Gebreyesus Yimer

The Nexus Between Legal Pluralism and Inclusive Finance

Insights from Ethiopia and South Africa

MAX PLANCK GESELLSCHAFT

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Springer

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Max Planck Institute for Comparative and International Private Law
Hamburg, Germany

ISBN 978-3-031-71652-2 ISBN 978-3-031-71653-9 (eBook)
https://doi.org/10.1007/978-3-031-71653-9

This work was supported by Max Planck Institute for Comparative and International Private Law

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Chapter 1
Introduction

Inclusive finance is considered an important step towards inclusive development. Inclusive finance is regarded as the most effective approach to solving most of the challenges faced by people living in poverty. Inclusive finance provides access to education, health, water, nutrition, and, more than anything else, employment and dignity. Inclusive finance allows people to unravel their potential and use their skills and ability to generate sufficient income to support their families. Inclusive finance also enhances saving and wealth creation. Researchers and policymakers recognise the critical role of inclusive finance in enhancing inclusive and sustainable development. Making the financial system as inclusive as possible is a key issue that needs more research and discussion. One important variable that determines access to finance significantly is the law. How the relevant laws such as contract law, law of loan, financial laws, cooperative laws, procedural laws, interest rate regulations, and other related laws are designed, organised and implemented significantly affect access to finance in a given jurisdiction.

One of the reasons that impede people's access to finance is how the law is made and implemented. How the law is structured and implemented affects access to finance in many ways. Laws disregarding pluralism and diverse socio-economic reality greatly limit access to finance to people. On the other hand, laws that embrace pluralism and consider the needs of the people on the ground support a more inclusive financial system. Laws that are designed and implemented considering the realities on the ground and recognising the diverse cultural, social, economic, and financial lives of the people can offer better opportunities for people to access financial services that are affordable and relevant to their situation. This book attempts to explain how legal pluralism can help to enhance inclusive finance based on the practice in Ethiopia and South Africa.

In Ethiopia and South Africa, the informal credit market provides access to finance to people who are excluded from the formal financial system for different

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G. Yimer, *The Nexus Between Legal Pluralism and Inclusive Finance*,
https://doi.org/10.1007/978-3-031-71653-9_1

reasons. Access to finance should be defined broadly, and financial services offered by institutions like rotating savings and credit associations (Eeqqub and Stokvels, as they are known in Ethiopia and South Africa, respectively) should be recognised as vital financial service providers that enhance inclusive finance. Laws should support these institutions in strengthening inclusive finance.

The book includes seven chapters. Chapter 2 provides an extensive review of informal credit markets. What social and economic functions do they provide to society, why do informal credit markets prevail even when formal financial institutions are geographically accessible to people, and how do governments and international development agents respond to informal credit markets? The theoretical discussion in this part provides insights into why the policy options to squeeze informal credit markets practically moneylenders have failed so far and what lesson can be taken from the nature and function of informal credit markets. Chapter 3 provides a rare kind of primary data from Ethiopia. The chapter explains how informal credit actors interact, how they prudently adapt to some of the substantive and formal requirements of the official laws, and how they use the laws to enhance and protect the transactions in the informal credit markets. On the other hand, when the laws appear less rational and inappropriate, they design effective strategies to avoid the official rules and replace them with laws that they consider more proper for their purpose. This part of the book is based on the author's field research.

Chapter 4 provides a comprehensive and extensive discussion of Informal credit markets in South Africa. Stokvels are explained based on a vast literature review. Chapter 5 discusses South Africa's policy and legal response to the informal credit market and how it tried to balance its interest in enhancing inclusive finance with the interest in protecting customers from abuse and onerous loan terms. South African experiment using different approaches to regulate interest rates was used to explain how the law should be used for a more inclusive financial system that balances different interests in the financial market.

Chapter 6 provides an insight into how courts deal with legal pluralism. This chapter is based on court decisions dealing with informal credit market transactions. The cases are collected from Ethiopian courts. The chapter provides an empirical account of the role of the courts in the viable informal credit market. The cases indicate how norms, customs, and usage interface with official laws codified by the state to solve practical cases. Chapter 7 includes conclusions and policy.

The book will interest researchers, university professors, and students in legal theory, law and society, law and anthropology, legal pluralism, law and culture, and African law. The book is also relevant to policymakers working on inclusive finance, law and development, and financial regulation in developing countries.

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Chapter 2
Informal Credit Market: A General Overview

2.1 Definitions of the Informal Credit Market

It is difficult to provide a single definition that reflects the nature, features, and scope of informal credit markets with the required depth and generality. The difficulty in providing a comprehensive definition emanates from the markets' diversified forms and natures, the different perspectives scholars use to study the topic, and the diverse cultures and customs underpinning their operation. Nonetheless, other researchers have attempted to provide a working definition by considering one or more features of the informal credit market. We review some of these definitions here.

Some scholars consider the lack of an established legal and institutional regulatory framework for informal credit markets an important variable in defining them. Steel et al. define informal credit markets as "a credit market that is not regulated by the national bank supervisory authorities."[1] According to Aryeetey, "informal finance might be defined to embrace all financial transactions that take place beyond the functional scope of various countries' banking and other financial regulations."[2] Based on the two definitions provided here, credit markets that are not regulated by the mandated authority overseeing financial markets in a country constitute informal credit markets. The ambiguity of these definitions emanates from the vagueness of the word "regulation."[3]

Some writers, however, prefer to rely on the source of the credit as an essential element to define informal credit markets. This approach defines informal credits as loans provided by private moneylenders, traders, families, and traditional financial institutions.[4] Mauri, in his paper assessing the situation in Ethiopia, defines informal credit markets as "the whole miscellany of non-institutional savings and credit

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[1] Steel et al. (1997), pp. 817–830.

[2] Aryeetey (2005), pp. 13–38.

[3] For a definition of regulation, see Levi-Faur (2011), pp. 12–46.

[4] Hoff and Stiglitz (1990); Boucher and Guirkinger (2007), pp. 235–250.

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G. Yimer, *The Nexus Between Legal Pluralism and Inclusive Finance*,
https://doi.org/10.1007/978-3-031-71653-9_2

arrangements and traditional institutions, which for the most part are without legal standing and outside any legislative control."[5]

Germidis explains informal markets by comparing them with the formal sector:[6]

> The formal sector theoretically refers to an urban-oriented, institutional, and organized system catering to the financial needs of the monetized, modern sector, while the informal sector is unorganized and non-institutional and deals with the traditional, rural subsistence and non-institutional spheres of the economy.

However, Germidis admits that such a clear-cut difference is only theoretical. The reality is much more complex. There are no black-and-white criteria to draw a line between the formal and informal sectors of the economy, and there is a grey zone where there may be interfusion and overlapping between the two sectors.

In this book, informal credit markets are considered financial markets that operate on a small scale at an individual or group level without following the procedures commonly used in the formal financial sector and without acquiring the organisational structure required by law for financial institutions in a country.

The shadow banking industry also plays a role, requiring inclusion in any discussion of informal credit markets. Although the two differ in scope and purpose, they both avoid prudent regulation and supervision by the authorities. The shadow banking sector has grown to an almost equal size to the regulated licensed banks in the global financial industry, mainly to reduce costs and increase efficiency. Shadow banking tries to avoid costs involved with prudential supervision and regulation, investor disclosure, and taxes.[7] Therefore, definitions of shadow banking may also help understand informal credit markets. McCulley first used the term "shadow banking" in 2007. He was the director general of the Pacific Investment Management Company, LLC (PIMCO), and he used the phrase "shadow comes out of the shadow" in a paper he presented at a conference.[8] Since then, the term has been the title of many academic publications and has been discussed at the meetings of high-level policymakers and in academic deliberations.[9]

The Financial Stability Board (FBS) defines shadow banking as "the system of credit intermediation that involves entities and activities outside the regular banking system."[10] This definition differentiates between traditional banks and shadow banking by the level of regulation. Adrian et al. suggest that the definition outlines "the complexity of the credit intermediation chain, as well as the fact that banks themselves may be an integral component in the shadow system."[11] Nijs, after

[5] Mauri (1987), pp. 1–29.

[6] Germidis (1990), pp. 5–22.

[7] Adrian et al. (2019), pp. 1–44.

[8] McCulley (2007).

[9] Adrian and Ashcraft (2016), pp. 1–44.

[10] Germain (2011).

[11] Adrian et al. (2019), pp. 1–44.

describing how broad and complex shadow banking is, provides the following definition:[12]

> We are therefore at risk of defining "shadow banking" as everything that happens behind the curtain, while everything that happens on the podium, in the limelight, and therefore subject to regulation, would then become the officially regulated (and therefore licensed) banking sector. The tone is set: we are on a mission but unsure yet where we want to end.

Pozsar et al. define shadow banking, drawing on the difference between traditional banks and shadow banks. They provide that "what distinguishes shadow banks from traditional banks is their lack of access to public sources of liquidity such as the Federal Reserve's discount window, or public sources of insurance such as Federal Deposit Insurance."[13]

2.2 Types of Informal Credit Markets

Informal credit markets operate in different forms. Participants include family and friends, private moneylenders, traditional institutions, voluntary clubs, nongovernmental organisations, and traders.

Traders provide credit to their clients by suspending payments. However, credit in the sale of goods and services is not discussed in this chapter as this topic is beyond the scope of this book. Credits from traders are dealt with mainly using promotion theory, transactional theory[14] and price discrimination techniques.[15] Therefore, sale with credit is not included in this book.

2.2.1 Credit from Family and Friends

Loans between family members and friends are one of the oldest reciprocal relations. Family or friends are the most significant source of credit in most developing countries.[16] In Uganda, for example, 48% of the rural population considers family and friends potential lenders if needed, according to Mpuga's 2010 survey.[17] In rural China, 67% of households use friends or family as a source of credit.[18] Individuals

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[12] Nijs (2020), p. 130.

[13] Pozsar et al. (2010), p. 2.

[14] Ferris (1981), pp. 243–270. https://academic.oup.com/qje/article-abstract/96/2/243/1860736, pp. 343–370.

[15] Petersen & Rajan (1997), pp. 661–691. https://academic.oup.com/rfs/article/10/3/661/1635350, pp. 661–691.

[16] Turvey et al. (2005), pp. 133–149.

[17] Mpuga (2010), pp. 115–148.

[18] Turvey and Kong (2010), pp. 144–148.

borrow from family and friends to buy consumable goods and agricultural inputs, start a business, or engage in other social activities. Farmers depend on loans from family and friends to smooth consumption in rural areas and obtain necessary agricultural inputs such as seeds, farming animals, fodder, and fertilisers.[19] It is common to seek loans from family and friends to cover expenses for relatives' weddings and memorial services.[20]

Loans can be provided in kind or money. Cereals are one of the most frequently borrowed goods by the rural community, both for consumption and to be used as seeds for farming. Usually, the loan is for less than one year, as it is expected to be paid back during the harvest season. Loans from family and friends are usually interest-free, but sometimes, interest may be imposed on borrowers.[21] The interest rate to be imposed on loans varies depending on the parties' relationship and, most importantly, on the local customs and practices.[22]

2.2.2 Credit from Moneylenders

Moneylenders are very active in developing countries. The introduction of modern formal institutions has not purged them in many developing countries; rather, they have advanced their involvement in credit market activity by adjusting their businesses to the new realities created by colonialism and the political, legal, and social changes most developing countries subsequently experienced.[23] Some countries require registration and authorities' permission to transact a moneylending business. However, in many cases, the moneylenders operate underground without proper registration or recognition by the authorities.

Most moneylenders belong to the higher class of society either by birth or through accumulated wealth; this position awards moneylenders strong leverage on their debtors to minimise the risk of default.[24] This social and economic status gives them a comparative advantage over formal financial institutions to minimise the cost of administration and collection of debt. Moneylenders use their economic and social power to force debtors to pay rather than seeking the help of courts to enforce contracts.[25] Moneylenders also use simulated contracts to disguise the nature of the loan contract or the exorbitant interest rates they commonly charge.[26]

[19] Ray et al. (2000), pp. 283–301.
[20] Turvey et al. (2005), pp. 113–149.
[21] Turvey et al. (2005), pp. 111–149.
[22] Brietzke (1974), pp. 149–167.
[23] Falola (1993), pp. 403–423.
[24] Roth (1979), pp. 1166–1170.
[25] Chandavarkar (1985), pp. 129–141.
[26] Falola (1993), pp. 403–423.

Lending money with interest is one of the most debated issues in human history. Collecting interest for loans has attracted much attention from religious and secular lawmakers, even very early on. All great philosophers and major religions strongly condemned lending money with interest charges.[27]

Law is a natural reflection of society's moral and ethical standards and thus regulates lending money with interest. All ancient law codes prohibited lending with interest or capped interest rates to protect debtors from unscrupulous creditors. In Greece,[28] Babylon,[29] Egypt,[30] Rome[31] and Japan,[32] lending money with interest was prohibited, and the interest rate was legally limited. However, lending money with interest survived all moral and religious condemnations and legal punishments and is still prevalent in developing and developed countries.[33]

2.2.3 Credit from Informal Financial Institutions

In many developing countries, different institutions provide diversified financial or related services. In this chapter, we focus on Rotating Savings and Credit Associations (ROSCAs), the most common form of informal financial institution that plays a significant role in the financial markets of many developing countries.[34]

ROSCAs comprise a group of people who decide to meet a predetermined number of times to contribute a fixed amount of money at each meeting and make the total amount available to one member of the group; they continue to do the same until every member of the ROSCA has received once the total sum of the contributions they paid into the ROSCA. ROSCAs usually draw lots to determine who will receive the collected money at a given meeting, thus a form of credit. The members continue to contribute and use the lot system to determine the recipient until all members have taken their share. However, ROSCAs also use other methods like bidding and social hierarchy to determine the priority of recipients among their members.[35]

[27] Noonan (1957), p. 200.

[28] Homer and Sylla (2005), p. 32.

[29] Homer and Sylla (2005), p. 34.

[30] Homer and Sylla (2005), p. 32.

[31] Homer and Sylla (2005), p. 32.

[32] Pardieck (2008), pp. 530–594.

[33] Peterson (2012), pp. 893–978.

[34] Yimer et al. (2017).

[35] Geertz (1962), pp. 241–263.

Most research on ROSCAs has focused on country-based case studies, such as Ardener in Cameroon,[36] Anderson in India,[37] Gugerty in Kenya,[38] Bascom in Nigeria,[39] and Levenson and Besley in Taiwan.[40] Gamble[41] and Tsai[42] researched ROSCAs in China, Katzin[43] in Jamaica, Campbell and Chang[44] in South Korea, and Mbizi and Gwangwava[45] in Zimbabwe. Please see Low's seminal work for a general overview and bibliography of ROSCA-related research.[46] Researchers have endeavoured to answer questions like: Why do members join a ROSCA? What is the role of a ROSCA in society? How do they function? How do they relate to other formal or informal institutions in society?

ROSCAs were initially considered intermediates for economic transformation from an agrarian economy to a commercialised society.[47] However, ROSCAs have not necessarily vanished with economic development as was expected. ROSCAs have continued to function even after the introduction of modern financial systems in most developing countries.[48] The reasons ROSCAs have continued as important social and financial institutions in developing countries have not yet been researched. However, their flexibility,[49] their deep-rooted relation with social norms and traditions in society,[50] their effect on solving the problem of self-control and their adaptability to new social and economic developments in society are considered important characteristics of ROSCAs that make them irreplaceable in most developing countries.[51]

[36] Ardener (1964), pp. 201–229.
[37] Anderson (1966), pp. 334–339.
[38] Gugerty (2007), pp. 251–182.
[39] Bascom (1951), pp. 63–69.
[40] Levenson and Besley (1996), pp. 45–68.
[41] Gamble (1944), pp. 41–42.
[42] Tsai (2000), pp. 142–170.
[43] Katzin (1960), pp. 297–331.
[44] Campbell and Chang (1962), pp. 55–68.
[45] Mbizi and Gwangwava (2013), pp. 181–184.
[46] Low (1995).
[47] Geertz (1962), pp. 181–266.
[48] Klonner (2006).
[49] Pearlman (2010).
[50] Chamlee (1993), pp. 77–99.
[51] Bouman (1977), pp. 181–219.

2.3 Features of Informal Credit Markets

Informal credit markets operate in different styles and structures so that similar features cannot be defined.[52] For example, moneylenders are controlled and owned by individuals, whereas traditional institutions like ROSCAs are commonly organised and owned collectively.[53] Loans from family and friends are commonly free of interest, whereas, with moneylenders, loans allegedly bear exorbitant interest rates.[54]

However, despite such differences, informal credit markets share some common features, and they have important common factors that can be systematically analysed to help us understand informal credit markets. The main characteristics of informal credit markets in urban and rural areas are five-fold. First, they function mainly based on personal relations. People join informal credit markets based mainly on their trust in each other.[55] Informal credit markets, being based on personal relations, offer advantages. They avoid reliance on hard information or rigid laws and regulations and allow flexibility in operations. Another common feature is that loans are limited and commonly given for a short term with the required flexibility in the payment schedule. Thirdly, informal credit markets are often segmented, especially in rural areas.[56] This is mainly true for moneylenders, where the debtors have a social and economic bondage with the moneylender, and it is not easy to change their creditor easily. Most moneylenders dominate a specific village or group of persons, and the competition between two moneylenders is minimal. Mookherjee and Motta claim:[57]

> An important aspect of our model is that the informal credit market is segmented, thereby providing informal lenders with some market power. In one form or another, the assumption of segmentation has been made in many theoretical treatments of informal credit markets in LDCs.

The fourth feature of informal credit markets is that they are sometimes interlinked with other markets. This is particularly true for moneylenders and traders. Moneylenders are also landlords and traders in the area, providing credits for their tenants and clients.[58] The fifth common feature of informal credit markets is that obligation enforcement commonly depends on social pressure, unofficial laws, and contract laws.[59] Finally, it is also commonly agreed that the operational costs in informal credit markets are low because there are no salaried employees, and

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[52] Aryeetey (2005), pp. 13–38.

[53] Chandavarkar (1985), pp. 129–141.

[54] Turvey and Kong (2010), pp. 133–141.

[55] Rajaram (2001), p. 370.

[56] Aryeetey (2005), pp. 13–38.

[57] Mookherjee and Motta (2016), pp. 121–191.

[58] Hoff and Stiglitz (1990), pp. 235–250.

[59] Anderson et al. (2009), pp. 14–23.

information costs are limited.[60] Transaction costs are low due to lenders' personal knowledge about borrowers.[61] The informal sector also commonly escapes the tax network as it is outside most government regulations in the financial sector.[62] Ray et al. generalise their findings as follows:[63]

> Numerous case studies and empirical analyses in a variety of countries have revealed that informal credit markets often display patterns and features not commonly found in institutional lending: (i) loans are often advanced on the basis of oral agreements rather than written contracts, with little, or no collateral, making default a seemingly attractive option (ii) the credit market is usually highly segmented, marked by long-term exclusive relationships and repeat lending (iii) interest rates are much higher on average than bank interest rates, and also show significant dispersion, presenting apparent arbitrage opportunities (iv) there is frequent interlinkage with other markets, such as land, labor or crop (v) significant credit rationing, whereby borrowers are unable to borrow all they want, or some loan applicants are unable to borrow at all.

2.4 Functions of Informal Credit Markets

The informal credit market plays a significant role in the economies of developing countries. Researchers claim it is massive in most developing countries and plays a crucial economic role.[64] Informal credit markets bring to the reach of the poor services like credit, insurance, and saving mechanisms that are not otherwise accessible. They help to smooth consumption and minimise the effects of the perils of life, such as illness, loss of a breadwinning family member, loss of a job, or other unexpected accidents. Small- and medium-sized enterprises (SMEs) also mainly depend on informal credit markets to meet their demand for credit. The informal credit market provides full or partial funding to start and expand SMEs in many developing countries.

2.4.1 Informal Credit Markets as Sources of Credit

Karlan and Morduch estimate that around three billion citizens worldwide cannot access formal financial services.[65] Those without access to formal financial services rely on informal finance to satisfy their demand for financial services. Informal credit markets are the most common sources of credit for poor people in most parts of the

[60] Guirkinger (2008), pp. 1436–1452.

[61] Guirkinger (2008), pp. 1436–1452.

[62] Chandavarkar (1985), pp. 129–141.

[63] Ray et al. (2000), pp. 283–301.

[64] Germidis (1990), pp. 5–22.

[65] Karlan and Morduch (2009), pp. 4703–4783.

world.[66] Banerjee and Duflo report data from Udaipur, India indicating that more than 60% of those living on less than $1 per day had a standing debt at the time of the data collection, and only 6.4% of the loan was from formal sources of credit while 18% was from moneylenders, 37% from shopkeepers and 23% from relatives.[67] In relation to the RSA, Mashigo and Schoeman describe the role of traditional informal credit markets as follows:[68]

> The formal financial sector, i.e., banks and other non-bank suppliers of credit, does not accommodate the need for credit by poor households because of the problem of imperfect information or informational uncertainty about them and the irreducible uncertainty of the economic environment of the poor. Quantification of risk under these circumstances is difficult. This means that poor households are impeded of access to cash and are without sufficient hedges against the severe impact of relatively minor adverse events like temporary illness. They cannot rely on financial intermediation and therefore remain deprived of need-based credit . . . The traditional informal financial sector exemplified by stokvels is in these circumstances very important in providing credit to poor households. Traditional institutions and instruments have a history of success and have for some time made access to credit possible for even the poorest of the poor.

The informal credit markets in rural areas provide credits mainly for consumption and for agricultural inputs such as fertilisers and seeds.[69] There are mounting efforts by governments to provide credit through formal channels for small-scale farmers; however, researchers have shown that the credit from informal credit providers is prevalent and expected to remain an important supplier of credit for many small-scale farmers and the poor in urban areas.[70] The role of the informal credit markets in urban areas is also significant. The informal sector, which is sometimes referred to as shadow banking, provides credit for SMEs and even for larger companies in some circumstances.[71] The practice of informal credit markets and the size of loans can vary; however, the kernel remains the same both in urban and rural areas.

Many researchers acknowledge that informal credit markets have some inherent advantages to lure clients.[72] Moneylenders collecting and using soft information, alternative mechanisms of enforcing contracts, existing trade or landlord-tenant relations with their debtors, and their knowledge of the traditional and cultural values of society are all advantages enabling them to remain vibrant even when formal financial institutions are operating in the locality; this remains the case even when the formal credit market provides credit with cheaper interest rates.[73] These advantages cannot easily be integrated into the formal sector.

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[66] Banerjee and Duflo (2007), pp. 141–167, (p. 154).

[67] Banerjee and Duflo (2007), pp. 141–167.

[68] Mashigo and Schoeman (2010), pp. 504–515.

[69] Steel et al. (1997), pp. 817–830.

[70] Hoff and Stiglitz (1990), pp. 235–250.

[71] Yifu and Xifang (2006), pp. 69–82.

[72] Germidis (1990), pp. 5–22.

[73] Chandavarkar (1985), pp. 129–141.

2.4.2 Informal Credit Markets as Risk-Sharing Mechanisms

Many researchers have demonstrated that informal credit markets provide the most needed risk-sharing services in society. Researchers have confirmed that credits from informal markets enable poor households to survive and recover from natural or other perils to which they are frequently exposed. Impactful research by Rosenzweig,[74] Posner,[75] Fafchapes,[76] Undry,[77] Klonner[78] and Caudell et al. all illustrate how informal credit markets subtly serve as risk-sharing tools.

Rosenzweig's seminal research explored the role family plays in smooth consumption in low-income countries and explains that family transfers and credits are frequently used to smooth consumption in those countries where family income often oscillates. Furthermore, he points out that the extremely poor rely on credit to survive income shocks. Rosenzweig claims that "households with little endowed wealth (landless households) rely much more heavily on credit relative to transfers than do wealthy houses."[79]

Posner, on the other hand, explains that family and friends provide interest-free loans because they consider the possibility of receiving reciprocal free loans in the future if they face similar challenges: loans given today to others provide confidence in having access to loans in the future. With this concept in mind, the forgotten interest may serve as a premium paid to secure a loan, in case the support of others in the community is needed in the future. Sometimes a loan may not be from a previous debtor; other family or community members commonly take into consideration someone's generosity and their readiness to help others in the community when they are making decisions about providing that person with credit. This suggests a latent contract exists within the community: those who have produced surplus provide the required food for those who have failed to produce enough.

Posner describes how loans are used in some African countries to reduce the risk of cattle loss from disease and when there is a lack of sufficient forage for animals:[80]

> The insurance function of loans in primitive society is especially pronounced in the cattle lending which is so prominent a feature of African tribal society. The main purpose of such "loans" is not to earn interest but to disperse one's cattle geographically, so as to reduce the risk of catastrophic loss because of disease.

Posner boldly argues that the gifts, free loans, feasts and generosities that we observe in poor rural vicinities are inclusive informal systems that operate under the grand rule of reciprocity. He concludes that the values, norms and customs in

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[74] Rosenzweig (1988); Kocherlakota (1996), pp. 1148–1170.

[75] Posner (1980), pp. 1–53.

[76] Fafchamps (1999), pp. 257–278.

[77] Udry (1994), pp. 495–526.

[78] Klonner (2003), pp. 979–1006.

[79] Rosenzweig (1988), pp. 1148–1170.

[80] Posner (1980), pp. 1–53.

primitive societies are affected by the pervasive uncertainty that makes insurance against income shocks so vital: they need to introduce exchange systems to share risk equally in society.

Hoekema explains well how reciprocity and mutual dependency work in traditional communities as follows:[81]

> These obligations are internal obligations, a kind of ethic which is assumed on the basis of generalized or indirect reciprocity by and to each member of the community. It means that not only in times of distress, a right holder feels the obligation to restrain from pursuing his individual interests and take care of others, but he also trusts that others will step forward to support him in the future. This behavior is not free like a matter of your private choice, neither is it altruism. On the basis of this caring, each person helps to maintain the social integrity of the community and may reasonably expect to be cared for in turn when stranded in adverse conditions. Over the long term, the accounts of these contributions given and received will balance, although it is impossible to express this balance in precise quantitative terms. These contributions derive their value from the honoring of the specific social relations or the overall good of the community between the community members. Someone's personal good depends on the overall good of the community ... Indirect reciprocity stresses the inequality in what someone has to contribute to the wellbeing of others or the community as a whole, and the inequality in your needs. In those kinds of small-scale societies, a person trusts that the others will also care for him under similar circumstances.

Furthermore, Fafchamps confirms that credit against asset accumulation, through the collection of gold and silver, is used by communities without access to formal insurance to minimise the negative effect of income fluctuations.[82]

Drawing on his research in Nigeria, Udry confirms that informal credit markets operate as risk-sharing mechanisms. He argues that "credit transactions in rural northern Nigeria play a more direct role in pooling risk between households."[83] Furthermore, he considers the credit markets to be insurance networks used by society to shield the most vulnerable individuals from the covariate and idiosyncratic shocks that are so frequent in poor countries.[84] He claims that loan repayments include insurance premiums, though the rates may not always be explicitly provided in the loan agreements. Platteau and Abraham, in another seminal research study, found that credit transactions among fishermen are being used to cope with risk.[85] Decisions to provide credit among the fishermen are influenced by expected reciprocity: the current creditor may need to become a borrower.

Research conducted in Sidama, Ethiopia, by Caudell et al. has also proved that informal credits are used to balance idiosyncratic shocks resulting from illness, death, or other emergencies.[86] This research by Caudell et al. has identified families with more cattle as potential community credit providers in case of emergencies,

[81] Hoekema (2017), pp. 67–84.
[82] Fafchamps (1999), pp. 257–78.
[83] Udry (1994), pp. 495–526.
[84] Udry (1994), pp. 495–526.
[85] Platteau and Abraham (1987), pp. 461–490.
[86] Caudell et al. (2015), pp. 34–42.

whereas individuals with a small number of cattle depend on credit for survival in drought seasons.

2.4.3 Informal Credit Markets as Saving Mechanisms

Many researchers argue that informal credit markets, especially ROSCAs, function as mechanisms to solve the self-control problem, as evidenced in work by Gugerty,[87] Ambec and Treich,[88] Basu,[89] and Dagnelie and Philippe.[90]

Gugerty, drawing on empirical research in Kenya, concludes that informal credit markets motivate saving in the neighbourhood.[91] For example, ROSCAs are commonly used to increase savings by those who have a problem saving alone; spending is controlled by committing compulsory contributions to the ROSCA.[92]

Ambec and Treich conclude that ROSCAs provide the required commitment to individuals with a self-control problem. Their research showed that individuals with difficulty controlling their spending benefit from joining ROSCAs. ROSCAs function based on strong self-discipline; they limit access to accumulated savings for a given period, helping control spending temptation.[93] A research study by Can and Erdem demonstrated that the present bias problem is higher among lower-income consumers.[94] The ROSCAs, therefore, can be used to control the present consumption bias problem. The present bias problem is a tendency to consume now rather than later. Most individuals are tempted to consume now, but saving requires extending consumption to future dates.

