision to provide loans.⁸⁶ Lack of effective legal remedy indeed encourages unscrupulous debtors to try to escape performance of contractual obligations, partially or fully. Creditors on the other hand try to compensate the risks relating to lack of effective enforcement mechanism or possible criminal prosecution for usury by increasing interest rate.⁸⁷ Indeed, artificial legal interest rates that do not reflect the realities on the ground aggravate the exclusion of the poor from financial services and exposes them to further poverty.⁸⁸ ■

⁸⁶ T. Jappelli, M. Pagona, & B. Magda (2005), 'Courts and Banks: the Effect of Judicial Enforcement in Credit Markets', *Journal of Money and Credit and Banking*, Volume 37(2), pp. 223-245.

⁸⁷ D. Fabbri & M. Padula (2004), 'Does Poor Legal Enforcement Make Household Credit Constrained', *Journal of Banking and Finance*, Volume 28(10).

⁸⁸ See, for example, C. Gonzalez-Vega (1984), 'Credit Rationing Behavior of Agricultural Lenders: The Iron Law of Interest Rate', in: D. Adams, D. Graham and D. Pischke (eds) (1984), *Undermining Rural Development With Cheap Credit*. Westview Press, Colorado, pp. 30-60.