Not respecting a binding financial agreement results in social condemnation and abomination; hence, it gives individuals who have a problem saving alone an incentive to increase their commitment to saving. However, fear of social condemnation is not the only reason commitment to saving is increased. Using economics modelling, Basu proved that even without social pressure, ROSCAs increase the commitment of members and improve individual saving behaviour.[95] ROSCAs also contribute towards wealth creation at the household level. A recent study has shown that most ROSCA members use savings that they receive as a lump sum payment to buy cars, invest in their businesses, buy houses, or other indivisible and durable

[87] Gugerty (2007), pp. 251–282.
[88] Ambec and Nicolas (2007), pp. 120–37.
[89] Basu (2011), pp. 143–171.
[90] Dagnelie and Philippe (2012), pp. 235–248.
[91] Gugerty (2007), pp. 251–282.
[92] Yimer et al. (2014–2017), pp. 229–238.
[93] Ambec and Nicolas (2007), pp. 120–137.
[94] Can and Erdem (2013), pp. 1–14.
[95] Basu (2009), pp. 1–25.

goods.[96] Furthermore, Dagnelie and Philippe, from their analysis of data from Benin, conclude that ROSCAs help individuals reject unwelcome requests for support from family and friends.[97] Of particular interest is a study in the Cameron, which showed that some individuals use borrowing to present themselves as poor to avoid demand from family and friends for loans, which they would otherwise be unable to refuse because of social pressure and expected reciprocity.[98]

2.5 Explanations for Pervasiveness of Informal Credit Markets

The question of why informal credit markets exist has challenged scholars. Researchers have provided several possible explanations to justify their pervasiveness in developing countries. Financial exclusion of the poor is considered to be the most important factor.[99] Lack of adequate and affordable access to formal credit markets forces the poor to depend on informal credit markets.[100] Researchers argue that lack of collateral, financial literacy, and complicated bureaucracy in formal financial institutions limit access to formal financial services and make them costly for most developing countries' populations.[101] The flexible nature of contracts in informal credit markets, simplified procedures, and flexible repayment schedules are also relevant factors that sustain informal credit markets alongside formal financial markets, both as complements and substitutes.[102] Hereunder, we discuss the main reasons that directly or indirectly contributed to the prevalence of informal credit markets in developing countries.

2.5.1 Financial Repression

The nature of government regulations and interventions in the financial market has a great impact on the efficiency, accessibility, and profitability of the credit markets in a given country.[103] The prevalence of informal financial markets in developing countries is allegedly the result of imprudent financial policies in these countries.[104]

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[96] Ibrahim (2020), pp. 29–58.

[97] Dagnelie and Philippe (2012); Caudell et al. (2015), pp. 235–248.

[98] Baland et al. (2015), pp. 1–16.

[99] Yaldiz Hanedar (2013), pp. 13–38.

[100] Tsai (2004), pp. 1487–1507.

[101] Yaldiz Hanedar (2013), pp. 1–182.

[102] Tsai (2004), pp. 1487–1507.

[103] Levine (1998), pp. 596–613.

[104] Bencivenga and Smith (1992), pp. 767–790.

The crux of this argument is that governments in developing countries impose excessive control over financial markets. Informal credit markets that escape these strict government regulations mushroom to serve those excluded from the controlled formal credit markets.[105] Scholars use the term financial repression to express an excessive intervention of governments in the financial sector.[106]

Financial repression provides some individuals or businesses with more favourable financial services, including access to cheap credit and flexible payment schedules. In contrast, most of the population is denied access to finance in the formal credit markets.[107] The financial policy in many developing countries depicts an artificially low interest rate for credits. Access to credit from government banks and institutions with low interest rates becomes possible only for government enterprises, individuals, and companies with a political affiliation. Credits are also channelled to projects selected and picked by governments, mainly based on non-economic calculations.[108] The cheap credits to large companies and government enterprises are made possible due to deposits by the masses of individuals, who receive meagre interest for their deposits from the banks. The banks collect deposits from rural areas using different mechanisms with artificially low deposit interest rates, and they use the collected money to provide loans to large urban areas. In this way, they transfer income from the poor to the rich. These policies create a fertile ground for informal markets to bloom by creating a demand from those excluded from the formal markets and a supply from those frustrated by the legally determined low deposit interest rates.[109] Empirical evidence has also confirmed that financial exclusion resulting from financial repression affects mostly poor people and Small and Medium Enterprises(SMEs).[110] However, Aryeetey notes that there is no strong empirical evidence that "those whose applications are turned down by formal financial institutions usually turn their faces into informal credit markets."[111]

2.5.2 *Constraints on the Formal Sector to Provide Funds for Poor Households*

We will discuss hereunder procedural and structural issues that negate inclusive finance in most countries, thereby making informal credit markets important in most developing countries.

[105] Gao (2015), pp. 45–95.

[106] Gao (2015), pp. 45–95.

[107] Lu and Yao (2009), pp. 763–777.

[108] Steel et al. (1997), pp. 817–830.

[109] Bardhan and Udry (1999).

[110] Beck et al. (2007), pp. 27–49.

[111] Aryeetey (2005), pp. 13–38.

2.5.2.1 Difficulty to Generate Information

Information is an important variable in financial decisions. Information is needed for screening potential clients, monitoring debtors, and collecting debts.[112] The applicant's financial history, total indebtedness, business experience, behaviour, family conditions, and social and business relations are critical factors that a creditor considers when deciding whether to approve or reject a credit application.[113]

Formal financial institutions have a hierarchical structure and a centralised decision-making process; therefore, they predominantly depend on "hard information" to make decisions.[114] However, most small and micro businesses in developing countries lack the hard information to fulfil formal banks' screening requirements.[115] The applicant must provide organised and verifiable evidence about his or her business to pass the screening procedures and qualify as a creditworthy client for a formal financial institution. Most small and micro businesses do not keep important records such as income statements and balance sheets, and they may not even have bank accounts.[116] In developing countries, many businesses operate informally without official registration or certification.[117] Generally, the difficulties obtaining adequate and credible information about these institutions and the cost of obtaining such information are reasons why the poor are excluded from the formal financial market.[118]

In contrast, informal lenders use soft information generated from personal relations with the debtor.[119] They depend on the goodwill of the person and their social and family ties in society, and personal information about their creditworthiness and the nature and profitability of their business. Therefore, they do not need the hard information that the formal financial institutions depend on to screen applicants.[120]

2.5.2.2 Lack of Collateral

Lack of collateral is another huge challenge for most SMEs and poor people, hindering access to credit from formal financial institutions.[121] Financial institutions require immovable property as collateral for credits. Unfortunately, most poor people lack immovable properties to provide as collateral, or if they have a property,

[112] Hoff and Stiglitz (1990), pp. 235–250.
[113] Yifu and Xifang (2006), pp. 69–82.
[114] Liberti and Petersen (2019).
[115] Aryeetey (2005), pp. 13–38.
[116] Yifu and Xifang (2006), pp. 69–82.
[117] Straub (2005), pp. 299–321.
[118] Hoff and Stiglitz (1990), pp. 235–250.
[119] Aryeetey (1998), pp. 1–25.
[120] Guirkinger (2008), pp. 1436–1452.
[121] Aryeetey (1998), pp. 1–25.

it is most often unregistered or lacks some formal requirement to be used as collateral.[122] The effect of lack of collateral on access to credit is a well-accepted thesis. The effect of the requirement for collateral on the financial exclusion of the poor and even on sustaining and increasing income inequality is articulated by Ghosh et al. as follows:[123]

> Access to credit is especially restricted for the poor, owing to their inability to provide collateral. Collateral both reduces default risk (for incentive reasons) and lender exposure in the event of default. Existing poverty and wealth inequalities may therefore tend to be perpetuated.

Although some studies have cast doubt over how much a lack of collateral affects access to credit in developing countries,[124] There is a consensus that the main challenge is preventing poor people in developing countries from accessing credit from formal financial institutions.[125]

2.5.2.3 Lack of a Proper and Effective Legal Framework

Access to credit is relevant to achieving sustainable development goals. Some argue that access to credit should be considered as a human right. The argument for access to credit to be considered a human right relies on the fact that access to credit plays a significant role in protecting human dignity. Dignity is at the centre of human rights theories. Access to credit allows many people to have decent jobs and living conditions. However, some hesitate to endorse the idea of including access to credit in the bundle of human rights. The main argument against categorising access to credit as a human right is based on the challenges in defining the duties that come along with it. Banks are private actors, and they work for profit maximisation. Banks also depend on investors who invest to earn profits. Therefore, we cannot impose obligations on banks to provide credit.

The relevance of law and its practical implementation for developing the financial industry is a well-established theory.[126] The quality of laws and their practical implementation help to improve financial inclusion and reduce the probability of exclusion from the formal credit market, particularly for small and micro enterprises.[127] Effective and efficient laws that can be enforced without a prolonged procedure and with minimum cost also reduce the cost of credit and increase the probability of repayment.[128] Furthermore, Hanedar's empirical analyses revealed that the lack of an effective and efficient legal procedure is one reason for SMEs'

[122] De Soto (2000).
[123] Ghosh et al. (2000), pp. 383–401.
[124] Domeher and Abdulai (2012), pp. 161–175.
[125] Allott (1975), pp. 73–83.
[126] Pistor et al. (2003), pp. 326–368; see also Hanedar et al. (2014), pp. 65–86.
[127] Grant and Padula (2006).
[128] Fabbri and Padula (2004), pp. 2369–2397.

dependency on informal credit markets.[129] An empirical research study that relies on a rich database collected from more than 30 countries has shown a significant positive relation between the low quality of a legal system and increased dependency on informal credit markets.[130] When a country's legal system lacks predictable, stable, and efficient laws and contract enforcement requires prolonged litigation, the result is a high financial exclusion rate of small-scale borrowers. Staschen et al. outline how laws hinder formal financial institutions' attempts to provide financial services to the poor, thereby aggravating financial exclusion.[131]

The informal financial market, however, does not operate in a vacuum. Credit markets, whether formal or informal, cannot exist without rules regulating the market transactions.[132] Rules that play an important role in credit markets can be formal laws created by the government or private actors.[133] The absence of formal laws does not imply the nonexistence of laws; rather, it shows that the market's rule has been taken on by private actors with the assumed implied consent of governments.[134] The practice of rulemaking by private actors is very common in small-scale markets and some self-regulatory large-scale markets.[135]

Most developing countries, however, are still struggling to develop a legal system that is consistent, predictable, accessible, and enforceable. Laws that consider the special situation of the poor and their justified interest in benefiting from the financial sources of the country are important to promote fairness and equitability in the financial market. Laws that are entrenched in social and economic realities have the potential to create an enabling environment with an inclusive financial system in a country. On the contrary, inadequate laws impede the capacity of both formal and informal financial institutions to control and minimise default, thereby aggravating the problem of financial exclusion of the poor.[136] Lack of well-thought-out laws and effective law implementation are among the main challenges that force the formal sector to remain sceptical of providing credit to small-scale borrowers.[137] High default rates imply that formal institutions' screening to provide loans needs to be very strict to mitigate the risk, which results in the exclusion of most SMEs and poor households from financial services.[138]

Lack of effective contract enforcement affects both formal and informal credit markets. However, informal credit markets use informal influences to ensure a better repayment rate, such as exclusion from membership, verbal warnings, and a threat to

[129] Yaldiz Hanedar (2013), pp. 1–182.
[130] Hanedar et al. (2014), pp. 65–86.
[131] Stachen and Nelson (2013), pp. 71–96.
[132] Pistor (2013), pp. 315–330.
[133] Pistor (2013), pp. 235–250.
[134] Pistor (2013), pp. 235–250.
[135] Pistor (2013), pp. 235–250.
[136] Aryeetey (1998), pp. 1–25.
[137] Steel et al. (1997), pp. 817–830.
[138] Zazzaro (2005), pp. 166–184.

exclude defaulters from interrelated transactions. For this reason, repayment is higher in informal credit markets than in formal credit markets, although very little court litigation is used to enforce contracts.[139]

2.5.2.4 Complex and Expensive Bureaucracy

The complicated bureaucracy involved in gaining access to credit in formal financial institutions also restricts poor people's access to credit.[140] In most developing countries, the lack of flexibility and delays in formal financial institutions inhibit the poor from benefiting from these services.[141]

Approval of loans takes a very long time in formal financial institutions; the paperwork required is complex, burdensome, and time-consuming. Applicants from SMEs may be discouraged not only by the long time that formal financial institutions take to process requests for loans, but also by the distance they have to travel to facilitate the process, the clearances and document authentications required and even the possible lack of attention of institutions to poor borrowers. SMEs in developing countries usually have meagre resources, so it is challenging for them to survive for a long time without access to credit while waiting for all these administrative hurdles to be dealt with. Small and micro businesses need access to credit quickly to stay competitive in a highly competitive industry. They do not have the infrastructure to survive without credit access.[142] Generally, the administrative hurdles in formal financial institutions, including microfinance institutions, are antithetical to small-scale borrowers.

Empirical evidence also proves the theory that the administrative cost of obtaining credit from formal institutions is relatively more burdensome for small-scale borrowers than for large-scale borrowers.[143] The marginal cost of loan administration decreases with the increase in the loan; the smaller the loan, the higher the administrative cost per unit.[144] The complex bureaucracy and paperwork render administrative costs very high, making small-scale credits expensive.[145] "The loan requirements of SMEs are small; therefore, costs of processing the loan tend to be more burdensome on small-scale borrowers."[146] Furthermore, researchers have proved that administrative costs, including time travelling to formal institutions,

[139] Aryeetey (1998).

[140] Adams and Graham (1981) pp. 347–366.

[141] Campero and Kaiser (2013), pp. 1–32.

[142] Aryeetey (1998), pp. 1–25.

[143] Gonzalez-Vega (1984), pp. 30–60.

[144] Gonzalez-Vega (1984), pp. 30–60.

[145] Guirkinger (2008), pp. 1436–1452.

[146] Aryeetey (1998), pp. 1–25.

bribes and paperwork, are more important determinants for small-scale borrowers than the interest rate in their decision to borrow from formal or informal sources.[147]

Generally, the formal credit market is inaccessible and has a limited capacity to serve most of the population in developing countries. Therefore, the formal and informal credit markets are mostly complementary to each other rather than competing with each other. Research has also shown that sometimes those who have access to formal financial institutions may also turn to informal credit markets for emergency funds or if they face an acute shortage of liquidity.[148] Further, the informal sector remains the only viable option for most people in poor countries. Informal lenders have a comparative advantage over the formal sector in relation to the required information about potential clients, which is known or accessible to them through social, business or family relations with their debtors. Actors in the informal credit market also have an alternative mechanism of enforcing contracts using social influence, by denying future credit, by excluding debtors from other related transactions, or even by using physical threats.[149] Traditional values and customs dominate social orientations towards credit and business and have made the informal credit markets indispensable in developing countries.[150]

2.6 Policy Approach to Informal Credit Markets

Informal business plays a vital role in developing countries' social, economic, and political situations.[151] The informal sector creates jobs and supports the economy in many ways. It will also continue attracting policymakers' attention and remain at the centre of economic, legal, political, and social policy issues in developing countries.[152] Most developing countries adopt a policy of reshuffling informal business into formal business using different policy instruments; however, there are still doubts over how the informal sector can be transformed into a formal business. It is agreed that the informal sector will remain the focal point of social, economic, and legal considerations in most developing countries for decades.[153]

Informal credit markets are among the most important informal markets in developing countries. The role they play in developing countries' economies cannot be overestimated, considering the financial exclusion of most people in the developing world. Therefore, the policy response to informal credit markets aims to promote inclusive finance in these countries. Although informal credit markets

[147] Bose (1998), pp. 265–280; Hanedar et al. (2014), pp. 65–86; Pistor (2013), pp. 315–330.

[148] Azomahou and Yitbarek (2015).

[149] Bhaduri (1977), pp. 341–352.

[150] Chandavarkar (1985), pp. 129–141.

[151] Ihrig and Moe (2004), pp. 541–557.

[152] Straub (2005), pp. 599–321.

[153] Dessy and Pallage (2003), pp. 225–233.

provide access to finance to a significant population, they are not included in the definition of inclusive finance as they are not commonly registered and supervised by the appropriate authorities. Inclusive finance is characterised by access to a regulated, affordable and safe financial system.[154] An inclusive financial system has been proven to promote economic growth and decrease income inequality.[155] The right to access credit is an important right that enables people to enjoy other fundamental rights such as the right to a decent job, the right to access health, the right to be free from poverty and the right to dignity.

Informal moneylenders, however, are accused of exploiting those who have no access to the formal credit markets.[156] Moreover, scholars argue that informal credit markets hinder countries from implementing effective monetary and fiscal policy and that they should somehow be controlled and regulated.[157] Many countries endeavour, therefore, to avoid them, or at least to minimise the dependency of the poor on them.[158] However, there is no consensus on how informal credit markets should be dealt with to bring them into the ambit of the formal system or to reduce their role in the credit markets. Scholars have provided a bundle of recommendations for developing countries to consider in their approach towards the informal credit market. Hereunder, we will discuss the commonly provided recommendations by researchers on how to deal with the ever-growing informal credit markets.

2.6.1 Liberalising the Financial Market

The most widely accepted recommendation to reduce the role of the informal credit markets, especially in urban areas, is to liberalise the financial markets. Liberalising the financial markets is expected to induce individuals to shift from informal to formal credit markets.[159] A reform in the formal sector is expected to strengthen the financial sector's capacity to provide quality financial services to the economy. The point here is that reforming the formal sector to avoid financial repression would help the formal sector operate based on market principles. A market principles-based credit market may increase interest rates for deposits. Higher interest rates for deposits would then serve as an incentive to encourage individuals to use formal banks to save their money. Higher interest rates encourage savings and reduce consumption. The increase in savings, in return, helps formal financial institutions mobilise savings to provide access to credit for those who need it. The lending interest rate should also reflect the real market value of money, driving out inefficient

[154] OECD (2013).
[155] Beck et al. (2007), pp. 27–49.
[156] Roth (1979), pp. 1166–1170.
[157] Germidis (1990), pp. 5–22.
[158] Besley (1994), pp. 27–47.
[159] Gao (2015), pp. 95–145.

borrowers who take out loans to benefit from the artificially low interest rates. The real interest rate for deposits and loans is expected to narrow the difference between the cost of borrowing in the formal and informal credit markets. The reduced gap between the cost of borrowing (due to an increase in the cost of borrowing in the formal sector) would attract some of the actors from the informal credit market to the formal credit market. Moneylenders may consider becoming registered and regulated moneylenders if the legal framework is open to them. Reform in the formal sector also affects the demand side in the informal credit market, as it opens up the possibility for SMEs to access credit due to the increased efficiency of the formal sector. Therefore, well-thought-out reform in the formal sector may result in a reduced share of business going to the informal credit market. Furthermore, it may bring interest rates down in the informal credit market.[160] Some scholars describe this approach of minimising the role of the government in the credit market as an integration approach, as the liberalisation is ultimately expected to lead to the integration of the informal and formal credit markets.[161]

However, liberalising the financial market may also bring problems unless accomplished gradually and with solid and adequate supervision.[162] A formal financial sector reform is insufficient to transform the credit market in most developing countries. In many countries, a structural adjustment to liberalise the financial market has resulted in a high demand for credits that banks could not satisfy.[163] This implies that reforms in the financial sector should be buttressed by related policy and legal reforms that enable the informal credit markets to evolve into formal or semi-formal institutions.[164] The formal sector must also introduce innovative schemes that increase accessibility to those currently excluded.[165] The linkage between the formal and informal sectors is needed to provide an inclusive financial service. Therefore, understanding the role of the informal and formal sectors and how the two markets function with or without each other is critical to establishing efficient and effective policy and a legal framework for the credit market.[166] Furthermore, legal recognition of the informal sector and providing a linkage between formal and informal financial markets will help minimise its negative effects and maximise its positive outcomes.[167]

[160] Aryeetey (1998), pp. 1–25.
[161] Germidis (1990), pp. 5–22.
[162] Villanueva and Mirakhor (1990), pp. 509–536.
[163] Aryeetey (1998), pp. 1–25.
[164] Straub (2005) pp. 299–321.
[165] Chandavarkar (1985), pp. 129–141.
[166] Jain (1999), pp. 419–444.
[167] Germidis (1990), pp. 5–22.

2.6.2 Providing Subsidised Credit to the Poorest Segment of Society

It has now become a well-established principle that access to financial services is an indispensable component of the development package to reduce poverty and empower the extremely poor.[168] Empirical investigations have shown that access to finance significantly affects poverty alleviation.[169] Governments and international development organisations have introduced varied credit schemes to provide cheap and subsidised credit for those excluded from the formal credit market due to a lack of collateral or other related problems.[170] Credit unions, microfinance institutions, credit cooperatives, government agencies, and private banks have tried to provide subsidised and cheap credit to mitigate the damage caused to the poor by financial exclusion.[171]

One of the main justifications for governments and other development agencies to provide cheap credit via different institutions is the need to protect the poor from usurious informal moneylenders.[172] The idea is that expanding financial services to include the disadvantaged segment of society may reduce the number of informal moneylenders—and ultimately eradicate them—who are presumably exploiting the poor.

However, providing cheap credit using formal and semi-formal financial institutions has not replaced informal moneylenders from the market. Empirical research has shown that subsidies that lead to negative interest rates for loans have the potential to negatively affect investment objectives in rural areas.[173]

2.6.3 Interest Rate Ceilings

Laws determining the maximum interest rates that creditors may impose on debtors are very common in developing and developed countries. A recent research study showed that "at least 76 countries around the world, representing more than 80% of the global [Gross Domestic Product] GDP and global financial assets, impose some restrictions on lending rates."[174] Using laws to control interest rates in credit markets has a long history, and almost all ancient law codes included rules to regulate interest rates. The ancient codes of Hammurabi, for example, provided that the maximum

[168] Hudon (2009), pp. 65–87.
[169] Geda et al. (2006).
[170] Imboden (2005), pp. 65–87.
[171] Adams and Graham (1981), pp. 347–366.
[172] Adams and Graham (1981), pp. 347–366.
[173] Braverman and Guasch (1986), pp. 1253–1267.
[174] Ferrari et al. (2018).

interest rate for loans in the form of cereals was 33%. The code set 20% as the maximum loan rate provided in silvers.[175] The higher potential interest rate for cereals may be explained by the fluctuation in the value of cereals in harvesting or seeding seasons. The punishment for violating the interest rate ceiling under the code law of Hammurabi was to forfeit the principal amount.[176]

The Romans also restricted interest rates in different ways.[177] The Greeks, however, usually followed a laissez-faire approach, and lending was considered an important activity for common prosperity.[178] Lenders charged interest rates based on the nature of the business in which the debtor invested the money. However, even in Greece, there was opposition to collecting interest: Aristotle and Plato considered it unhealthy, unnatural, and unproductive.[179]

The policy of having an interest rate ceiling has a strong moral basis in most societies: this makes it a desirable and readymade solution to fight predator lenders, especially in developing countries. However, there are strong arguments against the use of interest ceilings in the credit market as a means to protect credit consumers. The argument against interest ceilings emanates from its possible effect in excluding the poor from the credit market and exposing them even more to unregulated, hidden, exploitative credit markets that are difficult to control.[180] The credit providers respond to the credit ceiling by avoiding high-risk creditors.[181] Those who request smaller loans are excluded from the formal market because transaction costs are higher for smaller loans, and the costs cannot be compensated for by creditors charging higher interest. Creditors may also focus on urban rather than rural areas to minimise administration and other related expenses, thus affecting the distribution of credit in rural areas.[182] Creditors also exclude debtors who lack quality collaterals as high-risk clients, which often affects the poorest and those depending on SMEs. In Kenya, for example, after introducing a new law that capped interest rates, credits to SMEs and individual borrowers diminished significantly.[183] Interest rate ceilings may also pressure regulatory bodies in developing countries, making effective control practically challenging.[184] Therefore, the interest ceiling rate, which is meant to protect the poor, results in total exclusion of the poor from the credit market, forcing them to look for opportunities in the informal credit market, with even higher interest rates and with no or little protection from onerous contractual terms and enforcement mechanisms. The interest rate caps, therefore, in most cases,

[175] Nagarajan (2011), pp. 108–117.
[176] Nagarajan (2011), pp. 108–117.
[177] Maloney (1971), pp. 79–109.
[178] Maloney (1971) pp. 79–109.
[179] Maloney (1971), pp. 79–109.
[180] Gao (2015), p. 95.
[181] Ferrari et al. (2018).
[182] Ferrari et al. (2018).
[183] Ferrari et al. (2018).
[184] Ferrari et al. (2018).

hurt the welfare of consumers unless designed with caution and in a way that promotes and enhances financial inclusion.[185] An extensive review of the literature on this topic by Garz et al. concludes that interest caps generally have a negative effect.[186]

2.7 Inclusive Finance: Concepts and Definitions

Different international organisations and national policy documents provide a definition for inclusive finance that can be captured as fellows: Inclusive finance is a financial system that provides affordable, accessible, flexible, and sustainable financial products that consider the interest of people with limited literately, information, and capital. Inclusive finance demands financial institutions to plan and strategically work to open their doors to people excluded from the financial market because of the information asymmetry, high costs, high capital requirements, complex procedures and cultural and psychological hindrances. World Bank defines inclusive finance as follows: "Financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs – transactions, payments, savings, credit and insurance delivered responsibly and sustainably."[187] FATF defines inclusive finance broadly: Financial inclusion involves providing access to adequate, safe, convenient, and affordable financial services to disadvantaged and other vulnerable groups, including low-income, rural, and undocumented persons who have been underserved or excluded from the formal financial sector. Financial inclusion also involves making a broader range of financial products and services available to individuals who can only access essential financial products. Financial inclusion can also be defined as ensuring access to appropriate financial products and services at an affordable cost fairly and transparently. The Financial Regulation Act of South Africa defines inclusive finance as "that all persons have timely and fair access to appropriate, fair and affordable financial products and services." The National Inclusive Finance Strategic Plan II of Ethiopia provides no definition; however, it provides that inclusive finance is key for sustainable development, inclusive growth, financial stability and job creation.[188]

Inclusive finance has evolved from the essential requirement of financial institutions' geographical accessibility to demanding that financial institutions have a measurable and visible impact on society's well-being.[189] Financial institutions

[185] Cuesta and Alberto (2019).

[186] Garz et al. (2020).

[187] https://www.worldbank.org/en/topic/financialinclusion/overview.

[188] https://nbe.gov.et/wp-content/uploads/2023/12/National-Financial-Inclusion-Stratgy-II-2021-2025.pdf.

[189] Tuba and Lawack (2023), pp. 23–56.

should provide services appropriate to every segment of society and must provide services that consider the less fortunate and SMEs.

The critical role inclusive finance plays in national economies and financial stability has been proven. Inclusive finance is also recognised as a vital element of international development strategies and agreements. The following paragraph concisely discusses how inclusive finance has been recognised and framed in international agreements and conventions.

2.7.1 Inclusive Finance as an International Development Strategy

Since the introduction of microfinance as a development project, providing access to finance to those who need it has been considered by the international community to be a vital element in solving many of the problems we face in the twenty-first century.[190] Microfinance was recognised as the best approach in 2005 as the year was dedicated to microfinance. Inclusive finance directly and indirectly impacts the achievement of UN Development goals. Inclusive finance is connected to at least eight of the 17 goals the document provides. Inclusive finance is directly associated with the UN's goal of ending poverty. The no-poverty movement cannot be achieved without giving people access to finance. People need access to finance to deal with poverty, use their knowledge, skill and entrepreneurship to end poverty and manage national and manmade risks that expose people to poverty. The objective of creating decent jobs is also directly linked with access to finance. In most poor countries, the most important employers for poor people are small and medium enterprises and informal economies. Lack of finance is the main challenge for most people when creating jobs for themselves and others. Access to finance is directly related to access to education and health and improves human capital development.[191] The goal to eradicate hunger is also linked with inclusive finance, as inclusive finance minimises the risk of hunger. Inclusive finance is also an important determining factor that helps to achieve other goals like good health, gender equality, economic growth, industry, and innovation.[192]

Different international organisations have introduced different policy formworks and guiding principles to support the efforts of different development agents to enhance inclusive finance. In 2011, the Maya Declaration emphasised the importance of inclusive finance. The Financial Inclusion Action Plan (FIAP) was introduced by the Global Partnership for Inclusive Finance (GPIF). The action plan covers 2023–2026. There is a consensus that inclusive finance is critical for sustainable development and alleviating poverty. The Financial Action Task Force also

[190] Sethi and Acharya (2018), pp. 369–385.

[191] Tchamyou (2020).

[192] Chitimira and Warikandwa (2023).

recognised the importance of inclusive finance, and it has recently considered inclusive finance as one of its objectives in promoting a healthy financial system. The financial stability board took the issue and incorporated it as an international agenda that needs to be addressed. However, the issue has not received the required attention mainly because international financial regulation has been dominated exclusively by economically advanced nations. The advanced economies introduce laws and rules that promote their interests. They introduce standards that they consider best serve their interest in controlling their economy's risk and advancing their global economic and political agenda.[193] Nations from the global south are on the reception end, and they are expected to implement these imposed standards, or they face exclusion and other sanctions.[194]

Empirical researchers have provided convincing results that financial regulation plays a role in limiting inclusive finance in Africa, and financial exclusion negatively affects economic growth.

2.7.2 Unilateralism and Inclusive Finance

Universalised and centralised lawmaking processes based on norms and practices that are different in many ways from the standards, practices, values and customs of the people make the laws unacceptable to the people on the ground. As a result, the laws become detached from the practice on the ground. The law in the book and the law in action become different. The universalistic and unilateral approach hinders access to justice for many people and excludes most people, especially the economically less intense people, from the formal economy, including the formal financial system. The recent move by the Financial Action Task Force (FATF) to introduce international standards that financial institutions should apply to provide financial services further consolidated laws that fall far from the reality on the ground and push many people from accessing financial services. Research has indicated that a strict application of FATF recommendations hurts account ownership in developing countries.[195] Therefore, the unilateral and universalistic approach hinders an inclusive financial system, which is critical for sustainable and inclusive development.

2.7.3 Legal Pluralism and Inclusive Finance

Legal pluralism is a system that recognises multiple sources of laws, multiple laws and dispute settlement mechanisms that operate in the same jurisdiction. The various

[193] Jones and Knaack (2019).

[194] Alami (2023).

[195] Ofoeda et al. (2023).

systems may interact, contradict, compete and or supplement each other. There may be a supreme law that attempts to maintain harmony among the different laws and actors, or there may be no such supreme law that deals with the issue. The matter may be solved by horizontal interaction and by the social choice of the community. Such a system allows people to be involved in the economy and feel safe and protected in their economic life. This is particularly important in the financial life of the people as they will have a financial system that is designed and organised by the people from below and operates according to the laws that they consider are fair and known to them or even laws that they directly or indirectly contribute for their formation development. Legal pluralism, therefore, helps to provide a financial service that is more inclusive and fairer. This book offers arguments that enhance the thesis that legal pluralism helps most people access financial services that are not directly regulated and governed by official laws.

2.8 Chapter Summary

Informal credit markets commonly operate without direct regulation by authorities and without registration and licenses. However, they may have some relation to the formal sector. We have identified three primary sources of credit in the informal credit market. Family and relatives are significant players in providing credits with no interest or low interest rates to individuals who need help. Reciprocity is their main feature, and the creditor and debtor may exchange places frequently. Moneylenders who provide credits with interest are also very important players in the informal credit market. Moneylenders commonly charge exorbitant interest rates, and they are known for using morally unacceptable procedures to enforce contracts. Traditional financial institutions are also essential players in the informal credit market. Traditional financial institutions use local networks and knowledge to unite people and provide financial services to the group they form. They are well entrenched in the traditions and cultures of society. Joining these traditional institutions signifies social acceptance and a healthy social life. Joining these institutions may also help individuals strengthen their community's social capital.

The three kinds of informal credit markets we have listed have some important differences. Most notably, there is a difference between the values and principles behind a moneylender, who provides loans to maximise profits, and a family member who provides loans without interest out of altruism. However, they also share some common features. The short-term nature of loans and the fact that they operate based on networking and personal relations are common features of the informal credit market. Informal credit markets use soft information to screen and select potential members and clients, and trust is at the centre of the process. Informal credit markets play a significant role in many developing economies. They are important sources of credit and provide financial services for households and SMEs. They are also important mechanisms for sharing risk in society in a sustainable manner. Traditional financial institutions also play a vital role in promoting a culture of saving.

Policymakers have tried to deal with the informal credit market in different ways. The common objective among policymakers has been to bring the actors of the informal credit market to the formally regulated sector of the economy. Easing the procedures and steps required to obtain formal licenses and liberalising the credit market are solutions to narrow the gap between the formal and informal sectors. Subsidising the formal sector to provide adequate services to those excluded from the financial market and setting interest rate caps have been used to control the informal credit market. However, there is no clear policy on addressing the informal credit market so far, and they remain the dominant and even preferred markets for low-income households in many developing countries.

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Chapter 3
Informal Credit Markets in Ethiopia

3.1 Credits from Family and Friends

Credit is assumed to be among the oldest forms of socioeconomic interaction. Lending and borrowing are among the most common forms of social interdependence, necessitated by human beings' natural inclination to use their future income to satisfy current needs. History tells us that loans in different forms were common in all major ancient civilizations.[1] Ethiopia is one of the oldest nations in the world, and it has a long history of trading at local and cross-border levels.[2] There is sufficient evidence that the Kingdom of Aksum (4–7 AD), one of the oldest kingdoms in Ethiopian history, minted coins and established trade relations with the Arabian Peninsula, Egypt, Greece, the Roman Empire, and many other ancient kingdoms.[3] While the inscriptions on the coins used during King Endybis's reign (227–235) were in Greek, from the fifth century onwards, coins were written in Geez.

Coins provide a more advanced form of exchange than barter. Money as a medium of exchange and store of value facilitates loans. Inhabitants of Ethiopia used loans as important social and economic transactions, at least during the first years of establishing the Aksum Kingdom.[4] Since then, loans from friends and relatives have been the primary source of credit for most Ethiopians.[5] Recent Findex data indicates that 31% of those who get access to credit borrow from families and relatives, while only 11% borrow from financial institutions.[6] Beza and Rao report

[1] Homer and Sylla (2005), p. 30.

[2] Rena (2007), pp. 135–153.

[3] Phillips (1977), pp. 423–457.

[4] Rena (2007), pp. 135–153.

[5] Kedir and Ibrahim (2011), pp. 1–24.

[6] https://blogs.worldbank.org/africacan/financial-inclusion-in-ethiopia-10-takeaways-from-findex-2017.

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G. Yimer, *The Nexus Between Legal Pluralism and Inclusive Finance*,
https://doi.org/10.1007/978-3-031-71653-9_3

that 43% of adults in their field research were confident they could secure a loan from family or friends.[7] This finding is not surprising for anyone familiar with Ethiopian society, where small-scale loans in different forms, including food items such as Ingera (Ethiopian bread that is made from teff), are prevalent; providing a loan for free is considered a moral and religious obligation in Ethiopian society. Gelaw reports essential data on the frequency of loans from relatives and friends:[8]

> ...of the total of 243 respondents, 39.9% reported that they had lent money to a total of 113 relatives and neighbors... 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. The high default rate shows the ineffectiveness of such trust-based transactions.

People turn to credit to satisfy multifaceted socio-economic interests. In rural Ethiopia, farmers depend on loans from families and neighbors to satisfy their basic needs and obtain important agricultural inputs such as seeds, farming animals, animal feed, and fertilizers.[9] It is also very common to seek loans to cover expenses for weddings and memorial services for relatives.[10] In urban areas, individuals borrow mainly to start new businesses or refinance businesses, for consumption (particularly to buy indivisible household goods that they cannot afford to buy without long-term loans or after saving for years), to cover health expenses, and to cover the cost of social events.[11]

Friends and relatives can provide loans in kind or cash. Most fungible goods, such as cereals, seeds, consumable goods, and money, can be borrowed if there is a socially accepted measurement of quantity and quality.[12] The loans are usually short-term and minimal in amount. In rural areas, borrowers are expected to repay their loans in the next harvest season.[13] In most cases, loans from relatives and friends are interest-free and are meant to support those who need help.[14] However, sometimes, interest may be collected from loans. The interest rates on loans vary depending on the relationship between the parties. The local customs and practices are also relevant to determining interest rates.[15]

Everyday practice shows that credits among family and friends are based on pre-existing relationships, and lenders use soft information.[16] Parties do not pay

[7] Beza and Rao (2017), pp. 191–2001.

[8] Gelaw (2019), pp. 137–151.

[9] Alvi and Dendir (2007), pp. 1325–1343.

[10] Kedir and Ibrahim (2011), pp. 1–24.

[11] Alvi and Dendir (2007), pp. 1325–1343.

[12] Caudell et al. (2015), pp. 32–42.

[13] Caudell et al. (2015), pp. 32–42.

[14] Caudell et al. (2015), pp. 32–42.

[15] Brietzke (1974), pp. 149–167.

[16] Fanta (2015), pp. 169–179.

attention to the formal requirements of official laws.[17] While the official law, i.e., Article 2472 of the Civil Code of Ethiopia, requires a written contract for loans exceeding 500 Ethiopian Birr, many people depend only on oral agreements and do not reduce their agreements to a written contract. Beru articulates this as follows:[18]

> 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 family are commonly unsecured. Repayment of the loan mainly depends on trust. The borrower cares for the lender, as the lender cares for the borrower. Reciprocity is an important factor that plays a positive role in the repayment of loans. Frequent interconnections between the lender and borrower influence the parties' behavior and cooperation. Another reason for repayment is fear of social sanction; people who know both the lender and borrower would condemn the defaulter for not respecting the promise to repay.[19] Sometimes, parties may even conceal the existence of a loan from third parties to protect the dignity and goodwill of the borrower. However, creditors may sometimes prefer not to depend only on the borrower's trustworthiness but instead request additional guarantees. The creditor may require the borrower to adduce a guarantee either by calling on someone—who is better known to the creditor as reliable—to act as a guarantor or by requesting real security.

Using a guarantor in social and economic interactions is very common in Ethiopia. Providing real security is also an Ethiopian tradition, the most common practice similar to antichresis.[20] The possession of land is transferred to the creditor, who has the right to collect and enjoy the fruits of the land until the debt is paid.[21]

An important recent development among traders in urban areas is using a bank check as security for loans in the informal credit markets. A postdated check with a maturity date corresponding to the loan's due date is becoming very common as security in the informal credit market.[22] Using a check as a mechanism to access short-term credit relates to the failure of the Commercial Code provisions to reflect the needs of small businesses.[23] The official laws have failed to provide efficient and

[17] Brietzke (1974), pp. 149–167.

[18] Beru (2013), pp. 335–388, (346).

[19] Haldar and Stiglitz (2016), pp. 459–497, (478).

[20] Article 3117 of the Civil Code defines antichresis: "a contract of antichresis is a contract whereby the debtor undertakes to deliver an immovable to his creditor as a security for the performance of his obligations."

[21] Segers et al. (2010), pp. 520–544.

[22] Yimer (2019), pp. 472–494; Report by Ministry of Justice, Commercial Code Revision Council, on March 24–25, 2016.

[23] Brietzke (1974), pp. 149–167.

effective solutions for defaults in payments for credit in small business transactions. This has obliged traders to use checks as security for the repayment of loans.

3.2 Loans from Moneylenders

There has been insufficient research on private moneylending activities in Ethiopia. Providing loans with interest charges is generally considered an immoral practice in society. This negative perception towards moneylenders may relate to the fact that Christianity (Ethiopian Orthodox Church) and Islam have significantly influenced the values, norms, and practices of society. A significant part of society also strongly believes that lending money with interest charges brings bad fortune to the moneylender. For this reason, moneylenders always try to remain secretive. However, it is well known that moneylending with interest charges is a common practice in Ethiopia.[24]

The negative perception towards collecting interest for loans motivates lenders and borrowers to design different covers for their transactions rather than mentioning interest rates expressly in the contract. In rural areas, moneylenders provide loans to farmers during the planting season and expect the borrower to send their harvest to them in return.[25] The price of the goods is determined when the borrower takes the loan. Under such agreements, the loan contract also becomes a contract for the sale of future harvests of the borrower, but with a lower price than the actual value of the goods at the time of delivery. Such a contract resembles a contract of sale at face value; 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.[26]

In urban and semi-urban areas, moneylenders use different covers to conceal loan interest payments. Most moneylenders are traders and use their trade relationship with the borrower to cover the moneylending activity. The borrower is provided with goods without immediate payment; the borrower then affects payment after the goods are sold.[27] The trader who provides the goods includes the interest for the loan in the form of payment for the mercantile goods, i.e., in calculating the price. It is rare to find any explicit mention of an interest rate in such contracts or to identify the (hidden) interest rate.

Adding expected interest to the principal amount is a common strategy moneylenders use to conceal interest payments.[28] Moneylenders loan on the condition that the debtor signs a contract indicating that they have borrowed a much higher

[24] Gnamu (2014), p. 285.

[25] Gashayie and Singh (2016), pp. 9–20.

[26] World Bank. (2011), p. 30.

[27] Gashayie and Singh (2016), pp. 9–20.

[28] Kibrom (2016).

principal amount than actually borrowed. The written contracts for such agreements do not mention an interest rate in any way. The literal reading of the contract appears as 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 as we will see in the next sections, 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.

3.3 Legal Framework for Credits from Family, Friends, and Moneylenders

3.3.1 General Contract Laws

The Ethiopian Civil Code embraces the principle of freedom of contract. It guarantees contracting parties a right to freely determine the nature of their contract and the form 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 (suppletive laws) that can be modified or replaced by the agreement of the contractual parties.[29] The Civil Code sets mandatory principles, requiring the contract's objective to be sufficiently defined, possible, lawful, and morally acceptable.[30] As long as these mandatory requirements under the Civil Code are fulfilled, the contract terms articulated by parties in their contract are considered law and enforceable in a court of law.[31] Furthermore, the Civil Code provides that courts should interpret contracts assuming that good faith exists between contracting parties according to business practice.[32]

Regarding form requirements, Article 1681 of the Civil Code provides that contracts can be made orally, in writing, by signs, normally in use, or by conduct. Article 1719 states, "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 there are strong policy justifications for doing so. However, a loan contract is not one of the transactions that the Civil Code requires to be made in a certain form, so the parties are free to decide on the form of the contract. However, the Civil Code provides that a loan contract

[29] For an additional explanation on Ethiopian contract laws, see Krezeczunowicz (1983).

[30] The Civil Code of the Empire of Ethiopia, Proclamation No. 165/1960. *Negarit Gazeta*, No. 2, Addis Ababa, Ethiopia. Articles 1678, 17711–1718.

[31] The Civil Code of the Empire of Ethiopia, Proclamation No. 165/1960. *Negarit Gazeta*, No. 2, Addis Ababa, Ethiopia. Article 1731.

[32] The Civil Code of the Empire of Ethiopia, Proclamation No. 165/1960. *Negarit Gazeta*, No. 2, Addis Ababa, Ethiopia. Article 1732.

exceeding 500 Birr cannot be proved by oral evidence or the court's presumption. The requirement for written evidence is a mandatory provision that cannot be avoided by the parties' agreement. Therefore, written evidence is required to prove the existence of a loan that exceeds 500 Birr if a party contests it. The following sections discuss the special provisions that regulate a loan contract.

3.3.2 Contract of Loan as a Special Contract

The Civil Code defines a loan as follows:[33]

> 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 money and 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 that ownership of goods is transferred to the debtor for the contract of loan to be formed. Therefore, agreements that do not include transfer of ownership are not considered loan contracts. We can also infer from the definition that the borrower must not return the same thing but the same kind and quality as far as possible. This implies that the lender cannot require repayment for things that are identical to those provided.

What is unclear 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. A careful reading of the provisions indicates that written evidence requirements are limited only to loans provided in money. The phrase "where the sum lent exceeds 500" implies that this article is limited to loans provided in money and not other fungible things. Therefore, loans provided in kind, though the estimated value is greater than 500 Birr, can be proved using any evidence available, including witness testimony. In *Yusuf Siradje v. Nesira Abdulsemed*,[34] The Oromia Supreme Court reversed the lower court's decision by concluding that loans provided in kind could be proved by oral testimony and that the written evidence requirement of the law was limited only to loans provided in money; we concur with this decision.

The Civil Code under general contract law also provides formal requirements that a written contract must fulfill. Accordingly, a written agreement must be signed by

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[33] The Civil Code of the Empire of Ethiopia, Proclamation No. 165/1960. *Negarit Gazeta*, No. 2, Addis Ababa, Ethiopia. Article 2471.

[34] *Yesuf Siradje v. Nesira Abdulsemed*, Oromia Supreme Court, East Bench, File No. 250190, Decided on: 15/3/2009.

contracting parties and attested by two witnesses.[35] The code also provides that when a written contract is a requirement by law, such agreements cannot be proved by witnesses' testimony or presumption.[36] The question is whether the requirements for forming a written contract also apply to loan contracts that must be proved in a court of law by written evidence.

There is a difference between a form requirement for forming a valid contract (ad validate) and qualifying the proof that should be adduced to make a case (ad probation) in a court of law. Regarding a loan, it could be argued that the form requirement for forming a loan contract is not *a sine qua non-condition* under Ethiopian laws. The Civil Code requires written evidence to prove a contract of loan (*ad probation) in a court of law, but it does not require a written agreement to form* a valid loan contract. Recently, the Ethiopian Tax Authority enacted a directive requiring all loans among registered traders to be made in writing and registered if they exceed 500 Birr.[37] The authority provides this condition to consider the loan in tax assessment. However, this directive has limited application as the Tax Authority has no legal mandate to amend the provisions of the Civil Code.

It is imperative to note here that the requirements provided in the general contract law regarding the formalities that should be fulfilled for the formation of valid written contracts are not relevant to Article 2472 of the Civil Code because Article 2472 deals only with what kind of evidence can be accepted in a court of law; it does not require a contract of loan to be made in written form and there is not any other provision in the Civil Code that involves a contract of loan to be made in written form, or to be registered for that matter. Therefore, the kind of written evidence that can be accepted to prove loan contracts is at the courts' discretion. The Civil Code includes some provisions that explain the standards and criteria required for written evidence to be accepted in a court of law in some specific cases. However, these provisions have no general application. For example, Articles 7, 47, 97, 136, 137, and, in general terms, Articles 2011–2019 explain how courts should deal with written evidence. However, the provisions of the Civil Code mentioned above do not help qualify what kind of written evidence is admissible in a court of law to prove the existence of a contract of loan, as they are limited only to specific cases.

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[35] The Civil Code of the Empire of Ethiopia, Proclamation No. 165/1960. *Negarit Gazeta*, No. 2, Addis Ababa, Ethiopia. Article 1727.

[36] The Civil Code of the Empire of Ethiopia, Proclamation No. 165/1960. *Negarit Gazeta*, No. 2, Addis Ababa, Ethiopia. Article 2005.

[37] Book of record of transaction directive, Ethiopian Revenue and Tax Authority, Directive number 152/2011/. Article 6(2).

3.3.3 Civil Code Interest-Rate Caps

Another important point that this research addresses is the regulation of interest rates in the informal credit market. The Civil Code stipulates that interest will not be paid on loans unless the contracting parties specify otherwise. If the parties indicate that interests are to be paid without specifying the amount, the Civil Code sets 9% as a default rate.[38] The Civil Code also provides that the maximum legal annual interest rate is 12%. Courts should reduce interest rates to 9% whenever parties stipulate in their contract for payment of more than 12%.[39]

An interesting question that deserves the attention of our courts about 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. Following the fall of the socialist military government, Ethiopia has embarked on gradual liberalization of the financial sector. Private banks have joined the Ethiopian financial market after 17 years of exclusive dominance of government-owned banks as part of this liberalization process.[40] The National Bank was mandated to regulate the banking industry.[41] The National Bank is legally entitled to determine the legal interest rate, among other Things.[42]

However, the National Bank of Ethiopia preferred to give commercial banks and microfinance institutions the right to determine interest rates freely based on market principles. The directive provides only a minimum saving interest rate as the only legal interest rate.[43] However, the National Bank remains silent regarding the applicable interest rate for credits from informal sources. The lack of a directive or a guideline by the National Bank to regulate interest rates in informal credit markets has cast doubt over 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 are presented in the following two sections, to illustrate the issues involved.

3.3.3.1 Arguments for a Civil Code Interest Rate Ceiling for Informal Credit Markets

The first view is that since the National Bank has not introduced a new applicable interest rate to replace the provisions of the Civil Code, the maximum legal interest

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[38] Article 2479 of the Civil Code.

[39] Article 2479 of the Civil Code.

[40] Geda (2006).

[41] The National Bank of Ethiopia Establishment (as Amended) Proclamation No. 591/2008. *Negarit Gazeta*, No. 50, Addis Ababa, Ethiopia.

[42] The Civil Code of the Empire of Ethiopia, Proclamation No. 165/1960. *Negarit Gazeta*, No. 2, Addis Ababa, Ethiopia. Article, 5(4).

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

rate provided in the Civil Code remains valid and relevant to informal credit markets. This view seems to be implicitly accepted by the office of the Federal Attorney General and other regional attorney offices, as inferred from official documents of these offices and criminal charges filed by these offices about usury.[44]

The Cassation Division of the Federal Supreme Court cited the provisions of the Civil Code in its decision in *Fantaye Fiseha v. Dejene Marye* to nullify a 5% interest rate per month agreed by parties.[45] The court explained that according to the provisions of the Civil Code, the maximum interest rate to be paid for a loan is 12% per annum, and an agreement to pay an interest rate that exceeds 12% is invalid. The court did not refer to the bank laws and did not deliver any argument that the provision of the Civil Code about interest rates was still relevant or applicable. It is also surprising that the court declared that the lender would not be paid any interest because the rate in the contract had exceeded 12% annually. This is not what the provisions of the Civil Code provide for. The Civil Code provides that for any agreement stipulating an interest rate exceeding 12%, the rate shall be reduced to 9%.[46] Therefore, in this case, if we apply the provisions of the Civil Code, the court should have allowed the lender to collect a 9% interest rate from when the loan was issued.

In *Deresu Alemu v. Mulisa Werku,*[47] 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 requiring the borrower to pay double the principal as a 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 requiring the borrower to pay more than the legal interest rate or the agreed interest rate as a penalty for delay is unenforceable in a court of law:[48]

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[44] 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: Yimer (2017).

[45] *Fantaye Fisha v. Dejene Marye*, Federal Supreme Court, Cassation Division, File No. 102711. Issued in 17, 117.

[46] Article 2479 of the Civil Code. 2. *Rate of interest.*

(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.

[47] *Deresul Alemu v. Mulisa Werku*, Federal Supreme Court Cassation Division, File No. 43372, Issued in 8, 361.

[48] Article 2489 of 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 by the provisions of the Title of this code relating to 'Contracts in General' (Art. I790-l805). Any provision increasing the liability of the borrower shall be of no effect.[49]

The two decisions by the Cassation Division of the Federal Supreme Court and the lower courts' decisions show that Ethiopian courts are assuming that the provisions of the Civil Code are still applicable and relevant to private loans or loans in informal credit markets. Ethiopian courts failed to consider important elements that should be considered in determining interest rates vis-à-vis formal financial institutions that usually charge more than 15% interest rates.

In one case, however, the Federal Supreme Court Cassation Division has implicitly suggested that the Civil Code provisions related to interest rates are not binding for saving and credit cooperatives.[50] The court in this case argued that saving and credit cooperatives can freely decide the applicable interest rate in their internal rules. The court cited the provision of the Civil Code specifying "agreements freely made are considered as a law between parties" to give effect to the terms of a contract stipulating an 18% interest rate. However, the court restrained itself from expressly declaring that the provisions of the Civil Code which regulate the interest rate do not apply to loans obtained from saving and credit cooperatives or other loans. It is also good to note that the Cooperative Society Proclamation also allows cooperatives to decide freely the lending interest rate and the borrowing interest rate.[51]

3.3.3.2 Arguments Against a Civil Code Interest Rate Ceiling for Informal Credit Markets

The second view is that the maximum legal interest rate in the Civil Code is no longer applicable either to formal or informal credit markets. According to this view, the law has given the National Bank the right to regulate interest rates for formal financial institutions and loans in informal credit markets. Therefore, the provisions of the Civil Code that deal with interest rates are repealed tacitly by Proclamation No. 591/2008, and the inaction of the National Bank does not bring them back to life.[52]

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[49] Article 2489 of the Civil Code.

[50] *Metekel Development Association v. Kess Kalayu Kiros*, File No. 62162, Federal Supreme Court, Cassation Division, 13, 186. The case was decided in 2004.

[51] Cooperative Society's Proclamation No. 985/2016. *Federal Negarit Gazeta*, No. 7. Article *48*(2), 9436.

[52] Yimer (2017). See also *Abdulkadir Juwar v. 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. The Civil Code expressly provides under Article 2489 that only a legal interest shall be paid as damage for a delay in payment of a loan or interest. The action of the Cassation Court, endorsing a 14% interest rate as a damage for a delayed payment

Articles 4 and 5(4) of the National Bank Establishment Proclamation support the argument that the Civil Code's provisions regulating interest rates are no longer applicable. Article 4 provides that the National Bank aims to maintain a stable price and exchange rate, foster a healthy financial system, and undertake other related activities conducive to Ethiopia's rapid economic development.[53]

Article 5(4) provides that the bank regulates and determines the supply and availability of money and credit and the applicable interest rates and other charges. These provisions of the Proclamation have made it clear that the mandate of the National Bank is much broader than regulating the banking industry; they indicate that the National Bank has a legal mandate to decide legal interest rates for credits in the formal and informal credit markets. The National Bank 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 government office or agency other than the National Bank can issue a law regulating interest rates in Ethiopia.

The National Bank has been mandated to regulate price and exchange rates to promote healthy and stable economic growth. The National Bank has been mandated by law to regulate interest rates for all purposes, including loans in the informal credit markets. The lack of interest of the National Bank in determining a maximum legal interest rate that creditors and borrowers should apply in the informal credit market can be interpreted as intentional inaction by the bank to allow the interest rates to be determined by market forces.

The fact that formal financial institutions are given discretionary power to determine interest rates also implies that the National Bank has no interest in intervening in regulating interest rates, at least for the time being. In a free market economy, interest rates are determined by the opportunity cost of money, the inflation rate, the premium of risk, the cost of administration, and monopolistic profit.[54] The literature on the informal credit market generally concedes that when the market is left free to determine the applicable interest rate, it is usually higher in informal credit markets than in formal credit markets.[55] The high risk of lending in the informal credit markets,[56] lack of collateral, and unscrupulous creditors' selfish motives[57] are some of the reasons mentioned by researchers for higher interest rates in informal credit markets.[58]

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for the supplied sesame seeds, disregards the Civil Code provisions that provide 12% as the maximum legal rate in Ethiopia.

[53] The National Bank of Ethiopia Establishment (as Amended) Proclamation No. 591/2008. *Negarit Gazeta*, No. 50.

[54] Bottomley (1975), pp. 279–291.

[55] Bottomley (1975), pp. 279–291.

[56] Bottomley (1975), pp. 279–291.

[57] Bhaduri (1977), pp. 341–352.

[58] Germidis (1990), pp. 5–22.

In addition to the arguments that rely on the interpretation of the intention of laws that give broad power to the National Bank, there is also a strong practical reason for making the application of the Civil Code's provisions for determining the maximum interest rate irrational and discriminatory. The interest rates in the Civil Code have remained unchanged for the last 58 years, while financial and economic circumstances have changed fundamentally. The legal interest rate in the Civil Code does not consider the current high inflation rate in the economy, which has ranged between 10 and 12% in the last ten years, or the significant devaluation of the Ethiopian currency following the liberalization of the economy.

It is also important to note that the laws recently enacted recognize the validity of the interest rates in the formal financial market rather than the ceiling of 12% embodied under the Civil Code.[59] For example, the Tax Administration Proclamation 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%."[60] Therefore, requiring the informal credit market to be regulated by the legal interest rate provided in the Civil Code has no economic or financial rationale.

Trying to use the provisions of the Civil Code to define 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 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 (i.e., as a premium for the increased legal risk). Furthermore, the lack of clarity and the possible risk of criminal prosecution drive potential lenders out of the market. Only those inclined to take higher risks for higher premiums will dominate the informal credit markets.[61]

It is now widespread practice in Ethiopia for a lender to be criminally charged for usury and the borrower to be prosecuted for giving a check with insufficient balance. This scenario explains how the lack of a comprehensive legal framework for loans in credit markets is entangled with confusion and uncertainty in the informal credit markets. The lack of an extensive legal and policy approach is detrimental to the

[59] 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.

[60] Tax Administration Proclamation No. 983/2016, *Negarit Gazeta*, Extraordinary Issue No. 103, *37*(2).

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

interests of small and micro businesses that depend on informal credit markets for flexible and quick access to finance.

3.4 Informal Financial Institutions in Ethiopia

Ethiopia has different indigenous social, economic, and cultural institutions that provide various services to society, some of which provide financial or semi-financial services. Eqqub, Iddir, Mahiber, and Debo (Dada) are Ethiopia's most well-known traditional institutions that play an essential role in society's social, religious, and economic development. Eqqub and Iddir are Ethiopia's most wide-spread and prominent institutions, so we present a detailed description of these institutions here. The discussion on Eqqub and Iddir draws mainly on empirical data collected between 2014 and 2017 in northern Ethiopia (Tigray regional state) for a collaborative research project between KU Leuven and Mekelle University.[62] Mahbers are only briefly introduced and not discussed in depth because they focus more on social and religious rather than economic and financial objectives. Debo is also only briefly discussed, as fieldwork is still required to provide evidence of its practices and because it relates more to the labor than the credit market. However, we recommend that future research focus on Mahber and Debo to help unpack the principles, values, and laws that have kept Ethiopian society intact over thousands of years.

3.4.1 Mahber

Mahber is a prevalent religious and social association in Ethiopia. The word "Mahber" literally means "association" in Amharic (one of the widely spoken languages in Ethiopia). Mahbers are also known as *tsïwwa*. Both men and women can organize mahbers. The women's Mahber is commonly exclusively for women, and the men's Mahber is exclusively for men. There are also some Mahbers that spouses can join. In these Mahbers, the husband and wife are considered joint members and considered as one member for practical issues. It is common to see a Mahber organized by individuals who work in the same offices, live in the same neighborhoods, or are originally from the same city or town but now live in another city. Ethiopians in Diaspora also establish Mahbers; they serve as important institutions for sharing information among an Ethiopian community, supporting each other, feeling at home, and sharing local Ethiopian foods and drinks.[63]

[62] Yimer et al. (2017).

[63] Tesfaye (2000).

The Mahber is commonly associated with one of the names of God, the name of St. Mary, or the name of an angel or saint. Under the Ethiopian Orthodox Tewahdo Church, almost every date is dedicated to one of the names of God, a particular angel, or a saint. The main purpose of Mahber is to show love and respect for the saint or the angel that the Mahber commemorates.[64]

Mahber members come together once a month in the home of one of the members. The place of gathering rotates every month. The Mahber commonly consists of 10 to 15 members, and every member takes responsibility for organizing the event in their home at some point. However, unlike with Eqqub, in Mahber, members can decide when to take on this duty. There are no fixed or obligatory rules about the service rotation, and members commonly volunteer, if it is timely and affordable for them, to host the Mahber in a particular month.

At the end of the gathering, the priest or the leader of the Mahber asks who the next host will be, and one or two members stand to volunteer for the next Mahber. Members then decide who will be given the tsïwwa. The handing over of the tsïwwa implies the assignation of the next host. The tsïwwa comprises a picture of the saint, angel, or Jesus Christ, whichever the Mahber commemorates and is named after, a bread in mosseb (a traditional basket made of savanna grasses by women) and an Ethiopian local beer (Tella). The member receiving the tsïwwa is then joined by three or four other members as they walk home carrying the tsïwwa. The neighbors of the one who holds the tsïwwa commonly wait for her at her house to welcome the tsïwwa and share the bread and drink from the tsïwwa.[65]

Members who host a Mahber invite other families, relatives, and neighbors to the event. However, commonly the Mahber members use specific places in the house, or the other guests only arrive after the Mahber members have finished their program.

Mahber's main purposes are "serving God, social networking, information exchange, conflict resolution and reconciliation, entertainment, and social insurance."[66] Conflict resolution and reconciliation are an integral part of a Mahber, and every time the members meet, they ask if there is any disagreement among them. Every member stands before the group and asks for forgiveness for known or unknown misdeeds to others. Members must share greetings by meeting shoulder to shoulder, showing no animosity between them. Excommunicating a Mahber member is not allowed. If there is a serious issue between two members and they fail to solve the problem, then either both members or one of the members must leave the Mahber. If both members with an unresolved problem want to stay in the Mahber, then one who refuses to ask for forgiveness or one who refuses to accept repentance and forgive will be dismissed from the Mahber. To stay in the same Mahber and to drink the same tsïwwa is considered a sin and a disrespect to the saint or angel they commemorate and, therefore, totally unacceptable.

[64] Flemmen and Mulumebet (2016), pp. 3–31.

[65] Flemmen and Mulumebet (2016), pp. 3–31.

[66] Flemmen and Mulumebet (2016), pp. 3–31.

There is also a weekly gathering specifically named Senbete Mahber. Senbete Mahber is for women. They come together every Sunday after the end of the church service in the church's compound. The members rotate the duty of providing food and drink; however, elderly and less fortunate members are exempted from taking turns to provide food and drink.[67] However, the main objective is not social or the sharing of food and drink but rather the fundamental concept of respecting and dignifying a banquet to commemorate saints and angels, which is very important in Ethiopian Orthodox Christianity.[68]

According to Flemmen and Mulumebet, Mahber consists of the following elements: "...the tsïwwa, the mäsob, commemoration (zïkïr) of a patron saint, a muse, membership, lay people's homes, praying, sharing food, and drink."[69] However, it must be pointed out that Mahber has different variants, and differences in social and economic circumstances alter how Mahbers are organized. Among the youth, Mahbers are becoming less religious and more social.

3.4.2 Dabo (Debo)

Dabo is a social and economic system that farmers use to organize collective labor management in rural areas.[70] Collective labor is commonly employed for farm work; however, it is also widely used in the construction of houses and for other tasks. The kind of job that qualifies for Dabo is not the same throughout different ethnic groups in Ethiopia. There are also significant differences in how they are organized in other cultural groups. In some, various forms of collective labor exist for the rich and poor farms. Fujimoto, for example, identified three forms of collective labor structures among the people of Malo in southern Ethiopia. According to him, Dabo, Kete, and Zafe are all forms of collective labor that differ. Dabo is for wealthy farmers, as it is costly, and hosts provide breakfast, lunch, and dinner for participants. Kete is less expensive and features reciprocity, with hosts receiving help from others and helping others when they are hosting. Zafe is even more strict regarding reciprocity, with no obligation to provide food or drink and commonly organized by neighbors with no more than five or six farmers. Fujimoto explains that Dabo has economic, social, and psychological importance in society as "it fosters a sense of companionship and solidarity and a means to transfer knowledge and skills from experienced farmers to young farmers."[71] Dabo also has a conflict resolution element; two men who are not on good terms cannot participate simultaneously in one Dabo unless they resolve

[67] Flemmen and Mulumebet (2016), pp. 3–31.

[68] Ancel (2005), pp. 95–111.

[69] Flemmen and Mulumebet (2016), pp. 3–31, (9).

[70] Bartels (1975).

[71] Fujimoto (2013), pp. 21–36.

their problems.[72] Therefore, avoiding conflicts and being on good terms with your neighbors are important factors for farmers to ensure a good number of participants in their Dabo. Men and women commonly cooperate in different forms of labor; however, this is not a strict rule, and sometimes, men and women may participate in a Dabo together.[73] Dabo may be understood as one of the practical examples of a traditional social security system in many traditions. Society considers cooperation as a condition for its existence. Hoekema synthesizes the need to stand together in traditional societies as follows:

> The need to survive, help each other out, render each other crucial services in harvesting and preparing fields, and the important element of having the certainty to obtain some piece of land, if landless: these are the features of livelihood security.[74]

3.4.3 Eqqub (ROSCA)

3.4.3.1 Definitions and Background

Eqqub is the nomenclature used to refer to ROSCAs in Ethiopia. Eqqubs are voluntary associations established by individuals interested in pooling their savings to provide an interest-free loan to group members rotating. Eqqub is an institution that channels savings from one household to another based on the promise that every member will periodically receive the total sum of their contributions. One researcher claims that Eqqubs are used by 15% of the rural community and 28.6% of the urban society in Ethiopia.[75] However, other studies suggest that Eqqubs are increasing rapidly in urban areas, especially among traders.[76]

Eqqubs are important for many SMEs as a source of finance for starting, expanding, and/or covering the running costs of businesses.[77] Empirical research by Bekelle and Werku showed that Eqqub participation is a significant variable for the success of SMEs in Ethiopia.[78] The same research indicated that SMEs participating in Eqqub have a 3.25 times better chance of surviving in the long term than those not.[79] One anthropological research study indicated that Eqqub members are more satisfied in life than non-Eqqub members in Ethiopia, and Eqqub membership is significantly related to social security and the well-being of society.[80]

[72] Bartels (1975), pp. 883–925.
[73] Fujimoto (2013), pp. 21–36.
[74] Hoekema (2017), pp. 67–84.
[75] Amha and Alemu (2014), p. 118.
[76] Yimer et al. (2017).
[77] Bisrat et al. (2012), pp. 229–238.
[78] Bekele and Worku (2008), pp. 548–569.
[79] Bekele and Worku (2008), pp. 548–569.
[80] Dodd (2012).

Eqqub is one of the traditional institutions present in all parts of the country. There is no evidence linking Eqqub with a particular culture or tradition in Ethiopia. According to Kedir et al., ethnic Gurage households use Eqqub relatively more often than other households.[81] As Gurage are famous for their active participation in trade and commerce in Ethiopia and for their higher representation in running SMEs, their frequent use of Eqqub is not surprising.[82] The most plausible reason for the Gurage's frequent involvement in Eqqub is likely to be their strong involvement in trade and commerce rather than their cultural background.

Pankhurst and Esheté argue that Eqqubs—in their current form—are urban-born, mainly emerging with the expansion of urbanization. The idea that Eqqubs, in the form and structure they are known today, are urban innovations is convincing considering the income pattern of rural communities. In Ethiopia, farmers do not commonly generate daily, weekly, or monthly income; organizing Eqqubs, which demand contributions at defined intervals, is less appealing to the rural community. An important caveat, however, is that there are different social institutions that the rural community uses to provide essential support to those who need it and to distribute risks in society. It is also important to note some similarities between Eqqubs and Debo. Both focus on bringing together resources to solve specific problems efficiently. Eqqubs may therefore be a rendition of the values and principles rural farmers use in Debo to organize labor efficiently.

3.4.3.2 Membership and Periodic Contributions

Eqqub membership is voluntary and not limited by gender, age, or social status. It is in principle free for any interested person who can contribute the minimum amount required for Eqqub membership. However, Eqqubs apply some screening mechanisms to minimize the risk of default in the payment of contributions. Eqqubs uses social capital to screen potential members. Eqqubs also sometimes require the applicant to acquire an attestation from one or two members who have already been tested in the Eqqub for their honesty and integrity. Eqqub's screening methods include:[83]

> . . . selecting trustworthy members based on information in the society; linking new members to existing members by demanding the latter to act as a guarantor for the new member; checking if the candidates have an established business in the area or immovable property in the city; requiring an attestation from high-profile individuals about the good behavior and trustworthiness of the candidate.

Eqqub members contribute a predetermined amount of money periodically, usually weekly for businesspersons and monthly for salaried employees. The contributions in larger Eqqubs are commonly made weekly. In some Eqqubs, the weekly

[81] Kedir and Ibrahim (2011), pp. 998–1016.

[82] McCarthy (1968), pp. 105–122.

[83] Yimer et al. (2017), p. 13.

contribution exceeds 20,000 Birr, enabling a member to collect one million Birr as a one-time payment. This is a large amount of money by Ethiopian standards, and members may wish to receive this payment during the initial seasons of the Eqqub cycle so they can use it to expand or start a new business. Immediately after the money has been collected, it is decided, either by consensus or by using randomly drawn lots, who it shall be given to.

The random drawing of lots gives every member an equal chance of being a winner without considering the subjective circumstances of the members. The common procedure is to write the name of each member on a piece of paper, after which the paper is folded and placed in a bowl. The Eqqub leader then reads each name to ensure every member is included. Once it is assured that everyone's name is included, someone passing by is commonly called to select one of the folded papers. The member whose name is on the chosen paper is entitled to be paid that week. This practice continues every week or month until every member has been paid an amount equal to what they have contributed/saved in the Eqqub. Everyone continues to contribute until everyone has been paid.

3.4.3.3 Governance and Administration

Trust plays an important role in Eqqubs in Ethiopia. However, when Eqqubs evolve from small groups of friends into comparatively more significant associations with many members, they use written documents for vital transactions. Generally, as they grow both in membership and weekly contributions, they increasingly need to rely on written records. Trust remains essential in all Eqqubs, but members feel more comfortable if any misunderstandings or disagreements can be resolved with written evidence.

Some Eqqubs unite more than 500 members from different groups under one umbrella institution with one leadership. Most of these Eqqubs are organized by individuals with higher social acceptance. The goodwill of the leaders is a significant factor in successfully starting and running a new Eqqub.[84] Members in larger Eqqubs focus on the trustworthiness and solvency of the Eqqub leaders rather than on every member. Members may not even know each other, and they do not consider this important because the responsibility to collect contributions is assigned to the leaders. The relations in larger Eqqubs are mainly vertical, with limited interpersonal ties between members. Members assume that Eqqub leaders are responsible for enforcing the bylaws, including collecting weekly or daily contributions from members. If a member defaults or delays their contribution, Eqqub leaders are expected to cover the difference using their means.

Eqqubs stipulate in their bylaws the penalty for delay and default. The penalty for delay on the first occasion ranges from 40 to 50 Birr, increases with the number of defaults, and may ultimately result in a member being banned from the Eqqub in the

[84] Yimer et al. (2017).

next round. Other Eqqub associations are unlikely to accept someone whose membership has been terminated elsewhere, as the associations are based on trust. Penalties are accepted by society and by the members of Eqqub. These are considered necessary for the institution to remain functional.[85] Members accept the penalty as an appropriate measure for the good of all members, for the healthy functioning of the ROSCA system, and for promoting good behavior. According to the ROSCA's internal rules, penalties are only mentioned as incidental issues in litigation regarding contribution payments or if ROSCA leaders plead to the court that a defaulter should also pay the penalty.

Eqqubs maintains a book of records, where they record members' names, phone numbers, addresses, number of subscribed contributions, and any other details that leaders consider essential. The book of records has columns used to record the weekly contributions from members. Eqqubs also provide identity cards to their members. The subscribed contributions are recorded on the identity cards, along with the name of the leader and, often, a summary of the Eqqub bylaws. Eqqub leaders sign members' identity cards against each contribution record to confirm that it has been received.

Larger Eqqubs commonly have offices dedicated to the functioning of the Eqqub; they have well-drafted bylaws, issue identification cards for their members, and make records of contributions from and payments to members. Leaders commonly use their name to open a bank account for the Eqqub, and they pay with personal checks. Eqqub leaders in these larger Eqqubs are compensated for their services and the risk they assume as organizers and leaders. Registration fees and penalties collected from members are used to compensate leaders for the risk of needing to make contributions to cover defaulted payments by members and as remuneration for their services.[86] The weekly contribution amount commonly determines the registration fee. Members pay a fee equal to their weekly or daily contribution to join the Eqqub.

Members perceive Eqqubs as a fair, transparent, and efficient institution. They also seem to understand the company's working rules and like the simplicity of the payment-making and collection process.[87] It is important to note that complex procedures and bureaucracy are the principal reasons why SME owners fail to affiliate with banks. The simplicity of Eqqub's working guidelines makes them attractive; simplicity or complexity is thus a major factor for consideration when selecting a financial institution. However, some members have mentioned complaints about Eqqub governance and administration that need attention.[88]

[85] Yimer et al. (2017).

[86] Yimer et al. (2017).

[87] Yimer et al. (2017).

[88] Yimer et al. (2017).

3.4.3.4 Source of Credit

Eqqubs provides vital financial services in society. They serve as saving institutions for people who want to save part of their daily or weekly income. Especially for traders in the informal economy, Eqqubs are the most accessible and convenient saving institutions: traders can easily drop off their savings at the end of the day or the weekends. Most traders in the informal economy use Eqqubs to increase their commitment to saving. This is because once they commit to joining the Eqqub and save a certain amount daily or weekly, they must keep that commitment to the end of the cycle, i.e., until everyone has been paid. This helps control their present spending as they cannot breach their commitment without serious consequences. Eqqubs also provides crucial social capital; sometimes, joining Eqqubs may give an individual social goodwill. Ethiopia has a common expression: "Eqqub makes you a person," meaning that you become socially crucial because of your commitment to Eqqub savings.

Access to credit is becoming the most important reason for many SME owners to join Eqqub. Both formally registered and licensed SMEs and informal businesses use credits from Eqqubs. There are three possibilities for acquiring credit from an Eqqub. The first possibility is when a member wins the lot during the initial contribution rounds. When members win the lot early in the Eqqub, they are paid (in advance of their contributions) the total amount they will eventually have contributed.

The second means of acquiring credit is when payment to an Eqqub member is prioritized by the unanimous decision of the Eqqub members, with the deliberate intention of supporting the member. Members can ask for their payment to be prioritized if they have a convincing reason justifying the preferential treatment. Social events like weddings, an acute financial crisis due to the unexpected death of a family member, damage to property from manmade or natural causes, or the loss of a significant amount of money in business dealings are generally regarded as good justifications for prioritizing payment to a member.[89] The priority privilege based on unanimous consent is common in Eqqubs, which are formed mainly for social networking purposes rather than for finance generation.[90] However, larger Eqqubs that focus on the financial interests of their members also provide support to members who face unexpected financial crises because of health problems or damage to their businesses by fire or other causes.[91]

The third means of acquiring advance payment or credit is to buy the "Eqqub lot" from those who won it. Eqqubs that have members with a clear financial interest in joining the Eqqub also serve as a platform for those who want to buy and sell their lots in Eqqub. The common rate to buy and sell an Eqqub lot is 10%. The buyer and

[89] Yimer et al. (2017).

[90] Bisrat et al. (2012), pp. 229–238.

[91] Yimer et al. (2017).

seller pay 1% to the Eqqub leader for facilitating the transaction.[92] Research has shown that bigger ROSCAs have a very high demand to buy a lot from someone to get the collected money now rather than later. Members do not want to remain uncertain waiting for their lot, which is a matter of luck. Therefore, they prefer to buy the lot from someone and obtain control. The generally accepted rate to buy a lot is 10% of the total collected ROSCA money.[93]

3.4.3.5 Enforcement of Payments

Eqqubs can only function if they can ensure members honor their promises and continue to pay their contributions until the end of the process when everyone has been paid back. Eqqubs uses social pressure as the primary mechanism to ensure members respect their promises. In small Eqqubs, the leader's responsibility to enforce Eqqub is not dissimilar to the duties of other members. If a member fails to pay their contributions, leaders and other members use social influence to correct the situation so that everyone duly receives the payments they are entitled to. Commonly, in small Eqqubs, members are asked to call on an existing member to act as a guarantor. The guarantor then takes on the responsibility and moral obligation to ensure the guaranteed member respects their obligations towards the other members. Most small Eqqubs do not have written bylaws, written contracts, records, or receipts. Therefore, horizontal relations between members are much more critical in smaller Eqqubs than in larger ones. In small Eqqubs, the mutual commitments are primarily oral and are based on mutual trust. Disputes are resolved amicably. Few disputes reach the formal courts because these small Eqqubs focus on socialization. Eqqub members with strong pre-existing social connections also prefer mutual consensus regarding the sequence of beneficiaries of payouts; they prefer to make payouts based on members' needs rather than random lots.

In larger Eqqubs, common among traders, Eqqub leaders play the main role in ensuring everyone keeps their promises. Members commonly rely on the leader of the Eqqub because they may not know the financial details of other members belonging to the Eqqub. Larger Eqqubs are usually used by individuals who need financing to start new businesses, expand their existing businesses, or buy indivisible properties that cost a large amount of capital; hence, there is little tolerance for delays or defaults in contributions.

Larger Eqqubs also use different mechanisms to minimize members' defaults. The most common method is personal guarantees by at least two Eqqub members, evidenced by a written surety contract. Such written agreements, however, may not satisfy the formal requirements for forming a valid surety contract under Ethiopian law.[94]

[92] Yimer et al. (2017).

[93] Yimer et al. (2017).

[94] Yimer et al. (2017).

Another method employed as a precaution against default or delay in contributions in larger Eqqubs uses checks. Members and their guarantors must deposit a check for the amount they will collect from the Eqqub. Research in Tigray has indicated that most ROSCAs require a member to issue a check in the name of the ROSCA leader or for someone to issue a check on their behalf. Two checks are required: one from the member and another from the guarantor. The check is written for the value corresponding to the payout the ROSCA will pay the member. This gives leaders substantial leverage in two ways. First, they have a check to a higher value than the actual liability of the member. Secondly, such a check can be presented to banks for immediate payment without other conditions. Under the Criminal Law of Ethiopia, a person who issues such a check without sufficient balance in their account can face a criminal charge. Leaders can, therefore, use such checks to threaten to initiate a criminal charge and civil action.[95]

It is not typical for small Eqqubs, established by friends and people who work in the same enterprises, to enforce Eqqub agreements in court. However, in larger Eqqubs, where the main actors are traders, and the contributions and payouts are much more significant, it is expected to use the official system. Leaders present the check as a security from the defaulting member to the bank. Suppose the bank rejects the check due to a lack of funds in the defaulting member's account. In that case, they can then threaten to report the defaulting member to the police and the attorney's office for possible criminal prosecution. If the defaulting member still fails to pay their contribution, then the leader can file a complaint to the police office, accusing them of issuing a check without sufficient funds to cover it. The criminal charges are mainly used to force the defaulting member to initiate mediation or conciliation. This is often successful because defaulting members settle with the leaders by paying immediately or submitting a payment schedule if there is a good reason for delayed payments. If all efforts to acquire payments from the defaulting member fail, the leader can initiate a civil case against the defaulting member in the civil bench. Members also sue leaders in official courts for any unpaid money from the Eqqub if mediation and conciliation efforts have failed to solve a problem or if leaders abscond because of insolvency.[96]

3.4.4 Iddir (Burial Societies)

3.4.4.1 Definitions and Background

Iddir is an association that provides members with material, financial, emotional, and spiritual support during bereavement. It also arranges and facilitates a decent funeral

[95] Yimer et al. (2017).

[96] This issue is discussed in detail in Chap. 6.

ceremony for its members and their relatives, covered by the Iddir system.[97] Iddir is an indigenous institution that is designed to distribute—among its members—the burden of dealing with the loss of a loved one by a member.[98] Iddir provides financial and material assistance to families to help them cover funeral and related costs. It allows members to cope with the psychological and material damage that the death of a close family member inevitably brings.[99] Iddir is not limited to a specific region or culture and is one of Ethiopia's common traditional institutions.[100] Empirical research confirms that more than 80% of the population of Ethiopia belongs to at least one Iddir.[101] Naturally, there are minor differences in the formation and operations of Iddirs in different cultures and customs. In some cultures, for example, Iddirs play an essential role in wedding ceremonies by providing material and labor support to a member. In other cultures, Iddirs have no such responsibilities.

The underpinning grand principle of Iddir is to protect and promote human dignity by assuring that every member of society is valued and respected, alive or dead. The Iddir system ensures every member has a dignified burial ceremony according to the society's culture. Iddir can be considered as an indigenous traditional insurance system.[102] The willingness to share the pain and risk of another member is at the heart of Iddir associations. The founding value of Iddirs is that every member cares for other members, and all other members shall share the loss of a member. The whole cares for the individual, and the individual cares for the whole.

Iddir was traditionally reserved solely for supporting the family of a deceased person and ensuring that the relative was afforded a decent funeral. Still, it has now evolved into a broad social security institution.[103] Nowadays, Iddir provides financial assistance to members who need help, such as if they are ill. Iddirs also support children who have lost their parents. The money collected from members is sometimes also used to benefit the community, such as for constructing access roads, schools, and clinics. Some Iddirs also own businesses to create jobs for members. For example, the Iddir association in Adama has a workshop that produces furniture and rents buildings. Some Iddirs own schools and hotels that Iddir members mainly staff. Renting out tents, chairs, and other kitchen materials needed in Ethiopia for weddings and other ceremonies is common in many Iddirs to generate income.[104]

[97] Dercon et al. (2006).

[98] See for instance: Dejene (1993).

[99] Pankhurst and Deeme (2000), pp. 35–58.

[100] Teshome et al. (2014), pp. 1–10.

[101] Dercon et al. (2006).

[102] Germidis (1990), pp. 5–22.

[103] Germidis (1990), pp. 5–22.

[104] Bulti (2014).

3.4.4.2 Organization

Individuals with a good reputation in the community can initiate the formation of an Iddir. The elders communicate their plan to start an Iddir with the neighborhood and start to list the names of those who are willing to join them. Once they have enough members to start the Iddir, the founders call for a start-up meeting, and would-be members elect a committee to lead the Iddir office. The committee then drafts bylaws to be discussed and adopted by all would-be members.[105] After the internal rules and the general framework of the Iddir are agreed upon, the Iddir becomes functional without any requirement for formal registration at a government office.[106]

Although the rules of Iddirs are primarily unwritten and known to members as they are part of the customary laws and norms in the community, some of the regulations that Iddirs apply may be subjected to open discussion and approval by the founding members. The number of contributions, penalty for default to attend funerals, penalty for delay or default in payments, which family members are covered by the Iddir, procedures to elect leaders, and terms of service of leaders are some of the key points that Iddirs include in the written bylaws.

The Iddir bylaws are refined and adapted from society's customs, traditions, and practices. They also incorporate some principles and guidance from official laws. The bylaws are drafted by a committee of individuals who are assumed to have adequate knowledge and experience to prepare such rules. The drafting committee must prepare and present a draft to the general assembly. Iddirs aim for a consensus on such issues, but if it cannot be reached, decisions are made by a majority vote.[107]

Iddirs may provide copies of the written bylaws to all members, or the bylaws may be read out at general assembly meetings. Alternatively, a summary of the rules may be written on members' identity cards. Membership applications may take months, and newcomers often receive details of the rules of an association so they can make an informed decision about whether to join a particular Iddir. If there is more than one Iddir in a neighborhood allowing the choice of which to join, internal rules are usually relevant factors in the decision.[108]

Commonly, the written internal rules signed by all members are submitted to the Office of Social and Labor Affairs of the wereda[109] administration for registration. The office registers the Iddir and, in some cases, provides a certificate of registration, which must be renewed annually. These formalities allow the judicial and administrative authorities to recognize the internal rules. A leader may need a formal authorization letter from the association to represent the Iddir to formal institutions.

[105] Yimer et al. (2017).

[106] Yimer et al. (2017).

[107] Yimer et al. (2017).

[108] Bazezew and Chanie (2015), pp. 3–23.

[109] In Ethiopia "Wereda" is used to refer to Districts. Around 100,000 people reside in a wereda and around 4 or 5 Kebeles constitute a wereda. The common levels of administration are Ketena, Kebelle, Wereda, Zone, and then Kilili (from the lowest to the highest administration levels).

Iddirs amend their internal laws in response to changes in society's social and economic realities. They are considered pragmatic indigenous institutions focusing on their primary objectives and functions rather than maintaining traditional norms and customs. Leaders of the Iddir do not commonly resist calls for amendment or rule changes. The limited time members have for their social lives due to long working hours and inflation and the increasing number of members often necessitate modification of the bylaws. Further, formalizing registration and financial administration has also necessitated changes to such rules. The amendment of internal rules follows a similar procedure to enacting such laws.

The general assembly is the highest governing body in Iddir. It decides on vital issues such as the number and kind of contributions and the family members covered by the Iddir system. The leaders of Iddir, elected by the general assembly, run the day-to-day activities and decide on issues that do not significantly affect the main pillars of the association. Iddirs commonly have three leaders: a chairman, a vice-chairman, and a secretary. Iddirs also establish different committees with specific responsibilities.

3.4.4.3 Membership and Its Termination

The fact that a person wants to join an Iddir does not automatically guarantee membership. Iddirs screen applicants according to requirements. Attaining 18 years of age is one of the requirements in most Iddirs, aligned with legal capacity by age in the Ethiopian Civil Code.[110] Moreover, establishing an applicant's family is a requirement in some Iddirs, although divorced couples are allowed to join. Iddirs protect the whole family so that an unmarried person can be a family member; in this way, independent memberships to Iddirs are not necessary.

The applicant's reputation is another crucial criterion that Iddirs takes seriously when deciding whether to admit a new member. The most important points to be considered are the applicant's willingness and ability to help in the Iddir's activities, respect the bylaws of the Iddir, and be a trustworthy person in society. When an individual applies to join an Iddir that has already been active for several years, they may be asked to pay an entrance or registration fee. This is justified by the fact that existing members have already contributed to the Iddir's development in kind or through their knowledge and labor. The new member is, therefore, expected to pay an amount corresponding to the contributions of members who joined earlier. Having joined the Iddir, a member is entitled to equal rights and privileges. Some Iddirs require an applicant to bring a letter of release from a previous Iddir, if they belonged to one. This ensures the person has good social interaction and is free from any responsibility or liability to the previous Iddir. This supports mutual respect and protection among Iddirs, serving as a mechanism to discourage unacceptable behavior in society.

[110] Civil Code of the Empire of Ethiopia, Proclamation No. 165/1960, Article 198.

Iddirs do not discriminate against individuals based on gender, educational status, wealth, income, or social status. Most Iddirs focus on a particular neighborhood, mainly for practical reasons.[111] Some are women-only associations, but these Iddirs are commonly established to supplement larger Iddirs open to all genders.

Iddirs can also be established based on a particular workplace, specific business activity, ethnic background, or shared place of origin. However, during the last years of the Haileslasse government and during the socialist military government, officials banned Iddirs that were established based on members' ethnicity for political reasons.[112]

According to the written bylaws, religion is not a consideration for eligibility to join Iddirs. However, they have a strong connection and collaborate with local churches and mosques, sometimes providing services. Usually, most members belong to the same religion because individuals are naturally inclined to establish and join Iddirs with those who share the same religion.

The Iddir or the member can terminate membership. The general assembly may demand an explanation for any decision by Iddir leaders to dismiss a member. A member may also decide to terminate their membership for various reasons. Change of residence is one of the most common grounds for terminating an Iddir membership. As the essence of the Iddir is a closeness between members, it is only practical for a member to leave when moving residence and to join another Iddir in their new neighborhood.

Members generally leave an Iddir with no compensation for their contribution. Members rarely ask to repay their contributions, nor do they claim a dividend or share of the Iddir's property.

The death of a member does not terminate membership in an Iddir; the spouse or descendants can continue the membership in the Iddir. When there are contending interests regarding who shall become a member of the Iddir succeeding the diseased, the family decides on this. This implies that membership in an Iddir provides a family entitlement rather than being limited to the single member whose name has been registered. The fact that membership of an Iddir is considered more of a family right than an individual right can be further inferred from the fact that Iddirs do not allow divorced couples to continue as independent members. The couple agree on who should continue as a member, or it is determined by lottery. Newly formed couples can register as new members, paying an entrance fee.

[111] Many Iddirs are limited in scope. They are formed either based on neighborhoods, the workplace, or friendships. Hence, though the document may not define any exclusion rules, exclusion occurs, if a member does not belong to a group. The written Iddir regulations commonly include the place and location of the Iddir, implying that the Iddir is composed of members from that particular neighborhood. The place and location are included in the introductory part of the regulations, without stating them as grounds for exclusion. As a member must be involved in social life as per the rules of the Iddir, they must reside where they can fulfill this obligation.

[112] Dercon et al. (2006).

3.4.4.4 Functions in Society

Iddir is a social institution that provides material and psychological assistance to its members, particularly after the death of family members. It arranges and facilitates a decent funeral ceremony for its members and their relatives, covered by the Iddir system.[113] Moreover, members use the tents, chairs, and other utensils of the Iddir free of charge during marriage ceremonies and other family events. Mauri relates Iddir to *collegia funeraticia*, a politically and religiously influential institution of the Roman Empire.[114]

Iddir is a system of social networking intended to reduce the material and psychological burden during the death of family members.[115] Nowadays, Iddirs have even more comprehensive functions in society. They are very active in social,[116] economic,[117] And political matters. Iddirs can be considered an informal insurance system with agreed-upon rules based on risk pooling and sharing mechanisms.[118]

The level of support provided by Iddirs depends on the sources of the claim for support. If the need for support relates directly to the death of one of its members, the Iddir provides the maximum possible support for a decent funeral. If the victim is a spouse or a child of a member of the Iddir, most Iddirs provide the same level of support as a member. The general principle is that the level of support depends on the closeness of the relationship between the member and the deceased. More support is commonly provided if the victim is a spouse, a child, a father, mother, brother, or sister of the member. Different Iddirs vary in the amount of financial support provided, depending on the degree of relationship between the deceased and the member.[119]

Some Iddirs also provide short-term loans to their members,[120] If there are strong justifications.[121] Iddir leaders may approve loan requests and their conditions. Although Iddirs cannot be considered a primary source of loans for members because they do not have the required reserve to satisfy all members' credit needs,[122] they are effective social networks facilitating access to finance from the informal credit markets for members.[123] As a vital social network, Iddirs

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[113] Dercon et al. (2006), pp. 685–703.

[114] Mauri (1987).

[115] Pankhurst and Deeme (2000), pp. 35–58.

[116] Dercon et al. (2006), pp. 685–703. https://www.sciencedirect.com/science/article/pii/S0305750X06000076.

[117] Abay et al. (2018), pp. 174–190.

[118] Bazezew and Chanie (2015), pp. 3–23.

[119] Bazezew and Chanie (2015), pp. 3–23.

[120] Bazezew and Chanie (2015), pp. 3–23.

[121] Abay et al. (2018), pp. 174–190.

[122] Teshome et al. (2014).

[123] Abay et al. (2018), pp. 174–190.

membership provides the social capital necessary to access loans in the informal credit market.[124] Generally, the multifaceted services provided by Iddirs in society make them indispensable, illustrated by the fact that more than 80% of the Ethiopian population belongs to at least one Iddir.[125]

Some Iddirs also provide financial support to cover or share the medication costs of their members if presented with clear evidence that the member cannot afford the medication without the Iddir's support. Some health-related research suggests that Iddir can be used to boost community-based health insurance systems. Research in Dessie, reported by Kassahun et al., assessed the willingness of Iddir members to increase their contributions to include health insurance: 83.2% of participants in the study were willing to do so.[126] Iddirs have played a significant role in the fight to control HIV.[127] Iddirs also actively participate in the affairs of their local churches or mosques and provide the necessary support whenever requested.

Nowadays, it is becoming widespread for Iddirs to provide direct support to the less fortunate in their local areas or other localities with which they have a connection. Iddirs offer teaching materials for children from poor families; some provide clothes, help construct houses, or financial support for the elderly, orphans, and sufferers of chronic illnesses.

Protecting a community's peace and security is also a significant contribution Iddirs make. Iddirs usually cover the costs of hiring security personnel in their neighborhood or help organize the community for better protection. Some Iddirs are economically and organizationally capable of providing meaningful social services for the community. One Iddir in Axum, for example, supported its elderly by constructing drainage works, providing essential goods during high inflation periods (price hikes), building tents, and providing food for guests during a public holiday.

3.4.4.5 Contributions

Members' contributions are the primary source of Iddirs' income. There are two types of contributions made by members. The first is a regular fixed amount of money, contributed annually or monthly by all members. The amount may be increased or reduced at the discretion of the members. The regular contribution is mainly used to cover the fixed costs of Iddir, acquire materials that Iddir needs to meet its objectives and increase its savings. Iddirs buy chairs, cups, plates, bowls, other kitchen materials, and large marquees. Iddirs with good financial standing also

[124] Caeyers and Dercon (2012), pp. 639–675.

[125] Bazezew and Chanie (2015), pp. 3–23.

[126] Kassahun et al. (2018), pp. 249–256.

[127] Pankhurst and Deeme (2000), pp. 35–58.

acquire immovable properties like a meeting hall, office buildings, and spaces for ossuaries in church compounds to be used for members.[128]

The second kind of contribution a member is entitled to, according to the bylaws of the Iddir, is funded by a call for contributions when a member or one of their family, who is covered by the Iddir system, dies. The collected money and other contributions in kind (mainly food and drink) are provided directly to the member, who is entitled to receive the support under the supervision of the Iddir leadership. The amount varies from one Iddir to another and is decided in a general meeting, where all members have an equal vote. One of the most important in-kind contributions made by Iddir members is attending funerals and contributing to the labor in any way expected by the Iddir or the culture.[129] In addition to a contribution in cash or kind, members must attend funerals to morally support the families of the deceased, provide food and drink to the families and guests coming to the funeral of the deceased and be ready to take part personally in activities to support the families of the deceased.[130] With changes in society affecting social life and more stringent workplace demands, the requirements of Iddir have become more lenient for members with valid reasons preventing them from participating in the Iddir activities. For example, for teachers, some Iddirs substitute the obligation to attend a funeral with a commitment to participate in the house of the grieving member early in the morning to support them, making it possible for them to continue teaching classes.

Defaulting payments are penalized seriously in all Iddirs. Iddirs commonly impose fines for a failure to contribute; payments are required according to the values, norms, and rules of the Iddir. Repeated, unjustified failure to meet obligations specified in the regulations of the Iddir can result in expulsion from the Iddir. Iddirs also severely punish repeated failure to attend funerals. The penalty amount may increase as the number of defaults increases. One Iddir, for example, imposes five Birr for the first default, 10 Birr for the second, 15 for the third, and so on until the default reaches a level where expulsion is considered.

The fact that all members agree upon the internal rules of the Iddir and the rules are not imposed by an external body means that everyone knows them well; this gives them an internal legitimacy that makes their enforcement acceptable. Respect for Iddir bylaws, therefore, originates mainly from the substantial social capital attached to respecting Iddir norms and social condemnation of any disobedience or tendency towards free riding. Besides financial sanctions, Iddirs also use naming and shaming to discourage members from flouting the norms.

[128] Léonard (2013).

[129] Dercon et al. (2006).

[130] Dejene (2009), pp. 535–547.

3.4.4.6 Governance and Administration

The administration of Iddirs is mainly based on a division of mandates and responsibilities among the different structures of the Iddir. The general assembly is the highest body of an Iddir. It meets annually; in some Iddirs, it meets once a quarter or six-monthly. This is in addition to any other extraordinary meetings the assembly may hold. The assembly discusses performance evaluation, audits the activities of the chairperson and executive committee, accepts new members, elects new leaders, listens to performance and financial reports, purchases property, listens to members' applications/complaints, and arranges religious teaching for its members.[131]

The chairperson heads the executive committee. Their responsibilities differ between Iddirs based on size. In an Iddir with hundreds of members, management authority is shared with executive committee members. The vice chairperson stands in for the chairperson if needed and takes on responsibilities assigned to them by the chairperson.

Iddirs also establish committees to deal with specific issues and forward recommendations to the chairperson, the executive committee, or the general assembly for approval. A conciliation committee is, for example, responsible for settling disputes between members if the members themselves cannot reconcile them. A complaint-handling committee receives complaints about matters related to India. Some Iddirs have established entertainment committees, legal departments, HIV/AIDS and harmful traditional practices committees, cooperative society committees, and development committees.[132] Ad hoc committees are also established for specific events, such as election committees, which organize the election or reelection of Iddir leaders.

3.5 Informal Financial Institutions and the Law

No comprehensive legal regime deals with informal credit transactions or small-scale loans in Ethiopia. Nor are there laws specifically regulating informal financial institutions like Iddirs, Eqqubs, or other similar institutions. The Organization of Civil Societies Proclamation (Proclamation No. 1113/2019) expressly excludes Iddirs and Eqqubs from its scope of application. Generally, the legal approach does not recognize these institutions as associations with legal rights and duties in the official laws. They are denied any legal recognition, which would award them a right to be registered as legal entities unless they are restructured as an association

[131] Iddirs may have religious fathers responsible for the religious well-being of the members. This person advises members of the Iddirs on religious matters and delivers religious teachings.

[132] Yimer et al. (2017).

recognized under official law.[133] These traditional institutions are, therefore, left to operate as de facto associations. However, this does not mean that no law is applicable to regulate the relations and transactions in these institutions. The Civil Code and other laws *mutatis mutandis* apply to the informal credit market in general and the informal financial institutions in particular. This section focuses on the Civil Code and its relevance in transactions of these traditional financial institutions.

Some scholars argue that Ethiopian codes of law—particularly the Civil Code—fail to provide a framework for regulating traditional associations such as Eqqubs and Iddirs.[134]

3.5.1 Iddirs Under the Civil Code

The Civil Code includes detailed provisions that indicate how associations can be formed and how they should be regulated. Therefore, the question is whether the definitions and concepts of an association, as articulated in the Civil Code, are inclusive enough to confer legal personality to traditional institutions like Iddirs and Eqqubs.

The Civil Code defines an association under Article 404 as "a grouping formed between two or more persons to obtain a result other than the securing or sharing of profits." The definition is broad enough to include all kinds of associations not established for profit. Therefore, it seems that the Civil Code's provisions regulating associations also apply to traditional institutions as long as these institutions have no objectives to provide financial services. Therefore, it is possible to argue that Iddirs fulfill the requirements provided for associations in the Civil Code because they are not formed for profit sharing, and there are no other criteria that exclude Iddirs from being considered as associations in the Civil Code. However, associations organized according to the provisions of the Civil Code are banned from being involved in trade and commercial activities. The Commercial Code prohibits associations from doing business and provides that business involvement would be grounds to dissolve the association for participating in unauthorized activities.[135]

The Organizations of Civil Associations Proclamation repealed most of the Civil Code's provisions regarding associations.[136] The Proclamation provides that all customs, practices, and laws contradicting its provisions are inapplicable.[137] Although the Proclamation repeals various provisions in the Civil Code, it expressly

[133] Addis Ababa city administration has recently introduced a directive that requires Iddirs to be registered and recognized by the city. Its implementation and how Iddirs respond to this attempt to regulate their internal affairs is yet to be seen.

[134] Ross and Berhe (1974).

[135] Article 25 of the Commercial Code.

[136] Organizations of Civil Societies Proclamation, Proclamation No. 1113/2019/.

[137] Organizations of Civil Societies Proclamation, Proclamation No. 1113/2019/.

excludes Iddir from its scope of application.[138] Thus, the provisions of the Proclamation do not apply to Iddirs, rendering operational the requirements of the Civil Code relevant to Iddirs. In effect, the Civil Code is still relevant regarding the legal personality of Iddirs. Based on the arguments in the preceding paragraphs, the provisions of the Civil Code about the regulation of associations apply to Iddir associations, and we can examine how the requirements of the Civil Code relate to the norms and traditional practices of Iddir.

The Civil Code generally embodies the freedom to form associations based on a memorandum of associations and statutes developed by members. However, some requirements should be respected by all associations. The first requirement is to develop its statute within three months.[139] And deposit it at the appropriate government office, as required under Article 413 of the Civil Code. All members should agree upon the statute. This implies that associations can regulate themselves, providing the internal rules do not contradict the mandatory provisions of the Civil Code.[140] Five association members must sign the statute, and it must indicate the name, objectives, place where the association has its head office, and date of formation.[141]

Registration is important for Iddirs as it gives them the status of a legal entity under the law. Registered Iddirs can, therefore, own property and sue or be sued in a court of law. The Civil Code also expressly provides that an association has a distinct legal entity separate from its members, who thus do not become responsible for the acts of the association personally unless they are directors or act in that capacity.[142] However, the requirement for Iddirs to register according to the provisions of the Civil Code is optional; Iddirs may consider the advantages/disadvantages of being recognized as a legal entity by the formal legal system. Iddirs that opt out can continue to function as unregistered associations, not being recognized as legal entities by the formal legal system and courts.

One crucial factor the Iddir members may consider in opting in or out of regulation by the Civil Code is the issue of inheritance. According to the Civil Code, rights and privileges obtained from association membership may not be inherited.[143] This prohibition seems incompatible with the general customary practices of most Iddirs. Empirical research conducted in the Tigray regional state revealed that most Iddirs allow rights derived from Iddir membership to be inherited, and eligible successors of Iddir membership are specified in their internal rules.[144] The Civil Code also provides that changing or modifying the association's objective

[138] Organizations of Civil Societies Proclamation, Proclamation No. 1113/2019/ Article 3(3b).

[139] Article 409 of the Civil Code.

[140] Article 410 of the Civil Code.

[141] Article 411 of the Civil Code.

[142] Article 451 of the Civil Code.

[143] Article 419 of the Civil Code.

[144] Yimer et al. (2017).

requires consensus rather than a majority vote.[145] Although members have the right to withdraw from the association at any time, the requirement of consensus renders the evolutionary transformation of Iddirs complicated and challenging; it may be difficult to obtain consensus on each incremental change essential to keep up with changing social and economic realities in society.

This deviance in the Civil Code approach from the norms used for so long in Iddirs is attributable to the fact that the Civil Code was developed with a new form of civic association in mind, rather than traditional associations such as Iddirs. Therefore, the rules embodied in the Civil Code do not consider the special nature of Iddirs. Indeed, the Civil Code does not facilitate legal pluralism or provide a legal framework that expressly recognizes and supports traditional institutions such as Iddirs. As David, the drafter of the Code, explicitly admitted, its main objective was introducing modern laws into Ethiopia to create a new society based on Western legal tradition.[146]

3.6 Chapter Summary

This chapter describes the informal credit market in Ethiopia and laws relevant to the informal credit markets. Relatives and friends, moneylenders, and traditional institutions are the main actors in the informal credit markets. Credit from family and friends are important sources of credit in Ethiopia. Relatives and friends usually provide interest-free loans based on the principle of reciprocity. Most loan agreements are made orally, and most disputes are resolved through conciliation and mediation.

Moneylenders who provide credit with interest are also very common in Ethiopia. They commonly use disguised contracts to hide the exorbitant interest rates that they charge. They stipulate in the contract an amount higher than the actual principal loan. They also take a postdated check as security if they deal with traders. In this way, they avoid the risk of prosecution for violating the usury laws. They commonly use their substantial social and economic leverage to enforce contracts and sue defaulters in official courts. They have an advantage in official courts as they usually keep well-drafted contracts that protect their interests.

Ethiopia has no comprehensive or clear usury law. The Civil Code stipulates 12% as the maximum interest for loans. However, new banking laws enacted after the liberalization of the economy give parties a free hand to decide on the amount of interest. The National Bank follows a laissez-faire principle about lending interest rates. The apparent difference between the banking laws and the Civil Code has caused some ambiguities in the interest rates that non-financial institutions can legally charge.

[145] Article 441 of the Civil Code.

[146] David (1963), pp. 187–203.

Ethiopia is home to different traditional institutions. Mahber, Debo, Eqqubs, and Iddirs are discussed in this chapter. Iddirs play an essential role in society by enhancing mutual support after bereavement. Iddirs provide crucial social capital that can be used to gain community advantages, including credit access. Ethiopia has no law regulating Iddirs; they are self-regulatory institutions with minimal government intervention. The government, however, seems to acknowledge their contribution to society by allowing them to function without limitations, to own property, and to use official banks and other government services, even if, in the strict sense of the law, they are not registered legal entities, which would enable them to engage in official transactions.

Eqqubs provide indispensable economic and social services to society. They motivate a saving culture in society and provide credit for members. Friends and relatives may establish Eqqubs with 10 or 15 members. Eqqubs may also be formed by traders whose members have weaker personal interrelations and may number more than 50. Eqqubs uses social capital to screen members and enforce agreements. Eqqubs, with many members, have written bylaws, books of records, and receipts for payments. They use mediation and conciliation to solve disputes. Nevertheless, they also use official courts when it becomes impossible to solve disputes amicably.

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Chapter 4
Core Features of Informal Credit Markets in South Africa

4.1 Stokvels

4.1.1 Definitions

The term "stokvel" is believed to have been derived from the term "stock fair" used by English settlers in the nineteenth century in cattle auctions. Cattle auctions gradually became famous, and farmers and farm workers, including the black community, joined the events.[1] Africans used the event as a social gathering and buying livestock by pooling money together.[2] It is always tricky to know when such traditional institutions were formed, as they usually start with effortless and informal gatherings with few individuals as members. Although impossible to tell when the first unregistered stokvel was formed, the first registered stokvel was the "Bantu Burial Society"[3] registered in 1932.[4] The practice was introduced in most parts of South Africa by workers who moved to urban areas to seek jobs. Stokvel is now a significant social and economic institution, with more than 11 million South Africans participating in more than 810,000 stokvels, with transactions of 44 billion Rand per year.[5]

Stokvels vary in form, structure, function, and objectives. Researchers define stokvels according to their research focus. Therefore, "one size fits all" definitions

[1] Verhoef (2001), pp. 259–296. Here, one caveat is required. Sharing risks and reciprocity are entrenched deep in African culture. Coming together is a common strategy that Africans use to survive in their struggle against poverty and misfortune. Therefore, it is possible that institutions like stokvels existed long before white settlers arrived in South Africa.

[2] African Response (2012).

[3] Lukhele (1990).

[4] Lukhele (1990).

[5] African Response (2012).

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G. Yimer, *The Nexus Between Legal Pluralism and Inclusive Finance*,
https://doi.org/10.1007/978-3-031-71653-9_4

can distort the true nature and identity of the institution.[6] Mashigo and Schoeman define stokvel as "an umbrella term used to describe informal saving organisations in the African community in South Africa."[7] This definition recognises that stokvels have different objectives, institutional structures, number of members, management styles, and governance. It indicates that stokvel is a common taxonomy for all institutions based on the spirit of togetherness, notwithstanding differences in their structures or specific objectives.

Schulze provides two definitions of stokvels. The first definition considers a stokvel as "an agreement between two or more persons who enter it with a specific aim."[8] This general definition seems to include all forms of partnership regardless of their purpose. It is based on a critical feature of stokvels, i.e., consent. Free consent is a fundamental element in the formation of stokvels. It is a purely voluntary association based on the personal gains that members derive from it and their contributions to society.[9] The personal gain can be social, financial, or both, depending on the situation. Schulze, in another publication, describes stokvels as:

> A type of informal credit-rotating association in which a group of people enter into an agreement to contribute a fixed amount of money to a common pool on a weekly or monthly basis or as frequently as the members may agree upon.[10]

This definition is similar to the definition of ROSCAs. As we have seen from the first definition, a stokvel is an umbrella term that includes different kinds of informal financial and mutual social security associations. Schulze's second definition seems more appropriate for saving stokvels than the former generic interpretation. Chitimira defines them as follows:

> Stokvels are informal financial clubs that operate as rotating credit unions or saving schemes where members contribute some money to a central fund for future distribution among the relevant members.[11]

African Response defines stokvels as "group saving schemes providing for mutual and financial wellbeing as well as social and entertainment needs."[12] This definition includes the main functions different types of stokvels provide their members. However, not all stokvels provide all the services in this definition. Stokvels can be established for different objectives; members usually join two or more stokvels because not all services are available within a stokvel as a single package.[13] For example, stokvels to support members during bereavement are also unlikely to provide savings for investment services. Someone who needs mutual

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[6] Verhoef (2001).

[7] Mashigo and Schoeman (2010).

[8] Schulze (1996), p. 78.

[9] Hutchison (2019), p. 256.

[10] Schulze (1997a), pp. 18–29.

[11] Chitimira (2020), p. 272.

[12] African Response (2012).

[13] African Response (2012).

security from a stokvel will join a burial society stokvel; if they also want to join a mandatory saving scheme, they will probably join a separate saving or investment stokvel. Thus, people join more than one stokvel at a time to meet different objectives.

Lukhele, the founder and chair of the National Stokvel Association of South Africa (NASASA) defines stokvels in his book as “a type of credit union in which a group of people agree to contribute a fixed amount of money to a common pool weekly, fortnightly, or monthly.”[14] This definition defines stokvels as similar to widely recognised credit unions. Although some stokvels are similar to credit unions, not all have objectives or structures similar to those of credit unions. Some are more similar to insurance companies than credit unions.[15] Lukhele seems to have recognised the limitation of his definition in a recent article, where he redefines stokvel as:

> One of the types of rotating savings and credit associations (ROSCAs) is a credit union or communal group in which a group of people enter into an agreement to contribute a fixed amount of money to a common pool weekly, fortnightly, or monthly, to be drawn in rotation according to the rules of the particular society.[16]

The National Credit Act provides the following definition of stokvels, which indicates that they are exempt from strict requirements of the Act applicable to anyone who provides credit.[17]

> Stokvel means a formal or informal rotating financial scheme with entertainment, social, or economic functions, which (a) consists of two or more persons in a voluntary association, each of whom has pledged mutual support to the others towards the attainment of specific objectives; (b) establishes a continuous pool of capital by raising funds using the subscriptions of the members (c) grants credit to and on behalf of members; (d) provides for members to share in profits from, and to nominate management of, the scheme; and (e) relies on self-imposed regulation to protect the interest of its members.

It is interesting to mention here that it is not only the style, objective, and nature of stokvels that vary but also the institution’s name. South Africans use different names to refer to stokvels. This emanates from their having different objectives and purposes; hence, the names reflect the purposes. Mulaudzi, for instance, indicates that:

> South Africans do not use the word “stokvel” in a general way, but they use the word with a very specific meaning. A stokvel to them is a ROSCA. They do not consider rotating income groups as stokvels but instead as “umgalelo” or “muholisano.” They also do not refer to ROSCAs that focus on funerals as stokvels but instead as types of burial societies.[18]

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[14] Lukhele (1990).

[15] Hutchison (2017), pp. 17–42.

[16] Lukhele (2018).

[17] The National Credit Act, Section 1(40). See also Section 8(2).

[18] Mulaudzi (2016).

Different languages used in South Africa also led to the prevalence of multiple terms and words to describe stokvel. Verhoef mentions, for example, mohadisana, gooi-goois, amafella, and mogodiso,[19] which are alternative terms used in different parts of South Africa to describe stokvels.[20] Mohadisana is a Sotho term meaning giving to or paying each other. The Zulu term for the concept of giving to each other is Kuholisana, which is an alternative name for stokvels in Zulu-dominated areas. Gooi-goois is a common word to describe stokvels, and according to Schulze, it originated from the Afrikaans word "oorgooi," which means "throw over."[21] The term describes the stokvel concept of dropping or giving something away.[22] The term "makgotlas" is also used in South Africa to refer to stokvels.

4.1.2 Types of Stokvels

Scholars and researchers do not have a standard classification of stokvels. The lack of systematic and agreed methods of classification of stokvels means there is a lack of robust data for systematic analysis by researchers who depend on secondary resources. However, regardless of the different names, groupings, and definitions used to describe stokvels, they share a common underpinning principle: bringing members together for mutual financial and social co-existence; this makes it possible to discuss stokvels as a package. Two different classifications are discussed below, and some explanations are given for the different types of stokvels.

In 1996, Kritzinger divided stokvels into five groups. These are: burial stokvels, saving stokvels, investment stokvels, birthday stokvels and grocery stokvels.[23] A field research conducted by Africa Response in 2012 classified stokvels this way.[24] According to the 2012 survey, saving stokvels are the most common types, constituting 43%, followed by burial societies (22%) and grocery stokvels (16%).[25] Some researchers claim that burial stokvels are the most common and outnumber other types of stokvels.[26]

On the amount of contributions, savings, and investment, stokvels have the highest and burial societies the lowest. Saving stokvels collect 2.12 billion Rand

[19] Verhoef (2001), p. 264.

[20] Verhoef (2001), pp. 259–296.

[21] Schulze (1997a), pp. 8–29.

[22] It is interesting to mention here that in Ethiopia also a similar term is commonly used to describe making contributions to Eqqubs (Ethiopian version of ROSCAs): "Eqqub Metsal." "Metsal" means "throwing" in Amharic and was adopted in the context of Eqqubs to imply that you drop something from your income for saving.

[23] Kritzinger (1996), pp. 109–130.

[24] African Response (2012).

[25] African Response (2012).

[26] Orange (2017).

monthly, which amounts to 25 billion Rand annually.[27] Burial stokvels mobilise the second largest annual saving because of their higher number of members, although contributions are smaller than in other kinds of stokvels.[28]

Grocery stokvels are common among women, with the participation of only a few men, and are frequent in both rural and urban areas. Grocery stokvels buy in bulk products that are commonly used in the community. Stokvels commonly distribute staple products, cooking products, and washing powders to their members. Grocery stokvels can be taken as tangible evidence of the philosophy of Ubuntu, particularly because members receiving such products from stokvels donate most of them to their poorer relatives.[29] As grocery stokvels buy in bulk, they can bargain for advantageous prices with retailers and producers. The main challenge for them is transportation and storage.[30]

The second classification identifies four main groups and was introduced by Schulze[31] and Verhoef.[32] These are the saving clubs (gooi-goois), burial societies, investment groups, and high-budget stokvels, each described below.

4.1.2.1 Gooi-goois

Saving groups commonly known in the local community as gooi-goois are similar to ROSCAs in other countries. Saving groups are mainly established for two purposes: to encourage saving and to access affordable credit. The saving clubs operate based on pre-negotiated and agreed rules.[33] Members write and know most rules, and there are regular weekly or monthly meetings. Attendance is mandatory, with a penalty for absence or for delayed payments.[34] The meeting is also the payment date, so every member must attend. The meeting venue rotates, with each member hosting in their home.[35] The member who hosts the meeting normally provides food and drink, and the money collected on that day is given to her. The clubs usually terminate after the cycle ends, but members may start a new round.[36]

The members contribute a certain amount weekly or monthly, and the total sum is paid to one member without interest, although sometimes interest may be charged. Some gooi-goois provide loans with interest. The interest rate may vary from 30% to

[27] African Response (2012).

[28] African Response (2012).

[29] African Response (2012).

[30] African Response (2012).

[31] Schulze (1996), p. 78.

[32] Verhoef (2001) p. 264.

[33] Hutchison (2020), pp. 3–27.

[34] Hutchison (2020), pp. 3–27.

[35] Hutchison (2020), pp. 3–27.

[36] Verhoef (2001), p. 264.

50%.[37] In gooi-goois, every member is considered a creditor before they receive their payment; they become debtors after they are paid. They may, therefore, pay interest but also benefit from the interest payments others pay. To be paid first is commonly considered an advantage in gooi-goois, especially when no interest is charged. The model used to determine the priority of payments is usually provided in bylaws. Commonly, the order for payment is determined by a lot, although it can also be determined by mutual consent or by auction.[38]

4.1.2.2 Burial Societies

Burial societies are associations that provide multidimensional support during bereavement. Dafuleya defines burial societies as:

> Organizations made up of friends, relatives, workmates, and community residents who come together to insure themselves and their extended families against death-related expenses.[39]

In African culture and tradition, the deceased should be buried with dignity and respect; thus, funeral ceremonies and related activities can be expensive. A funeral ceremony is commonly a demanding task both financially and in terms of logistic arrangements, and therefore, something that the family of the deceased cannot accomplish alone.[40] Therefore, community members lend a hand in many ways for funeral ceremonies. Funeral procedures in Africa demand a huge labour force in addition to the financial burden they impose on the family. The need for mutual support is the underpinning reason burial societies flourish throughout Africa.[41]

In South Africa, burial societies are also attractive to society for another reason. Most black workers live far from their birthplace or what they call their homeland. For cultural reasons, these urban workers prefer to be buried in their place of origin. Taking the corpse to a rural area imposes an additional burden on the family. Burial stokvels are thus crucial to share the burden; they provide a system by which the community shares the cost, based on the principle of reciprocity.[42] According to research by Ngcobol and Chisasa, "burial society stokvels were formed to assist in the event of death with expenses such as the cost of transporting the body of the deceased to their place of origin, providing food and care for people who accompany the corpse, and providing food for families who come to attend the funeral from afar."[43]

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[37] James (2012), pp. 20–40.

[38] Mulaudzi (2016).

[39] Dafuleya (2018), pp. 156–168.

[40] Ngcobol and Chisasa (2019), pp. 204–216.

[41] Ngcobol and Chisasa (2019), pp. 204–216.

[42] Dafuleya (2018), pp. 156–168.

[43] Ngcobol and Chisasa (2019).

Verhoef divides burial stokvels into two groups. The first group is a less organised small stokvel, with no regular fixed contribution by members. Members contribute only when there is a death of a member or a relative of a member who is covered by the Stokvel insurance system. Such stokvels do generally not keep records and function based on reciprocity. The second group includes well-organised institutions with more than 1000 members and with written bylaws. Members pay an entrance fee and a permanent fixed contribution, and there are payments requested explicitly if the burial stokvel covers a death or an accident.[44] Stokvels apply strict enforcement procedures to avoid fraud and illicit behaviour. Members must inform the Stokvel secretary of a relative's death, who is covered by the Stokvel system. The secretary then checks whether the claim is by the laws of the Stokvel; if the request is accepted, the required support is provided.[45]

The second type of stokvel covers almost all significant funeral ceremony costs and transportation costs.[46] According to Schulze, burial societies provide services similar to funeral insurance providers. He further claims that burial societies meet all the requirements of a mutual insurance contract.[47] This raises the question of why burial societies have survived the new wave of modern insurance companies that provide coverage for burial services. Recent research indicates that even educated and economically recognised middle class participate in burial societies in South Africa.[48] This disproves the assumption that such traditional African institutions only serve the poor and will vanish with economic changes.

Schulze provides the following two reasons for this. First, most black people in South Africa perceive modern insurance as expensive. Secondly, they require an individual subscription for each family member; the traditional system provides coverage for the whole family when the head of the family joins the stokvel.[49] In addition to Schulze's two reasons, cultural elements are also essential.[50] Traditional African burial societies provide not only financial and material support but also social and psychological support, which is not provided by business-oriented insurance companies.

> Belonging to a burial society helps members to prepare for death, enables them to have a decent funeral, and ensures that those who attend the funeral service do not go home hungry.[51]

[44] Verhoef (2001), p. 264.

[45] Ngcobol and Chisasa (2019), pp. 204–216.

[46] Verhoef (2001), p. 264.

[47] Schulze (1997b), pp. 153–170.

[48] Ngcobol and Chisasa (2019), pp. 204–216.

[49] Schulze (1997b), pp. 153–170.

[50] Hutchison (2017), pp. 17–42.

[51] Ngcobol and Chisasa (2019), p. 208.

4.1.2.3 Investment Stokvels

Verhoef's third classification is investment stokvels. These differ from ROSCAs in many important ways, like accumulated savings and credit associations (ASCRAs).[52] In investment stokvels, members contribute a defined amount not to be paid back to members on a rotating basis but to be invested in specific projects instead, including providing loans to members and non-members with interest. Investment stokvels can be established for a limited or indefinite time. When the stokvel is dissolved, the money is divided among members. Investment stokvels operate like cooperative societies. Members contribute money weekly or monthly, which is invested in a profitable business or used to buy a property for common use. Most investment stokvels do not pay members on a rotating basis but instead invest the contributions collectively; however, members may be granted a loan with interest from the stokvel if extra savings are available in the stokvel account. Stokvels that invest collected money distribute profits to members as per their bylaws.

There are, however, some investment stokvels that operate like ROSCAs. These investment stokvels collect money from members to buy a taxi or land or anything that members need to own but cannot afford to buy with their savings. The stokvels buy cars or land for each member turn by turn, and members continue to contribute until each member receives the same from the investment club. Investment stokvels do not normally distribute money but rather something members have agreed to buy in advance. This can be something expensive, like a house, a refrigerator or even clothing, with the same design or colour for everyone.[53]

4.1.2.4 High Budget Stokvel

According to Verhoef's classification, the fourth group is a high-budget stokvel. These stokvels are organised by individuals with very high status in the community. The number of organisers can vary from 10 to 20. The founding members, who commonly also become the board members of the stokvel, have a vital role as they decide when payments are to be made to members. With such decisions at their discretion, there is a risk of corruption or nepotism. High-income persons commonly use high-budget stokvels, and unlike other types of stokvel, they are dominated by men. The high-budget stokvel model also allows members to borrow money with interest.

[52] Bouman (1995), pp. 371–84.

[53] Verhoef (2001), p. 264.

4.1.3 Features of Stokvel

Stokvels are voluntary associations with self-rule. They can be initiated by any person or group of people with good social connections. The founding members may invite relatives, friends, colleagues, and neighbours to join them by explaining the objectives of the stokvel. The founding members consider the trustworthiness of the people they invite to join them. High social reputation and good relations with members are crucial to stokvel admission.[54] A pre-existing relationship is important in most stokvels. However, it is now becoming common in some stokvels to invite people through social media and websites, thereby enabling new members to join a stokvel without having any previous acquaintances among members. Some stokvels use WhatsApp and similar social media outlets to make contributions and for online meetings.[55]

Most stokvels elect their leaders based on an open and direct voting system. The elected leaders lead the organisation's day-to-day activities and open bank accounts for the association.[56]

Stokvels function based on contractual relations among members because "an obligation is created between the members who belong to it."[57] Members agree on the rules and regulations of the stokvel in advance, and in most cases, the rules stipulate the rights and duties of members.[58] The internal rules of stokvels are made by consensus, and the laws are, in most cases, reduced to written agreements.[59] The members know the rules by heart and respect the laws; not respecting the laws is strongly condemned in society.[60]

> The role of an agreed set of rules, or a constitution, is both traditional and crucial in the smooth running of a stokvel.[61]

The legal status and style of management of stokvels are comparable with partnerships. Most stokvels can be considered as partnerships under South African law.[62] Research suggests that stokvel members do not welcome government intervention.[63] Stokvels function well underpinned by norms and traditions in the community, and any intervention from the government may thus taint this practically tested tradition that connects generations. An interview respondent in a survey led by Arko-Achemfuor stated, "We do not need government intervention because this is

[54] Hutchison (2020), pp. 3–27.
[55] Kariuki and Ofusori (2017).
[56] Verhoef (2001), p. 264.
[57] Hutchison (2020), pp. 3–27.
[58] Schulze (1997a), pp. 18–29.
[59] Hutchison (2020), pp. 3–27.
[60] Schulze (1997a), pp. 18–29.
[61] Lappeman et al. (2020), p. 7.
[62] Schulze (1997a), pp. 18–29.
[63] Hutchison (2020), pp. 3–27.

our traditional way of saving, and the government always hijacks and spoils things."[64]

Stokvels uses formal financial institutions to save money and perform other financial activities. In 1988, the Permanent Building Society (PERM) introduced the first tailored bank account for burial stokvels.[65] The PERM account included the following features: (1) If monthly savings contributions were made, the balance was increased by the rate of interest, (2) Interest was capitalised monthly, (3) Stokvels could withdraw all funds available in the account and no minimum balance was required, (4) There were no bank charges, (5) Stokvels were issued with a book as a record of their savings and withdrawal balances, (6) There was no limit on the number of withdrawals (7) Members of the stokvel executive committee were signatories on the account.[66] This clearly shows that the formal financial institutions recognised the potential of the informal institutions and tried to attract stokvels to work with them by providing a banking service that best suited them. Other South African banks have followed the PERM bank's initiative, and currently, almost all major banks provide specially tailored services for stokvels.[67]

South Africa has enacted a law that openly excludes stokvels from its regulatory ambit but recognises them as a legal activity.[68] The fact that stokvels can operate without following strict banking rules shows the government's interest in allowing them to evolve naturally. The reserve bank also allowed stokvels to open bank accounts in formal banks and to operate openly.[69] Stokvels are currently operating as self-governing entities without strict government regulations. A national association, the National Stokvel Association (NASASA), also exists. Its main objective is to provide technical support and connect with industry in the formal sector.[70]

Most Stokvels do not have the status of a juridical person.[71] However, they do not fall entirely out of the legal framework.

Lukhele states:[72]

> Exemption notice No. 2173 allows informal member-based groups to pool funds and utilize the funds for the benefit of their members on condition that a bond exists between members within the group, relying on self-imposed regulation to protect the interests of their members.

Norman Axton, the senior general manager of First National Bank, states that stokvels play a vital role in the economy and could powerfully promote economic empowerment.

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[64] Arko-Achemfuor (2012).

[65] Ngcobol and Chisasa (2019), pp. 204–216.

[66] Ngcobol and Chisasa (2019), pp. 204–216.

[67] Lukhele (2018).

[68] The Banking Act of 1994.

[69] Lukhele (2018).

[70] Lukhele (2018).

[71] Schulze (1997a), pp. 18–29.

[72] Lukhele (2018).

> Given their ability to collect very small amounts of money from their often low-income members to help them meet large financial commitments, stokvels complement the country's formal financial sector.[73]

4.1.4 *Reasons for Joining Stokvels*

A 2013 survey confirmed that stokvels are the choice of the future generation in South Africa; 63% of young people aged 18 to 30 and 49% of the adult population use stokvels to save.[74] A survey in 2017 also clearly indicated that 74% of the black middle-class population belong to at least one stokvel.[75] In this section, we present the answers researchers provided on why people join stokvels. Individuals join stokvels for different reasons, and no researcher can give an exhaustive list of reasons for the growing number of members. The purpose of the discussion in this section, therefore, is to provide a general overview of the main reasons motivating people to join stokvels.

Research by Kibuuka in Pretoria on high-budget stokvels revealed that the main reason people join stokvels is to increase their commitment to saving.[76] Indeed, many researchers report that group saving is an important remedy for individuals who want to curb their consumption rate and increase their savings.[77] Group saving is a form of involuntary or forced saving because once committed to collective saving, it is difficult to withdraw without losing social respect and acceptance in society. Group saving schemes like ROSCAs are thus a good remedy for individuals who find it difficult to save alone.

The second important reason identified by Kibuuka is to avoid bank fees or taxes. Members mentioned that banks pay very low interest for savings and charge very high interest for loans.[78] They can, therefore, avoid paying high interest rates and other service fees to banks by joining a stokvel that provides credit without interest or with very low interest rates. Socialisation is the third important reason behind South Africans' ever-increasing membership of stokvels.[79] Members become close friends, and collaboration is not limited to the stokvel scheme; they share many business experiences and other important information. This makes stokvels appealing to many people; members learn from each other.[80]

[73] Lukhele (2018), p. 18.

[74] Ngcobol and Chisasa (2019), pp. 204–216.

[75] Orange (2017).

[76] Kibuuka (2006).

[77] Gugerty (2007), pp. 251–282.

[78] Kibuuka (2006).

[79] Kibuuka (2006).

[80] Kibuuka (2006).

Matuku and Kaseke identified three main reasons for the growing interest in joining stokvels: women's unemployment, social influence, and the need for mutual support.[81] The lack of permanent and stable income makes it difficult to access formal financial services. Income earned from an informal business is unstable, generating a sense of insecurity. Stokvels provide access to credit, insurance, and saving opportunities based on proven trustworthiness and good behaviour.[82] For this reason, women join grocery stokvels, which enable them to acquire goods with small weekly or monthly contributions. Social influence is also important; joining a stokvel is a sign of a healthy relationship in the community.

The deep-rooted culture of helping one another is also an important factor in the increased prevalence of stokvels. The principle of Ubuntu, based on the philosophy of "I am because you are," requires everyone to care for another being and trust that the community cares for him or her. People thus also join stokvels to support their community as part of society. Verhoef argues that stokvels are mainly needed in South Africa to replace the declining kinship networks because of urbanisation.[83] South Africans who have moved away from their native homes to work in cosmopolitan cities live far from their kinship networks. This means that depending on kinship networks is impractical; a new network of friends and neighbours is therefore needed in the form of stokvels, and this becomes indispensable for the urban black community to enhance mutual security. James also stresses the importance of stokvels as an institution that upholds traditions in the community. She notes that stokvels "reinforce tradition while also giving members a means to save and invest in a more modern fashion."[84]

According to Matuku and Kaseke, the main virtues that enable stokvels to continue to be relevant in society are trust and honesty, harmonious relationships among members, and the constitutions that are developed by consensus of parties. The Constitution has both internal and external validity in the eyes of members; therefore, everyone respects them.[85] The formal law enforcement authorities provide critical support in executing the decisions of stokvel members if a member violates the norms and refuses to pay as per the agreed laws.[86]

[81] Matuku and Kaseke (2014).

[82] Hutchison (2020), pp. 3–27.

[83] Verhoef (2001), p. 264.

[84] James (2015), p. 1051.

[85] Matuku and Kaseke (2014).

[86] Matuku and Kaseke (2014).

4.1.5 The Role of Stokvels in the Community

This section discusses the main services and benefits society gains from stokvels. This discussion may also help further explain why such traditional institutions are still relevant to people.

The most important benefit of stokvels is their contribution to improving the saving culture in the community. Stokvels inculcate a saving culture that can be optimised and used to mobilise savings in poor countries. Saving is the single most important device to emancipate people from poverty. As Hutchison observes, stokvels "harness financial discipline to provide a mechanism of wealth creation for members."[87] It must, however, be noted that stokvels do not substitute formal banking services but complement them by filling a gap. Ardington et al. summarise this as follows:[88]

> In South Africa, stokvels, burial societies, and Village Banks are natural community partners for such a scheme. The decentralized management and ownership structure of these organizations decreases the risks of adverse selection and moral hazard associated with insurance provision in the low-income market.

Stokvels play a decisive role in implementing financial inclusion policies.

> Achieving sustainable and inclusive development in the financial sector goes hand-in-hand with improving access to financial services, particularly for the poor, and vulnerable.[89]

Mashigo and Schoeman indicate that stokvels are filling a gap in the financial market by providing mutual insurance services, smoothing income and consumption among the poor, and providing social capital needed to access credit from friends.[90] Stokvels serve the poor, who formal financial institutions do not serve. Therefore, there is no direct competition between the banks and stokvels. Banks and policymakers have recently recognised the positive role that traditional institutions can play in improving inclusive finance, and they have started strategising to work with them. "The stokvel market is a prime area of focus for the major banks in South Africa."[91]

Hutchison summarises the link between the formal sector and stokvels stating that:

> Banks and retailers drain capital from the informal economy into the formal economy through their interaction with stokvels, but in a way which proves symbiotic and mutually beneficial.[92]

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[87] Hutchison (2020), p. 26.

[88] Ardington et al. (2004), pp. 604–640.

[89] Lukhele (2018), p. 1.

[90] Mashigo and Schoeman (2010).

[91] Lukhele (2018).

[92] Hutchison (2020), p. 18.

Researchers have also indicated the possibility of using stokvels to address the lack of universal health insurance coverage. Research by Shale, for example, emphasises the potential of burial societies for minimising the burden of flooding and other environment-related risks.[93]

Stokvels have also attracted the attention of retailers, and as a result, many companies are working hard to provide special offers to stokvels who buy their products. Stokvels have huge purchasing power. The retail market recognises this opportunity and provides different models to accommodate the nature and interests of stokvels. Retailers provide services not provided to individual consumers because stokvels help them to expand their markets. Lappeman et al. summarise some of the services that retailers provide:[94]

> Retailers that successfully attract stokvel groups year after year have been found to have developed unique business models tailored to the stokvel needs. These include their own storage space, a consistent payment system with a built-in additional discount from the bulk buying desk, a team dedicated to handling stokvel needs, a free transport system close to the homes of stokvel members, and, in some instances, assistance in dividing up bulk grocery orders.

Schulze has identified the following main advantages of participating in stokvels in South Africa: (1) They increase household savings, thereby creating small capital; (2) They are flexible and accessible, meeting the needs of people to save on a small scale; (3) They provide an affordable loan for consumption as well as for businesses; (4) "They serve as socialising mechanisms for converting peasants into 'traders' as far as their attitudes towards the use of money are concerned;"[95] and (5) They inculcate a saving culture.[96]

Using the knowledge and experience accumulated from time immemorial, Stokvels helps improve efficiency in society by promoting a coordinated response to community problems.[97] Verhoef explains that "stokvels have a definite multiplier effect in the economy by keeping money in the informal sector."[98] In urban areas, stokvels also help to bridge ethnic differences in society as they are commonly formed based on workplace or neighbourhood relations rather than within ethnic group connections.[99] Furthermore, stokvels promote the principle of Ubuntu. They have institutionalised and transformed the abstract concept of Ubuntu into something that can be "seen" in the eyes of the young generation. Verhoef, in her research report, indicates that stokvels are both economic and social institutions that "rely on Ubuntu to reduce the impact of fluctuations in income."[100]

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[93] Shale (2014), pp. 256–265.

[94] Lappeman et al. (2020), pp. 1–30.

[95] Schulze (1997a), pp. 18–29.

[96] Schulze (1997a), pp. 18–29.

[97] Mashigo and Schoeman (2010).

[98] Verhoef (2001), p. 264.

[99] Mashigo and Schoeman (2010).

[100] Verhoef (2001), p. 264.

Some researchers prefer not to link Ubuntu with stokvels because the latter require reciprocity that may not be in harmony with the principle of Ubuntu.[101] However, it must be noted that the requirement for repayment is so important to maintain the whole. In communal societies, the whole is much more important than the individual; the practice is not, therefore, in conflict with Ubuntu. Hutchison argues that Ubuntu is the underlying philosophy behind the stokvel model of relational contract:

> We also see here a form of Ubuntu which fits the business mold, rather than an utopian ideology which has largely been abstracted from the conventional market forces of commercial reality.[102]

However, there are critics of stokvels. The first critique is mainly against the extravagant spending and alcohol drinking associated with stokvels,[103] as commented on by one author:

> The rowdy social nature of stokvels has also created a very negative image of the body in many communities. Their activities are often indistinguishable from those of a tavern (typically a house where liquor is sold and consumed, generally accompanied by loud music).[104]

The most substantive and rational critique is on the limitation of stokvels to serve the poorest members of communities. There is skepticism over their ability to serve the poor because they carry reciprocity as the primary moral foundation, and the poorest of the poor may find it difficult to be included in stokvels. Kritzinger, for example, argues that:

> In the rotating income stokvels, often the poor will be mostly disenfranchised because the richer members of the stokvel will manipulate the order of the rotating income to receive the pot first.[105]

This means that, under such circumstances, the poor do not benefit from credit but rather receive back their savings as they are commonly the last recipient. After reviewing the literature in relation to saving, insurance and access to finance in South Africa, Ardington et al. concluded that:[106]

> Even more traditional options such as stokvels have not opened up options for the poor. Stokvels are accessed primarily by Africans and by those in the rural areas. However, the reviewed literature consistently shows that these access rates are very low across all income deciles. Furthermore, while stokvels are accessible to households in the middle of the income distribution, they do not appear to be accessible to households in the bottom decile.

[101] Bähre (2007).

[102] Hutchison (2019), p. 256.

[103] Kritzinger (1996), pp. 109–130.

[104] Kritzinger (1996), pp. 109–130.

[105] Kritzinger (1996), pp. 109–130.

[106] Ardington et al. (2004), pp. 604–640.

Stokvels are also being called upon by many researchers and social workers to focus on investment rather than on consumption. Stokvels are currently using savings for consumables rather than for investment; researchers recommend the focus shifts to investment.[107]

4.2 Unregistered Private Moneylenders (Mashonisas)

4.2.1 Introduction to Mashonisas

In South Africa, there are registered and unregistered private moneylenders. The unregistered moneylenders are known as mashonisas or skopers. "Mashonisa" means in the local language "a person who depletes or drains someone's financial resources through exorbitant interest rates."[108] Mashonisas are defined as:

> Neighbourhood moneylenders who are not registered with the National Credit Regulator as required by the basic legislation (the National Credit Act of 2005).[109]

Unregistered moneylenders commonly provide loans for a very short period, such as a week. The average interest rate is 30% to 50% daily or weekly.[110]

Mashonisas are diversified in terms of occupation and social status. Some mashonisas are co-workers in the same enterprises or offices with debtors, and others are former employees who used their savings to join the moneylending business after they left their jobs.[111] Some lenders are even government employees.[112] Generally, people who provide loans as mashonisas are not related to a specific social class or race; any person may enter the market as there are no entry barriers.[113] Based on empirical research in the town of Mamelodi, Mashigo reports that "53.3% of mashonisas are shebeen owners (private alcohol stores), 26.7% are formally employed, [and] 20% . . . own and operate spaza shops."[114] Nurses, teachers and policemen with no housing and transport expenses and no dependent families use their savings to become mashonisas by providing small loans to other co-workers and friends.[115] Mashonisas do not have a permanent place of business, and they operate from wherever it is convenient.

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[107] Arko-Achemfuor (2012), pp. 127–133.
[108] Mashigo (2012), p. 7.
[109] Wonga Finance SA (Pty) Ltd (2018), p. 16.
[110] Wonga Finance SA (Pty) Ltd (2018).
[111] Wonga Finance SA (Pty) Ltd (2018).
[112] James (2012), pp. 20–40.
[113] Wonga Finance SA (Pty) Ltd (2018).
[114] Mashigo (2012), p. 7.
[115] Krige (2019), pp. 403–429.

According to James, it is wrong to generalise South African mashonisas.[116] Some are very powerful and commonly lend more than US$100 and charge 50% interest monthly. These generally provide loans to salaried employees with regular income and confiscate borrowers' ATM cards.[117] Others are small-scale loan providers who offer loans for less than US$30 and charge about 15% interest per month.[118] Most of the mashonisas that provide only small loans are less strict in calculating interests and mainly depend on trust and social pressure to collect repayments for the debt. Large- and small-scale lenders do not compete because large-scale lenders focus on middle-class employees. In contrast, small-scale lenders provide loans mainly considering long-term relationships. With the latter type, lenders may become borrowers and vice versa. Isaksson argues that as reciprocity is the underlying principle of small-scale loans, today's debtor is expected to provide credits to their lender in the future if their financial positions are reversed.[119]

From his ethnographic research, Krige showed that mashonisas prefer to provide small loans to many borrowers rather than large loans to one; they feel instinctive that it will be more difficult to collect a large repayment and borrowers are more likely to report to the police. He states:[120]

> It was risky for him to lend large amounts of money – he knew from experience that larger loans were more difficult to recover. It was less risky for him to spread his capital over several smaller loans than investing it in fewer larger ones. Moreover, borrowers owing large amounts, with sometimes considerable interest added on top, were more likely to seek protection from the state or an outside party when struggling to repay a loan; a situation he preferred to avoid.

4.2.2 Reasons for Survival of Mashonisas in the Credit Market

Mashonisas are illegal in South Africa as the National Credit Act requires registration for all credit providers. Any unregistered moneylender is, therefore, considered illegal. However, they continue to operate in the community as people need their services for different reasons.[121] The mashonisas are sometimes the only lenders available for debtors, as the loans required are tiny and unattractive to formal

[116] James (2014) pp. 17–29.

[117] It is illegal under South African law to take ATM cards as a pledge.

[118] Research in South Africa shows that a 30% interest rate for small-scale loans is the profit-making rate for formal microfinance institutions. Small-scale loans are, therefore, motivated not only by profits but also by other social interests such as supporting borrowers. See Mohane et al. (2000), pp. 730–738.

[119] Isaksson (2002).

[120] Krige (2019), p. 412.

[121] Wonga Finance SA (Pty) Ltd (2018).

sources.[122] Most individuals who provide loans in the neighbourhood know they are violating the law; however, they do not risk being caught seriously. They do not consider the law applicable to the small loans that they are providing in the community. They claim that the law does not work for the community people; this works only for big guys and prominent businesspeople.[123]

Research indicates that there are around 40,000 mashonisas that operate in South Africa.[124] It is argued that mashonisas are everywhere in the country, they operate openly in the community, and the community does not consider the services they provide as illegal or immoral. The number of mashonisas maybe even more significant than estimated based on empirical research.[125] Mashonisas are socially embedded; anyone with extra cash may become a mashonisas without facing public condemnation or any social pressure to stop practising. The formal laws, therefore, have a limited impact on the decision of an individual over whether or not to join the business.[126]

According to Siyongwana, most loans from unregistered moneylenders are used for consumption. Such loans are commonly provided using networks. The mashonisas tell friends and neighbours about their willingness to provide loans with interest. Those who use the service also usually introduce new borrowers to mashonisas.[127] Those who have introduced a new borrower to the moneylender are considered guarantors. A new client introduced by an existing customer to the creditor is called "Ihlahla." In Xhosa language,[128] This means "a branch;" new clients are thus considered branches from the one who introduced them to the creditor and who is obliged to ensure they behave appropriately and are capable of repaying their debts. If a new client fails to repay a debt, the one who introduced that person to the moneylender is responsible for paying on their behalf. As a matter of procedure, the introducer is first asked to pressurise the defaulted debtor to discharge their debts.[129] If the introducer fails to pressurise the debtor, they are responsible for repayment. Moneylenders also use borrowers' ATM cards as a pledge.[130] The moneylender then uses the card to withdraw whenever available in the defaulter's account, even without their consent. This is standard practice if the debtor has permanent employment with a monthly or weekly wage.[131] However, the National

[122] Mashigo (2012).
[123] Wonga Finance SA (Pty) Ltd (2018), p. 28.
[124] Wonga Finance SA (Pty) Ltd (2018).
[125] Krige (2019), pp. 414–415.
[126] Krige (2019), pp. 414–115.
[127] Siyongwana (2004).
[128] One of the official languages in South Africa.
[129] Krige (2019), pp. 414–115.
[130] Torkelson (2020) pp. 1–11. This research paper presents how credit providers use the electronic payment system to maximise profit by reducing or avoiding their risk. The system denies debtors the possibility of renegotiating or delaying payments to creditors, as creditors control their incomes.
[131] Torkelson (2020), pp. 1–11.

Credit Act (NCA) expressly prohibits seizing ATM cards, identity cards, or bank books as collateral under Section 90.

Most of the borrowers who use these moneylenders' services are from the black community. They have diversified sources of income including from informal trade, employment in the informal sector, wages from factories, salaries as permanent employees of the civil service sector and some also receive pensions.[132] In particular, black civil servants employed by the expanding bureaucracy and government enterprises have often indulged in a new lifestyle that they cannot afford. Those who work for enterprises or government with regular incomes are also challenged to balance their incomes with increasing living and other expenses.

In this way, various members of the black community, including those who have regular income, fall into a debt trap.[133] The employees with regular income also have access to credit from formal sources but still seek more credit from mashonisas to meet their obligations towards the formal financial institutions.[134]

Expenses for wedding ceremonies (that are sometimes considered profligacy by the community), buying a house with a mortgage, buying furniture, and sending children to schools and colleges are some of the reasons forcing salaried individuals to look for additional loans from the informal credit markets, in addition to the credit they commonly also take from formal sources. As Krige notes:[135]

> The largest pool of his clients were in fact police officers and nurses who were not able to keep up with the repayments on their "bond" houses. These borrowers resorted to borrowing expensive credit in the underground credit market so as to pay off house loans in the formal sector. They were of course also trying to avoid being blacklisted by the powerful (and then largely unregulated) credit bureaus while risking the consequences of not repaying loans in the underground credit market.

4.2.3 Mechanisms of Debt Collection

The enforcement mechanism moneylenders use concerns policymakers and human rights defenders. Mashonisas have been criticised for using physical power to beat or kill defaulting debtors and for confiscating household equipment forcefully.[136] However, research based on interviews with both borrowers and mashonisas suggests that the use of physical force is rare.[137] The same research claims that they are not totally uninhibited; social factors limit their freedom to do whatever they would like.

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[132] Krige (2019), pp. 403–429.

[133] James (2012), pp. 20–40.

[134] Krige (2019), pp. 414–115.

[135] Krige (2019), pp. 414–415.

[136] Siyongwana (2004).

[137] Wonga Finance SA (Pty) Ltd (2018).

> They need a social license to operate and are embedded in circumstances where communities, especially local leaders, are well positioned (and known) to mediate disputes.[138]

Krige confirms that sometimes police officers enforce usury laws, commonly acting as mediators to solve disputes between mashonisas and debtors.[139] Borrowers and lenders are so close that they value their relationships. Moreover, both parties attach great value to their goodwill in the community at large; hence, they do their best to be perceived as faithful and trustworthy among friends and relatives.[140] Mashigo points out that mashonisas mainly use written contracts. Loyalty, trust, and reputation within the community are important traits that mashonisas want to preserve. Krige emphasises the importance of reputation for mashonisas as follows:[141]

> Such a reputation would not just reduce his potential clientele in a neighborhood where other lenders also operate, but could result in existing clients refusing repayment as a group. Moreover, as the practice is embedded in neighborhoods where values and practices are regulated by social perceptions, reputations, and the possibilities of witchcraft accusations if not community action, lenders do not want to make enemies.

Mashigo argues that it is difficult to regulate mashonisas given the social relation and the connection between lenders and borrowers, and suggests a different approach be applied to protect debtors.[142] On regulating mashonisas, Mashigo remarks that:

> . . .of importance is how to maintain the social connections which justify and confirm the fact that mashonisas have comparative advantage over formal financial institutions in providing finance (credit) to the households.[143]

This opinion seems to be shared by Krige who argues that although the government and other actors have attempted to bring the money of the poor into the formal system, local communities are reluctant to replace the "various practices they have developed over time to deal with individual, household and community financial managements" by modalities the formal and regulated sectors offer.[144]

Siyongwana's research also revealed that debtors introduced by guarantors are more likely to pay their debts than those who borrow by pledging their ATM card or working through paid agents.[145] Borrowers who pledge their ATM cards sometimes try to avoid paying their debts by cancelling the ATM card and requesting a new one from their bank. To strengthen their claim over the debtor, moneylenders usually ask

[138] Wonga Finance SA (Pty) Ltd (2018), p. 31.
[139] Krige (2019), pp. 403–429.
[140] Wonga Finance SA (Pty) Ltd (2018).
[141] Krige (2019), p. 413.
[142] Mashigo (2012).
[143] Mashigo (2012).
[144] Krige (2019), p. 409.
[145] Siyongwana (2004).

for an ATM and an identity card.[146] Banks need identity cards to issue new ATM cards, so creditors holding identity cards prevent the issue of new ATM cards and thus prevent debtors from evading repayments. A debtor must first pay their debt to the moneylender before the moneylender returns their identity card. James analysed debtors' diaries and, from this research summarises the practice of mashonisas holding ATM and identity cards against loans:[147]

> ... arrangements involve a combination of willing engagement and resentment by borrowers. Lenders ask them for their ATM cards as loan security. After withdrawing the money owed to them on payday, lenders return these to their owners. Whereas banks and regulated lenders require a "pay slip" before agreeing to offer credit, informal lenders do the equivalent after the event by taking the borrower's card and withdrawing the money owed to them directly from the bank. Typically, borrowers, shorter of money than previously, then borrow again, once again voluntarily yielding up their ATM cards. When borrowers nonetheless tried to escape by canceling their ATM cards at the bank and applying for new ones, lenders, aware that it is impossible to get a new ATM card without an ID (identity) book, retaliated by asking to keep borrowers' ID books as well.

4.3 Chapter Summary

Informal credit markets play a vital role in South African society, especially among the black community. These markets provide irreplaceable social and financial services, thereby playing an important role in the country's economy. Moreover, they maintain and enhance the community's social cohesiveness. They bridge the societal gaps caused by new social and economic conditions in the country.

Although all stokvels may not have similar forms and structures, they are defined broadly as institutions voluntarily established by a group of people to provide social and economic services to their members. "Stokvel" is a general umbrella term for different institutions. Specific institutions include burial societies, gooi-goois, grocery stokvels, and investment stokvels. They are all commonly referred to as stokvels, although they have different objectives and organisational structures. In Ethiopia, there is no such general common name that gathers the institutions under one common taxonomy. Iddirs are similar to burial societies. It is interesting to note that in both Ethiopia and South Africa, both large and small Iddirs (burial societies) exist. The large ones provide a comprehensive service to society during bereavement; they have a permanent and well-organised leadership with negotiated and predetermined bylaws. They also somehow follow a less pragmatic approach in their decision-making process. They provide their members with the service funeral insurance companies provide in modern society. The small burial societies/Iddirs provide a limited service to their members and with ad hoc structures, only coming together when there is a death in the community.

[146] James (2012), pp. 20–40.
[147] James (2014), pp. 17–29.

The gooi-goois are similar to Eqqubs in Ethiopia. These both collect a specified amount of money from members and then pay a lump sum to each member in rotation. However, there are some noticeable differences. Paying interest never happens in Eqqubs, whereas some gooi-goois pay interest to their members. Eqqubs commonly use a lottery system to determine the priority of payments to members but not auctions whereas an auction system is used in gooi-goois. Another important difference is that gooi-goois gather in rotation at members' houses, with the host providing food and drink for everyone, and collecting the money contributed by members on that date. The rotation of meeting places is more similar to Mahbers than Eqqubs in Ethiopia. Eqqub members commonly meet in one place throughout the Eqqub cycle.

Although unknown in Ethiopia, Grocery stokvels may be important organisations from which Eqqubs and Iddirs in Ethiopia could learn. Iddirs, in particular, could use their strong structures to bargain with suppliers for better prices for basic goods and services for their members. Some Iddirs in Ethiopia are allowed by local administrators to act as consumer associations; they, therefore, supply basic household goods to their members. However, this is not widely practised because official laws impose restrictive administrative requirements; this excludes Iddirs from participating in the supply of basic goods to their members.

Recently, some Eqqubs have evolved to be structurally similar to the high-budget stokvels of South Africa. This similarity emanates from having been started by individuals with high social status and strong economic leverage among members. The leaders of similar Eqqubs in Ethiopia are well rewarded for their services as leaders of the Eqqubs. In high-budget stokvels, however, the leaders have autonomy in deciding payment schedules. Eqqub leaders do not have such powers; payment schedules are decided by a lottery in the presence of all members. Recently, some Eqqubs in Ethiopia emerged which were similar to investment stokvels. Members were paid in (predetermined) kind. However, such Eqqubs were not accepted by society and failed to win public trust; some failed to keep their promises or to repay collected money. Generally, the function of stokvels in society is similar to that of Eqqubs and Iddirs in Ethiopia. The literature review concerning stokvels and mashonisas shows that they provide services similar to those provided by the informal credit markets in Ethiopia.

Another important point when comparing stokvels with Eqqubs and Iddirs is the lack of national or even regional associations in Ethiopia that serve as umbrella associations for these institutions. In South Africa, the National Stokvel Association of South Africa (NASASA) works to protect the interests of stokvels.[148] The association conducts research to help institutions learn from each other and provides important data and know-how to other stakeholders, who are interested in collaborating with these institutions. The banks in South Africa also provide specially tailored services for stokvels and compete to provide the best services. In Ethiopia, there are no such well-organised efforts, particularly not from top management of

[148] See the website of the association here: https://nasasa.co.za/.

banks, although some branch managers collaborate with Iddirs and Eqqubs; managers try to lure Eqqubs and Iddirs to open savings accounts in their branches. Attention from researchers and scholars to Eqqubs and Iddirs is also lacking in Ethiopia, with very little national level study of Iddirs or Eqqubs. In comparison, the literature on stokvels in South Africa is comprehensive, providing input for policymakers and other stakeholders.

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Chapter 5
Regulation of Informal Credit Markets in South Africa

5.1 Regulation of Small and Micro Credit Markets in South Africa

5.1.1 Introduction to Legislative History of Small-Scale Credit

The South African legal system is so mosaic that it is considered the best example of a blended legal system that has evolved from indigenous African laws, Roman-Dutch laws, and common law.[1] Under the common law tradition, the loan contract is largely left to the parties. The courts applying common law principles have shown limited interest in intervening in the credit market by frequently rejecting debtors' attempts to invalidate credit agreements considered unfair due to high interest rates.[2] The courts, however, were using the principle of *in duplum* that prevents creditors from claiming interest more than the principal debt. The *in duplum* principle provides that accumulated interests in whatever form cannot be more than the principal debt, and thus, a creditor cannot collect an interest that is more than 100% of the principal from the debtor. The *in duplum* principle has its roots in Roman law and is accepted within the common law system. The principle of *in duplum* is included in the NCA in a more elaborated and broader context.[3] The NCA provides that any interest or other charge accumulated during the loan period cannot exceed the unpaid principal amount.

[1] Hahlo and Kahn (1968).

[2] Vessio (2016).

[3] Section 3(5) of NCA. *Nedbank LTD and others v. National Credit Regulator and Another*, 2011 (3) SA 581 (SCA).

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G. Yimer, *The Nexus Between Legal Pluralism and Inclusive Finance*,
https://doi.org/10.1007/978-3-031-71653-9_5

5.1.1.1 1926 Usury Act

The 1926 Usury Act was the first national law that tried to control interest rates in South Africa.[4] The Usury Act provided a maximum interest rate that creditors could charge, and it imposed a penalty for charging more than the prescribed rate. The Usury Act also provides that any interest payments higher than the legal maximum rate should be repaid to the debtor. The Act did not apply to banks, and its application was limited to small-scale loan providers in the microcredit sector.[5] The Usury NCA was mainly intended to cap interest rates in the informal credit markets. Its main objective was to curb the exorbitant interest rates of non-financial institutions.[6]

However, as Chitimira notes, the Usury Act failed to curb interest rates because it did not address the reasons economically disadvantaged people take on loans with exorbitant rates.[7] The people who seek credit from the informal credit markets are the unbanked poor who are denied access to financial services from formal financial institutions. The poor need access to affordable credit for many reasons. The fluctuating income they earn from the informal sector makes credit vital to smooth consumption. The non-bank actors who provide the credit are assumed to have much social and economic power to impose onerous contractual terms and exorbitant interest rates. Interest caps alone cannot solve the problem of exploitation of debtors by moneylenders unless the root problems that inhibit the poor from accessing affordable financial services are solved.

Although the Usury Act tried to protect debtors by imposing a legal maximum interest rate, creditors avoided the effect of the 1926 Usury Act by shifting gains from interest rates to fees not regulated by the Act. The Ministry of Finance established a committee to evaluate the impact of the Usury Act; the committee reported that the Act was avoided by creditors using skewed contract agreements. Creditors dictated the terms of the contract, hiding the exorbitant interest rates charged. Debtors who signed the contracts had no other options.[8] Following the report, the Ministry initiated the Limitation and Financial Disclosure and Charges Act 73 of 1968. The 73 Act of 1968 was meant to address emerging problems and to avoid the gaps in the Usury Act of 1926. It was later renamed the Usury Act 73 in 1968.[9]

[4] Otto (2010), pp. 257–273.

[5] Vessio (2016).

[6] Mohane et al. (2000), pp. 730–738.

[7] Chitimira (2020), pp. 269–284.

[8] Chitimira (2020), pp. 269–284.

[9] Chitimira (2020), pp. 269–284.

5.1.1.2 Usury Act 73 of 1968

The Limitation and Financial Disclosure and Change Act also failed to protect customers and pave the way for affordable and reasonable credit for the economically disadvantaged segment of society. The introduction of the Act discouraged lenders from granting loans to small-scale borrowers, further excluding the poor from the credit market. The Act encouraged lenders to exclude high-risk creditors who could not provide quality collateral.[10] It only provided maximum legal interest rates without offering any alternative solutions to the poor. People deprived of access to affordable credit from formal financial institutions are forced to look for harsher credit terms in the informal credit markets.[11]

This shows that the complex problem in the credit market cannot be solved by imposing maximum legal interest rates. The authorities, therefore, amended the Usury NCA in 1992 to exclude loans of less than 600 Rand from the Act's scope.[12] The microcredit industry expanded quickly, and credit-providing shops flourished in cities, becoming a multimillion-dollar industry. The Department of Trade and Industry introduced a new exception gazette notice (No. 20145) in 1999 and established a regulatory office. The new notice embodied four main features. It expanded the exemption amount from 600 Rand to 10,000 Rand; it required registration of all credit providers and restricted the loan term to 36 months and interest rates to below 10 times the prime rate.[13]

5.1.1.3 Hire Purchase Act of 1942 and Credit Agreements Act 75 of 1980

The scope of the Usury Act was limited, dealing only with moneylending. It had no application in relation to credits extended in the form of the sale of goods or services. The Usury Act, therefore, provided no solution if parties in the contract mixed the sale of goods with credit. For this reason, the Hire Purchase Act was enacted in 1942. The Hire Purchase Act protected customers from onerous contractual terms imposed by sellers. Act 75 of 1980, the Agreement Act replaced the Hire Purchase Act to address new issues emerging as commerce and technology advanced.[14]

Dissatisfaction with the credit market and the majority of the black population not having access to finance forced the government to reform the credit market further. The Microfinance Regulatory Council (MFRC) was established in 1999 to investigate the problems in the credit markets and provide recommendations. The committee produced a document that showed the fragmentation of laws regulating the credit market. The Committee noticed that the existing legal framework did not provide the

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[10] Van Heerden and Renke (2015), pp. 67–95.

[11] Vessio (2016).

[12] Vessio (2016).

[13] Mohane et al. (2000) pp. 730–738.

[14] Otto (2010), pp. 257–273.

required protection for customers in the credit market. The problem identified in the credit market could only be solved by introducing a new comprehensive law with the required legal and policy framework to improve access to credit, protect customers from reckless credits and minimise over-indebtedness.[15] Following the committee's recommendation, a bill was introduced in 2005 by Congress and signed by the President in 2006 as a law.[16]

The NCA includes many provisions that protect credit consumers. The NCA has followed a comprehensive approach to the problem of financial exclusion,[17] introducing proactive measures such as raising awareness, the right to obtain information, acquiring affordable credit, being advised, being protected from arbitrary incursion by creditors, and protection from humiliation and harassment by creditors, all aimed to promote the welfare of the debtor. The NCA also underlined that debtors must fulfil obligations for the health of the credit markets. As shown in the following sections, the NCA recognises creditors' right to be paid and to charge reasonable charges and interest for their services within the legal framework stipulated by law.

5.1.2 NCA 34/2005

The NCA 34 of 2005 is a comprehensive and detailed law that replaced the Credit Agreement Act and the Usury Act. The NCA renders South Africa an African country with a comprehensive and integrated legal framework dealing with consumer-to-consumer credits and small-scale loans. Schmulow suggests that "The NCA regulates the provision of consumer credit in South Africa, and covers every type of entity that extends credit: banks, micro-lenders, furniture and even clothing retailers."[18] The NCA provides a very broad definition of a credit agreement that almost brings under its ambit credit granting and credit contracts such as direct money loans, instalment sales of movables, leases of movables, sale of land, overdrawn check accounts, credit card accounts, the rendering of services and guarantees in connection with credit agreements and accounts with department stores.[19] However, the NCA is also criticised for its lack of clarity and its ambiguity. The South African Supreme Court of Appeal comments:[20]

> Unfortunately, the NCA cannot be described as the "best drafted Act of Parliament which was ever passed," nor can the draftsman be said to have been blessed with the "draftsmanship of a Chalmers." Numerous drafting errors, untidy expressions, and inconsistencies make its interpretation a particularly trying exercise. Indeed, these appeals demonstrate the

[15] Green and Sewnunan (2015), pp. 1757–5764.

[16] Act 34/ 2005.

[17] Renke (2011), pp. 208–229.

[18] Schmulow (2016).

[19] Otto (2010), pp. 257–273.

[20] *Nedbank LTD and others v. National Credit Regulator and Another*, 2011 (3) SA 581 (SCA).

> numerous disputes that have arisen around the construction of the NCA. The interpretation of the NCA calls for a careful balancing of the competing interests sought to be protected, and not for a consideration of only the interests of either the consumer or the credit provider.

The NCA has exempted stokvels from its strict regulations. Stokvels are defined in the NCA and can regulate their internal affairs using their bylaws. This implies that credit agreements within the stokvel structure are not subjected to the strict scrutiny of the NCA. The NCA avoided intervening in how stokvels practised by leaving them unaffected.

The sections below discuss the objectives and purposes of the NCA, the institutions the NCA has established, the policies the NCA has introduced to protect creditors, the regulation of credit agreements and the dispute resolution process it provides. The main objective is to discuss the merits and limitations of the NCA in enhancing access to finance and protecting credit consumers based on the relevant literature.

5.1.3 The Purpose NCA

The preamble of the NCA expresses its major objectives as follows:[21]

> To promote a fair and non-discriminatory marketplace for access to consumer credit and for that purpose to provide for the general regulation of consumer credit and improved standards of consumer information; to promote black economic empowerment and ownership within the consumer credit industry; to prohibit certain unfair credit and credit-marketing practices; to promote responsible credit granting and use and for that purpose to prohibit reckless credit granting; to provide for debt re-organization in cases of over indebtedness; to regulate credit information; to provide for registration of credit bureaus, credit providers, and debt counseling services; to establish national norms and standards relating to consumer credit; to promote a consistent enforcement framework relating to consumer credit.

The preamble of the NCA implies that the legislature has multifaceted objectives. However, the underlying objective is to create a credit market system that serves all citizens equitably and fairly. The NCA encourages creditors to provide competitive and affordable credit to small-scale creditors, and at the same time, the NCA imposes strict obligations on creditors to be aware of their customers. Creditors must collect data about their debtor to make sure that he/she can repay the debt. The creditor must also make all contract terms understandable to the debtor and provide all required information to make rational decision-making possible. Section 3 stipulates that the purposes of the NCA:

> . . .are to promote and advance the social and economic welfare of South Africans, promote a fair, transparent, competitive, sustainable, responsible, efficient, effective and accessible credit market and industry, and to protect consumers.

Renke states four points as the main objectives of the NCA:

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[21] The National Credit Act 34/2005.

> (i) to avoid and control over indebtedness of consumers; (ii) to discourage reckless credit granting by credit providers; (iii) to create awareness among consumers; and (iv) to introduce legal mechanisms that protect debtors against onerous credit terms by rendering disclosure of standardized information mandatory.[22]

The Court of Appeal also enunciated in one of its decisions as follows:[23]

> The objectives of the NCA include encouraging responsible borrowing, avoidance of over indebtedness, and fulfilment of financial obligations by consumers. It seeks to promote equity in the credit market by balancing the respective rights and responsibilities of credit providers and consumers, and promotes responsibility in the credit market by providing for a consistent system of debt restructuring, enforcement, and judgment which places priority on the eventual satisfaction of all responsible consumer obligations under credit agreements.

The NCA also provides detailed strategies that are designed to achieve its objectives. Some of the strategies are the following:

1. Promoting the development of a credit market that is accessible to all South Africans, particularly to those who have historically been unable to access credit under sustainable market conditions
2. Encouraging responsible borrowing by creating awareness, by making the credit market transparent, and by discouraging creditors from providing reckless credit
3. Promoting equity in the credit market by balancing the respective rights and responsibilities of credit providers and consumers and protecting customers from device and fraud
4. Addressing and preventing over indebtedness of consumers so that customers discharge their financial obligation
5. Providing for a consistent and accessible system of consensual resolution of disputes arising from credit agreements; and
6. Providing for a consistent and harmonised system of debt restructuring, enforcement, and judgment, which places priority on the eventual satisfaction of all responsible consumer obligations under credit agreements.

The NCA recognises the systemic exclusion of the black community from the formal financial sector in the past, and it aspires to rectify this historical injustice by providing a favourable regulatory environment. The NCA does not focus on penalising creditors for exorbitant interest rates. Rather, it recognises that interest rate ceilings discourage creditors from providing loans to small-scale borrowers, thereby ultimately making financial inclusion challenging. The NCA tries to promote a fair, transparent and responsive credit market. Hence, it focuses on raising awareness in society and protecting debtors from mischief by promoting transparency and accountability in the credit market.

Moreover, the NCA requires creditors to refrain from providing loans without assessing the ability of the borrower to repay the loan. This is based on the "let the creditor be aware" principle to avoid providing loans that aggravate the financial

[22] Renke (2011), pp. 208–229.

[23] *Nedbank LTD and others v. National Credit Regulator and Another*, 2011 (3) SA 581 (SCA).

conditions of the debtor. The creditor must explore the borrower's financial conditions and ensure that (at least at the time the contract of loan is signed) the debtor has the ability and means to repay the debt. The creditor should also provide clear information about the contract terms and ensure they are clear and understandable to the debtor.

Brits argue that punishing the creditor is not the main objective and is only incidental; the punishment element is awarded to the tribunal, which may cancel the credit provider's registration.[24] As Schraten notes, the NCA embodies the principle of the sanctity of contract and enhances a competitive credit market, providing opportunities for disadvantaged groups to benefit.[25] He indicates two positive features of the NCA. First, it encourages credit providers to become formal financial institutions by registering and protecting creditors. Second, the NCA has provided a flexible interest rate cap, encouraging institutionalised credit providers to provide unsecured credit to attract customers to formal credit markets.[26] The NCA also provides extensive and detailed protection for credit consumers, as discussed below.

5.1.4 Institutions Established by the NCA

The NCA has established two important government organisations, The National Credit Regulator (NCR) and The National Consumer Tribunal, to ensure its efficient and effective implementation. The power, structure, function, and jurisdiction of these institutions are discussed here.

5.1.4.1 National Credit Regulator (NCR)

The NCR is an independent institution that operates only according to the Constitution and the law.[27] The Regulator has a national-level jurisdiction, and it must carry out its duties based on impartiality and transparency and be free from any influence.[28] The NCA does not allow other government bodies to intervene in the affairs of the Regulator and requires them to provide the support necessary to

[24] Brits (2018).

[25] Schraten (2014), pp. 1–20.

[26] Schraten (2014), pp. 1–20.

[27] National Credit Act Section 34 of 2005, Section 12 (c).

[28] Provinces may establish their own provincial credit regulator to regulate the credit market in their perspective province and the national credit regulator has the mandate to cooperate with them in discharging its activities. Section 17 of the act provides detailed provisions on what matters and how the national credit regulator may cooperate with provincial credit regulators.

accomplish the Regulator's duties.[29] The NCR is governed by a board that may consist of 11 persons with voting rights and one member who is also the Chief Executive Officer and becomes an *ex officio* board member. Three of the board members are appointed by the Finance, Housing Matters, and Social Development cabinet. The minister responsible for credit consumers has the mandate to appoint the chairperson, the deputy chairperson, and five more members to serve on the board of the NCR.[30] The minister is also mandated to appoint the NCR's Chief Executive Officer.

The NCR has four primary responsibilities that are expressly assigned in the NCA.

1. To develop accessible credit markets. The regulator must endeavour to promote a fair, transparent, competitive, sustainable, responsible, efficient, effective, and accessible credit market for those historically disadvantaged, with low income, or in remote and unpopulated areas. This is a general obligation that the regulator endeavours to achieve by taking different measures or by initiating various measures to be taken by the government. The regulator also has the power to set the conditions for credit to be qualified as a development credit agreement and conducts surveys of credit availability, price, market conditions, market share, market conduct, and competition within the consumer credit market. The regulator is also mandated to create a favourable environment for small businesses to benefit from the credit market.
2. The National Regulator has the mandate to register credit providers, credit bureaus, and debt counsellors. In 2020, there were 78,837 registered credit providers.[31] The regulator also has a legal mandate to suspend or cancel the registration of these institutions when they breach the provisions of the NCA. One of the most important elements of the NCA is that it requires registration for businesses and offices that take part in the credit market and they are regulated by the National Regulator. The NCA has imposed on credit providers an obligation to be registered. The NCA provides that any person who provides credit with at least 100 different credit agreements individually or in conjunction with others or anyone who provides an amount that exceeds the threshold to be determined by the relevant ministry as a loan to one or many debtors must be registered as a credit provider. The NCA provides that the threshold to require registration shall not be less than 500,000 Rand. The NCA further provides that a person who should be registered as a credit provider according to the provisions of the NCA, and who nevertheless fails to register may not provide any credit, and any agreement entered into with debtors is unlawful and void. In *Du Bruyn and others* v. *Karsten,* the Supreme Court of Appeal decided that even a single credit agreement between persons, who had an existing relation before the credit

[29] The National Credit Act 34 of 2005, Section 12.

[30] Section 19 of the National Credit Act.

[31] National Credit Regulator Report for 2019–2020,

agreement, would be void under the NCA if the credit provider was not registered as per the requirements of the NCA.[32] The court decided that to be a frequent participant in the credit market is not a condition for registration and any credit agreement that is made with full power of negation shall be considered as an arm's length transaction that should be regulated according to the NCA.

The NCA requires all persons who generate data in relation to credit applications, credit agreements, payment history, and other information required to provide the business of credit bureaus, to be registered. The person who applies for registration as a credit bureau must demonstrate the required competence and qualifications. The NCR must be convinced that the applicant can carry out the obligation efficiently and fairly. The bureau must also introduce procedures to ensure that consumers are provided with a mechanism to table their complaints to the bureau whenever they have an objection to a decision of the bureau. The NCA also provides that all debt counsellors must be registered and no person shall provide such service without registration. The NCA has outlined the application procedure for registration, and the general requirements that a debt counsellor must meet to be registered by the National Credit Regulator.

3. The Regulator has the power to enforce the NCA by facilitating discussion between consumers and credit providers or credit bureaus. The Regulator has no mandate to adjudicate disputes but can encourage parties to solve their disputes amicably. The Regulator has the power to monitor the consumer credit market, to receive complaints on violations of the NCA, to investigate and prosecute credit providers, credit bureaus, and credit consultants that violate the provisions of the NCA or directives or regulations that emanate from the NCA. The Regulator has the power to refer suspicious anti-competition activities to the Competition Commission. In the 2019–2020 report, the Regulator referred 64 cases to the National Credit Tribunal and to the Higher Court.[33] The NCR also reported that it carried out raids on small credit providers that retained the identity cards, bank books, visa cards and other documents of debtors, which they were not allowed to hold as security. According to the report, a total of 2601 personal items of consumers were recovered, and 10 criminal cases were filed.[34]
4. Research and public information: The NCR is responsible for increasing knowledge of the nature and dynamics of the consumer credit market and industry, and to promote public awareness of consumer credit matters, using the powers and methods provided it by the law National Consumer Tribunal

The NCA established a National Credit Tribunal (NCT) that adjudicates disputes arising in relation to the NCA, which has jurisdiction throughout the country. The President can appoint the chair and up to 10 judges to serve in the tribunal. The tribunal has jurisdiction to decide on applications made to it based on the NCA. It

[32] *DU Bruyn and Others v. Karsten*, 2019 (1) SA 403 (SCA).

[33] National Credit Regulator Report for 2019–2020.

[34] National Credit Regulator Report for 2019–2020.

can make any order provided for in the NCA regarding such an application, or (ii) it can examine allegations of prohibited conduct and determine whether prohibited conduct has occurred and, if so, may impose a remedy provided for in the NCA. The tribunal may also grant an order for costs in terms of Section 147 and exercise any other power conferred on it by law.

Section 142 of the NCA provides that:

- the tribunal must conduct its hearing in public
- in an inquisitorial manner
- as informally as possible and
- in accordance with the principle of natural justice

5.1.5 Consumer Credit Policy

Protecting credit consumers is one of the main objectives of the NCA. Chapter 4 of the NCA embodies important rights and protections to credit consumers. The NCA has introduced mechanisms that protect creditors from unfair and unacceptable practices. Brits argues that consumer protection is considered in the NCA as an important element of the economic empowerment mechanism to promote social welfare:[35]

> Preventing the granting of unaffordable loans . . . contributes to the protection of consumers' inherent human dignity and it instils prudential integrity in the broader financial industry. Hence, the first intended effect of these remedies is to discourage credit providers from concluding reckless credit agreements with consumers and, to this effect, to encourage them to do the required pre-agreement assessments. The second intended effect is to provide debt relief for consumers who have suffered prejudice as a result of entering into a reckless credit agreement.

Green and Sewnunan identify the following rights that the NCA has established:

> (i) The right to apply for credit; (ii) The right to know why credit was refused; (iii) The right to receive information in an official language; (iv) The right to information in a plain and understandable language; (v) The right to receive documents; and (vi) The right to confidentiality.[36]

The NCA recognises that every person, who has legal capacity to enter into a legally binding contract, has the right to apply for credit and the credit provider must not discriminate against any person.[37] The NCA sends a clear message to credit providers that they must act reasonably and avoid reckless lending. Therefore, the NCA continuously reminds creditors that they should provide loans only to those who are qualified to take a loan.

[35] Brits (2018).

[36] Green and Sewnunan (2015), pp. 1757–5764.

[37] The NCA, Section 61 and The Constitution of the Republic of South Africa, Section 9(3).

The NCA allows creditors to develop criteria and standards to evaluate the creditworthiness of potential clients. Creditors are expected to evaluate the conditions of the person who applies for credit without discrimination. The credit provider must adhere to the relevant sections of the law in assessing the applicant's creditworthiness, determining the credit's cost, and determining the terms of the contract. Protecting against discrimination and unfair practices is not limited to credit providers. Credit bureaus, credit counsellors, and other agents must operate based on the principles of fairness and non-discrimination. The customer has a right to seek a written explanation for the rejection of an application for credit, the rejection of the application to renew a credit agreement and the unwillingness of a credit provider to increase a credit limit.[38] These are important rights that help consumers to assess whether there has been discrimination and unfairness in the decision of credit providers.

The consumer has the right to receive documents in one of the official languages they understand, and the terms of the contract and other documents must be written in plain language that the consumer understands. The terms and language used must consider the consumer's subjective conditions. The contract terms must be designed to consider the consumer's literacy level and credit experience. The NCR is legally empowered to develop guidelines for evaluating the clarity and quality of documents a credit provider uses. The NCA indicates that the NCR shall consider efficiency in developing the guidelines in addition to clarity and accessibility to consumers.[39]

A consumer can seek and investigate any record or information held by a credit provider, credit bureau, or the national credit registry. A credit provider must provide consumers with any information it reports to a credit bureau. The customer has a right to challenge the accuracy of any report or record held about their financial position, and the report must be corrected immediately. The cost of correcting the error must be covered by the person who reported the incorrect information.[40]

The NCA prohibits credit providers from market practices that induce a person to enter a credit agreement without consideration. The NCA also provides important limitations on a credit provider's offer. For example, a credit provider may not lure a customer for credit by visiting them at home or the workplace. The NCA also provides terms and conditions regarding advertisements for credit to avoid undue influence on customers.[41]

Another important protection that the NCA provides for consumers is protection from credits that are reckless on the part of the creditor; this aims to protect customers from becoming over indebted due to unchecked credits that negatively affect their financial, social, and economic circumstances. The NCA is based on the principle that credit must be extended by credit providers when it is proved by a

[38] NCA, Section 62.

[39] NCA, Section 64.

[40] NCA, Section 72(1).

[41] NCA, Section 76.

preponderance of evidence that the customer's economic condition enables them to repay all their debts.

The NCA recognises the possibility of mutual support among close relatives and family members in African communities and provides a wider definition of "financial means, prospects, and obligations." To this end, Section 78(3) of the NCA provides that the financial conditions of the customer's immediate relatives, as far as they have a custom of sharing incomes and economic burdens together, shall be considered. This is a very important consideration that considers African social and economic realities.

However, it is to be noted that certain funds are not considered in assessing the financial conditions of customers. In *NCR v. Aristoscan CC trading as JMK Cash Loans,* the National Credit Tribunal decided that child support funds and foster care social grants would not be considered as incomes in the assessment of the financial condition of the potential client.[42]

Section 79 (1) provides that:

> A consumer is over-indebted if the preponderance of available information at the time a determination is made indicates that the particular consumer is or will be unable to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, having regard to the consumer's financial means, prospects, and obligations and probable propensity to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is party, as indicated by the consumer's history of debt repayment.

Credit provided to an overindebted customer can be challenged in a court of law, and the court may declare the loan agreement void and unenforceable. Credit provided by the creditor without assessment of the debtor's understanding of the risks involved in the loan agreement and other conditions provided by the NCA is also considered reckless and can be invalidated by a court upon the debtor's application.

Section 80(1) provides that a credit agreement is reckless under two conditions: (1) The creditor failed to evaluate the conditions of the debtor to learn if the debt put the client in a further financial crisis or over-indebtedness; (2) If the creditor provides credit to the customer knowing that the customer has no clear understanding of the risks, costs, and the rights and obligations under the contract.

Renk argues that:[43]

> Section 81, probably one of the most important sections in the NCA, compels a credit provider first of all to do a three-part assessment before entering into a credit agreement with a consumer. Reasonable steps must be taken to determine the proposed consumer's general understanding and appreciation of the risks and costs of the proposed credit, as well as of the rights and obligations of the consumer under a credit agreement. In terms of the second part of the assessment, regard must be had to the proposed consumer's debt repayment history under credit agreements ... Thirdly, the proposed consumer's existing financial means, prospects, and obligations must be assessed.

[42] *NCR v. Aristoscan CC trading (JMK Cash Loans),* NCT/128380/2019/140(1).

[43] Renke (2011), pp. 208–229.

The NCA gives a debtor the right to request a debt counsellor to declare him or her an over-indebted debtor. The debtor may also require the counsellor to declare the credit reckless. After evaluating the application, the counsellor may declare the debtor over-indebted and suggest to the court the need for a decision to enable the debtor to perform the contractual obligation through rearrangement of the agreement. The counsellor may also suggest to the court that a credit agreement should be declared as reckless credit. The counsellor may act as a mediator and try to solve the problem by discussing the case with the credit provider and consumer and possibly restructuring the credit agreement. Counsellors have no legal mandate to decide on the issue other than providing recommendations to the court or the parties.[44]

Although the NCA tries to protect credit consumers from reckless lending and unfair practices, it has a clear message to borrowers that all obligations should be fulfilled per the contract. The NCA provides some mechanism of restructuring that may help the borrower to repay the loan. However, the NCA does not encourage default in any way, and it demands that borrowers fulfil their obligations to the creditor. As stated earlier, the credit provider must also consider the debt repayment history of the applicant and the financial means, prospect, and viability of the proposed business for which the credit is to be used. In this regard, the creditor must use the standard of preponderance of evidence to make assessments.

5.1.6 Consumer Credit Agreements

Section 90 of the NCA provides a long list of terms of a credit agreement that are considered unlawful by the NCA. The NCA prohibits agreements that defeat the NCA's purpose or deprive the consumer of rights embodied in the NCA. This general protection seems vital; courts can interpret any terms of the contract considering the general purposes of the NCA and may invalidate any term that negates the purpose of the NCA. The court, therefore, does not need to cite a specific section of the NCA to render a term of an agreement void if there is evidence that the contract terms contradict the purpose and the objective of the NCA. The Act also provides general protection to consumers against deceitful and fraudulent agreements and any terms of an agreement that override or deprive the consumer of the rights enshrined in the NCA.

In addition to declaring any terms of an agreement that negates the purpose and objective of the NCA as unlawful, the NCA further considers some specific agreements as illegal. The list of such unlawful agreements includes the following:

1. Acknowledgement by the consumer regarding the receipt of goods, services, or documents that have not been delivered

[44] NCA, Section 86.

2. Appointing the credit provider or any employee or agent of the credit provider as an agent of the consumer except when allowed by the NCA
3. Authorising any person acting on behalf of the credit provider to enter any premises for the purpose of taking possession of goods to which the credit agreement relates
4. Granting power of attorney in advance to the credit provider in respect of any matter related to the granting of credit in terms of the NCA
5. Undertaking to sign in advance any documentation relating to enforcement of the agreement, irrespective of whether such documentation is complete or incomplete at the time it is signed
6. Agreement to deposit with the credit provider, or with any other person at the direction of the credit provider, an identity document, credit, or debit card, bank account or automatic teller machine access card or any similar identifying document or device
7. An agreement to provide a personal identification code or number to be used to access an account.

The NCA further defines the kind of charge or fee a credit provider may impose on the consumer.[45] A credit provider may include the following charges in the credit agreement: an initiation fee, a service fee, interest, cost of insurance, a default administration charge, and collection costs. However, the NCA does not give a free hand to the credit provider to decide the amounts. In consultation with the NCR, the ministry is mandated to determine the maximum amount to be charged. The NCA stipulates that the ministry must give different rates for different sub-sectors in the credit market. The ministry is also required by law to consider the following issues, among others, in determining the rates;[46]

1. The need to make credit available to persons who are historically disadvantaged, low-income individuals, and communities in remote and isolated areas with low population density[47]
2. Conditions prevailing in the credit market, including the cost of credit and the optimal functioning of the consumer credit market
3. The social impact on low-income consumers.

The NCA bans unilateral modification of interest rates, the period of payment, or the calculation methods. Section 104 makes it clear that even contracts with variable interest rate agreements cannot be modified without giving notice to clients. This is an important protection for clients so that they will not be subjected to frequent modification of rates.

[45] NCA, Section 101.

[46] NCA, Section 105(2).

[47] NAC, Sections 105 and 13.

5.1.7 Dispute Settlement

The NCA includes a chapter that explains how disputes are to be resolved between a credit provider and a consumer. The NCA provides different options to the consumer, including applying to the NCR, initiating a case before the National Credit Tribunal (NCT), referring the case to the debt counsellor, submitting to the Ombudsman, applying to a Consumer Court, or an alternative dispute resolution agent. As stipulated in the NCA, we will discuss the role of an alternative dispute agent, the NCR, and the NCT.

Application to the alternative dispute agent is not mandatory, and the respondent may reject it within ten days. However, suppose the matter is considered by the NCT as a proper subject to be solved by the alternative dispute agent and the respondent's rejection is without good reason. In that case, the NCT may order the respondent to cover the cost. The NCA, therefore, encourages parties to solve their disputes using an alternative dispute agent, and unreasonable rejections are sanctioned by the NCT.

The dispute resolution agent may direct parties to the NCT or other appropriate adjudicators if the matter is considered unresolvable through the alternative dispute resolution process. In this case, the NCT may issue a certificate indicating that the agent cannot solve the matter. Section 135 of the NCA provides that if the parties to the dispute agree on the decision to be made with the assistance of the dispute resolution agent, the agent may record the decision in the form of an order and submit the same to the NCT or the court. The NCT or the court then considers the decision as the result of the disputant parties' consensus and approves the decision. An important consideration here is that the decisions proposed by the dispute resolution agent cannot be objected to by the NCR.

The NCR is also important in solving disputes and investigating complaints from parties in credit agreements. Under Section 136 of the NCA, not only parties but other persons can submit a complaint to the NCR regarding the alleged violation of the NCA. The NCR is legally mandated to initiate a complaint in its name. The NCR has broad power regarding how to handle complaints. It can dismiss frivolous accusations, which do not deserve investigation because they are not supported by facts or legal grounds. It can also refer complaints to other relevant offices if it considers the matter to be the jurisdiction of the NCT, the Consumer Court, or the Ombudsman. The NCR may investigate the case if it considers the matter under its jurisdiction and deserving investigation. The NCR has the power to call on any person and demand access to documents and recordings. If the NCR suspects there is a crime that needs to be investigated for prosecution, it may refer the case to the National Prosecuting Authority (NPA).

The NCT is another important player in resolving disputes in credit markets. Section 142 of the NCA provides that a tribunal must conduct its hearings in public in an inquisitorial manner, as expeditiously as possible, as informally as possible, and by the principles of natural justice. Section 143 allows the NCR and any other person with a material interest in the matter to participate in the hearing, forward questions to witnesses, and inspect documents presented in the trial. The fact that the

NCT is using fewer formal procedures, the preference for the inquisitorial approach, and allowing parties with material interests to participate in the process directly indicates that the NCA is trying to make the process more comfortable to credit consumers.

The NCT has the jurisdiction to give interim measures based on the criteria and standards stipulated under Section 149. The NCT must assess the evidence presented. Although the standard (i.e., preponderance of evidence, prima facie evidence or preliminary evidence) the court should apply in evaluating the evidence for interim measures is not expressly indicated, it is commonly a prima facie evidence required for provisional and protective measures.[48] The necessity of the interim measures to prevent irreparable damages or to preserve the purpose of the NCA must also be considered. The tribunal must also consider the balance of convenience in its decision, and it may allow the opponent to be heard unless this negates the purpose of the interim measure or unless the urgency of the matter renders it impossible.

Section 149 of the NCA balances the need for interim measures and the need to protect the other party's interests by limiting the duration of the interim measures to six months. The tribunal may extend the interim measures for another six months only for good cause. Under NCA 7 of 2019, clients with a monthly income of less than 7500 Rand and unsecured debts of less than 50,000 Rand are entitled to free intervention services by the courts, NCR, and NCT.[49] Appeals from the tribunal must be lodged with the Higher Court.

5.1.8 Lessons from South Africa's Approaches

South Africa has tried to regulate the informal credit market through legislation, particularly enacted statutes that have directly addressed the problem of exorbitant interest rates. Such legislative responses to the problem started in 1926 by enacting a law determining the interest rate ceiling. The Usury Act was introduced to protect debtors from exorbitant interest rates that the government considered morally and socially unacceptable. The law intervened in the credit market by setting a maximum interest rate without providing detailed provisions in relation to other charges that can be imposed by creditors. The actors in the informal credit markets in South Africa responded to the 1926 Usury Act by continuing to charge exorbitant interest rates using various contract drafting schemes. As a result, they rendered the Usury Act practically irrelevant.

Using interest rate ceilings to control interest rates in the informal credit markets seems to be the modus operandi in Ethiopia. However, there are some uncertainties regarding the status of these provisions in the Civil Code, as discussed in Chap. 3 of

[48] Yimer et al. (2018), pp. 329–345.

[49] The National Credit Amendment Act, Act 7 of 2019.

this dissertation. The courts are inclined to give effect to the requirements of the Civil Code. Here, we notice that the responses of the moneylenders in South Africa and Ethiopia are similar. As we have seen in Chap. 6 of this dissertation, moneylenders in Ethiopia also commonly use disguised contracts (or simulated agreements) to avoid the effect of the interest rate ceilings. They use the provisions of the Civil Code to swing around the interest rate ceiling stipulated in the code. This approach by moneylenders has worked well, at least in civil litigation. They can enforce the credit agreements in a court of law without facing a strong defence from debtors. Although moneylenders in Ethiopia almost always win in the civil bench, they can encounter criminal charges through the public prosecutor's office. However, the criminal charges against some creditors have pushed many moneylenders underground, and they use more subtle techniques such as keeping with them all evidence that can be used against them in a court of law.

South Africa responded to the problem of hiding interest payments and abusive contract terms by introducing the Limitation and Financial Disclosure and Charge Act, which made it difficult for creditors to avoid the Usury laws. In Ethiopia, on the other hand, there has been no harmonised policy, and there is no legal response to the problems caused by creditors operating behind disguised credit agreements. Moneylenders' practice is not hidden from the regulatory office holders, who know how creditors conceal the exorbitant interest rates they charge. However, there has been no legal response at the regional or federal level. Instead, the executive tends to use its power arbitrarily. In one scenario, the Tigray regional state tried instructing courts not to enforce loan agreements by writing a circular letter.[50] Local administrators also usually take arbitrary actions, such as searching the houses of those suspected of lending money with interest or threatening to bring a criminal charge against them. Charges against unfair and abusive contracts by creditors in Ethiopia have been more of a political strategy to quell public complaints against the actions of moneylenders who use exorbitant interest rates.

South Africa has somehow controlled the exorbitant interest rates by making it difficult to hide them through disguised contracts owing to the enactment and enforcement of the Limitation and Financial Disclosure and Charge Act. The subsequent reaction of the South African informal credit market actors was to dry up credit for small-scale debtors. It became clear that the moneylenders could not continue to provide the required credit given the strict laws that made the business unattractive. The fact that the moneylenders pulled back from the informal credit markets caused more difficulties for the poor in their efforts to obtain credit. Attempts to implement the interest rate cap have thus revealed that interest ceilings do not provide an ultimate solution to the problem of exorbitant interest rates. The poor who could not afford to provide the collateral and securities commensurate with the official credit market were also excluded from the informal credit markets due to

[50] The attempt to receive the latter failed because the courts and the regional prosecutor office were not willing to share the document. However, both the judges in court and the prosecutors confirmed in personal communications that the letter was written to them from the president's office in 2017.

the latter's substantial decline. Therefore, the intervention by the South African policymakers failed to provide access to affordable and fair credit markets, as assumed.

The South African policymakers responded to the side effects of interest caps by introducing laws that relaxed the control of the credit market. As indicated in 9.2.1 Above, they introduced a law exempting credits of less than 6000 Rand, allowing creditors to continue freely providing their services. The new exemption attracted many actors, so providing small-scale credit became common. The new exemption incentivised small-scale credit providers by allowing them to determine interest rates and other charges freely. This was problematic because, as one may expect, the creditors abused this exemption, and as a result, over-indebtedness and unfair practices became very common.

This triggered another legislative response in South Africa aimed at controlling abuse and unfair practices, and this led to the enactment of a new directive that required small-scale credit providers to be registered. This legislative option is meant to balance two fundamental interests. First, it presents an opportunity for those excluded from the official credit market to obtain small-scale credit, and second, it tries to control unfair market practices by requiring registration, disclosure, and standardising the market. This action has contributed significantly to managing the delicate balance between protecting credit consumers and providing an alternative market to those who have limited access to banks and other financial institutions.

Ethiopia faces the same problem as South Africa and the social setting seems almost similar in this regard. The actions taken in South Africa may thus help to deal with the problems Ethiopia is facing. The inaction in Ethiopia is creating a complicated problem as the regulatory bodies are abusing gaps in the law, due to a lack of a clear policy direction, thereby causing arbitrary interventions in the market to advance short-term political gains rather than long-term strategic solutions.

5.1.9 NCA as a Model to Address Exclusion

The discussion of South Africa's experience in chapters 8 and 9 shows that scattered legislation cannot solve the problem of financial exclusion. Therefore, legislative responses to the situation in South Africa pursued a comprehensive approach. As a result, the NCA was introduced in 2005 to give an integrated, thorough, and lasting solution to the problem of financial exclusion. The NCA has introduced many innovative ideas believed to keep the delicate balance between the need to protect credit consumers from exorbitant interest rates, unfair credit terms and harsh debt collection practices and meanwhile allow the majority of the population to access finance in the alternative regulated credit market. The NCA approach is a model other countries may adopt to enhance inclusive finance.[51] As Whittaker notes:[52]

[51] Whittaker (2008), pp. 561–581.

[52] Whittaker (2008), p. 581.

> South Africa's new model has the potential to prove that usury laws can be effective if they are regulated in a supportive and reasonable mechanism. If the NCA continues to be successful, it could enhance significantly the world's attempts to find that balance between idealistic attempts to end poverty and the forces of business.

Hereunder, we discuss how the NCA may be adopted as a model to deal with Ethiopia's current problem of financial exclusion of the majority. The NCA provides clear objectives that guide the actions of the executive body, the legislator, and the courts. The scope of application of the Act is comprehensive, and it covers most credit transactions. The noticeable exception is the exemption awarded to stokvels. Ethiopia has no clear objective in dealing with the informal credit markets. The actions taken by regulatory bodies are uncoordinated and sometimes inconsistent. Even court decisions in the civil bench may contradict decisions in the criminal bench. This is mainly attributable to a lack of clearly defined objectives supported by the force of law.

The NCA's approach to traditional financial institutions like stokvels may also be considered one of the best solutions to deal with conventional institutions like Eqqubs in Ethiopia. The NCA has defined and explained stokvels and then stipulates that they are exempt from the provisions of the Act. This helps clarify doubts about the legal status of stokvels because they are given the autonomy to decide on their internal affairs. In Ethiopia, on the other hand, there is a lack of clarity on the status of Eqqubs and Iddirs. Although they have not, in practice, faced serious legal problems relating to their recognition, there are confusions and uncertainties about some of the activities of these institutions, such as the legality of the payment to Eqqub leaders, the 10% commission/interest payment to buy lots and the penalty that they impose for the delay. Therefore, some lessons can be drawn from the NCA, which assigns full autonomy to stokvels; this may also work for Eqqubs. Giving autonomy to Eqqubs is indeed in conformity with the prevailing practice in Ethiopia, and such express recognition provides a stronger legal base for the practice.

The institutions that the NCA has established are also lacking in Ethiopia. The NCR under the NCA has taken on the responsibility of enhancing awareness of credit consumers and protecting them from unfair practices. The NCR also has a mandate to register credit providers. This helps to attract more credit providers to the regulated market. It allows individuals to join the regulated financial market with limited capital without establishing large financial institutions. Registering individual credit providers in South Africa has given many individuals the right to join the credit market as legal credit providers. The legal recognition in South Africa has also helped individual credit providers enforce credit and secondary security agreements (concerning collateral agreements) with equal status to financial institutions. As discussed in this chapter, some unregistered credit providers exist in South Africa. However, introducing a legal framework to open the door for small-scale credit providers to join the regulated market has significantly reduced the number of unregistered individuals.

On the other hand, in Ethiopia, there is much discrimination against individual credit providers in relation to security contracts. Banks and microfinance institutions have a special privilege of foreclosure: They can seize a mortgaged or pledged

property without the need to apply to a court if agreed upon in the contract.[53] Article 3 of the Property Mortgaged or Pledged with Banks Proclamation stipulates that:

> Notwithstanding the provisions of Articles 2851 and 3060 of the Civil Code, an agreement authorizing a creditor bank with which a property has been mortgaged or pledged and whose claim is not paid within the time stipulated in the contract, to sell the said property by auction upon giving a prior notice of at least 30 days to the debtor and to transfer the ownership of the property to the buyer, shall be valid.

The law, which resulted from a very strong lobby by banks, has avoided prolonged court procedures to enforce secured transactions for financial institutions. As discussed in Chap. 4, although the law entitles cooperatives to be paid before other creditors, they do not have the same rights as banks and microfinance institutions to enforce secured contracts and avoid prolonged court procedures.

Creditors operating in Ethiopia's informal credit markets are unregistered and unlicensed and face challenges in enforcing secured contracts. For this reason, they commonly demand the transfer of ownership at the formation of the contract of loan, or they demand the transfer of the possession of goods or documents required for the transfer of ownership of the goods. Unlike South African law, Ethiopian law does not allow small-scale credit operators to be registered and licensed, thereby rendering entry to the regulated credit market difficult.

The National Bank of Ethiopia has shown no interest in responding to issues emerging in the informal credit market. The discussion in this chapter shows that banks and microfinance institutions are the only institutions in Ethiopia allowed by law to provide full-fledged financial services. Cooperatives may only give credit to their members and other cooperatives. The lack of opportunity to join the regulated credit market with limited resources has thus forced many private credit providers to remain in the informal credit markets and use opaque approaches in dealing with debtors. The fact that private credit providers remain unregistered and unregulated has only exacerbated the deteriorating conditions of debtors. In Ethiopia, the National Bank has a broad mandate to deal with fiscal and monetary issues. This gives it the power to address some of the challenges that creditors and debtors face in the informal credit markets. However, as discussed in this chapter, the National Bank has not yet shown interest in dealing with these issues.

In addition to the gaps in developing a conducive legal environment for the informal credit markets in Ethiopia, the combat against usury is largely ineffective. The Attorney General's Office is mandated to investigate and prosecute suspects of usury under the Criminal Code. However, there are some limitations in this regard. First, there are gaps in expertise and experience in dealing with financial transactions to protect credit consumers effectively. Second, it lacks the required legal and policy framework to deal with the challenges and bring a sustainable solution to the problems. Third, it focuses on punishing the acts of lending with interest rather than creating an enabling legal environment that addresses the root problem, i.e., the severe financial exclusion that has deprived many citizens of the opportunity to

[53] Property Mortgaged or Pledged with Banks Proclamation No. 97/ 1998.

access affordable credit in the regulated official market. The NCA has also established a credit bureau to help make information about debtors available to creditors. This is a good step to ensure creditors know more about their debtors so they can evaluate their condition. This contributes significantly towards avoiding over-indebtedness. The NCA also stipulates detailed provisions of law that ban activities that may be used against the debtor's interest. Sections 89 and 90 of the NCA prohibit agreement terms that unscrupulous creditors can abuse. Most of the techniques that creditors use to avoid the applicability of the provisions of the Civil Code in Ethiopia are interestingly identified and prohibited by the NCA under Sections 89 and 90.

Another legal gap in Ethiopia is the lack of institutions that help solve disputes amicably, especially concerning individual loan transactions. The debt counsellors in South Africa help credit consumers get the required assistance to deal with their debts. The service of a debt counsellor is greatly needed in Ethiopia as most debtors have limited experience or understanding of the agreements they subscribe to, and they also know very little about the possible legal remedies available to them if the agreements are abusive and exploitative. Debt counsellors may also help the courts in Ethiopia by providing technical support regarding how to deal with cases that involve small-scale loans.

The NCT in South Africa is mandated to take civil and administrative measures against creditors who violate the provisions of the NCA. The NCT is staffed by people with the required expertise to deal with financial transactions, enabling it to provide better protection to debtors than the courts in Ethiopia. Ethiopia's courts lack the technical and specialised expertise to deal with financial transactions. Moreover, the courts are overloaded with many other cases, making their decisions not timely. The discussions in Chap. 6 indicate uncertainties and contradictions in the courts' decisions concerning credit agreements. These problems can be addressed by a special tribunal or a special bench that deals only with credit agreements. This may also help to develop more informed and experienced judges to deal with the problem more effectively and creatively.

Moreover, South Africa's NCT is not required by law to rigidly pursue the formal procedural requirements; it can be informal to the extent required under the circumstances of the investigation. The NCT is required by law to use inquisitorial methods in the trial. This allows the tribunal to provide the necessary support to debtors with limited litigation experience or knowledge. This NCA approach is also required in Ethiopia to deal with the problem many small-scale debtors face in the informal credit markets. The courts in Ethiopia are expected to apply the procedural laws and the laws of evidence strictly, although this may sometimes be disregarded in practice. The NCA Amendment in 2019 that provided a right to debtors with low income to submit their case to the NCT free of charge shows the level of commitment in South Africa to steadily enhance access to justice for the poor so that they can protect themselves against abusive and unfair practices in their relations with creditors.

The NCA provides vital rights, as discussed above that paved the way for small-scale creditors to access credit. The National Bank of Ethiopia has also introduced a

directive in 2020 to protect credit consumers.[54] However, this directive applies only to credits obtained from banks and microfinance institutions. It does not protect credit consumers in the informal credit markets. The directive is very general and lacks detailed provisions to provide concrete and enforceable rights to consumers. The directive requires banks to develop internal complaint-handling procedures and report to the National Bank the steps and actions they have taken to comply with the directive. The directive gives consumers the right to submit complaints to the National Bank. The right to file a complaint to the National Bank seems largely symbolic to most potential customers. This is mainly because the National Bank only has an office in the capital and is physically inaccessible to most of the population. Second, only a few high-profile economic actors may be ready to challenge the commercial banks.

In South Africa, credit consumers may also use the consumer protection laws and apply them to consumer courts, as the credit providers are registered, and the NCA has recognised this right. On the other hand, debtors in Ethiopia's informal credit market may not benefit from the consumer protection laws in the country as the credit providers are not licensed and registered traders.

The only remedy in Ethiopia available to borrowers in the informal credit markets to protect them from fraud or deceitful contractual terms or agreements that can be qualified as unconscionable contracts is to rely on the provisions of the Civil Code. The Civil Code under Article 1710 stipulates that:

> 1. A contract may not be invalidated because its terms are substantially more favourable to one party than the other.
>
> 2. Where justice requires, any such contract may be invalidated as an unconscionable contract where the consent of the injured party was obtained by taking advantage of his[/her] want, simplicity of mind, senility, or manifest business inexperience.

It is to be noted that the Civil Code, inter alia, embodies provisions that protect contracting parties in general and it is not designed to specifically deal with credit agreements. As a result, it is not comprehensive or detailed enough to protect borrowers in the informal credit markets from unfair practices. In this regard, South Africa's NCA can be used in many developing countries as a model for access to finance for the majority of the population in the context of a regulated credit market.

The NCA entrusts the ministry in charge of financial issues with the right to determine the maximum interest rates. The ministry must consult the NCR to make its decisions. The NCA embodies the guiding principles to determine interest rate ceilings. The interest rate must not be the same for all credit groups. Second, the rate must consider access to finance as its primary objective in determining interest rate ceilings.

[54] The National Bank of Ethiopia, Financial Consumer Protection Directive, No. FCP, 01/2020.

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Chapter 6
Courts and the Informal Credit Markets: The Case of Ethiopia

6.1 Court Decisions on Loans from Friends, Relatives, and Moneylenders

6.1.1 Contract of Loan as a Cover for Other Transactions

The cases discussed below explain how loan contracts are used to achieve other covert agreements that cannot be formed legally for public policy reasons. In *Tadesse Tamirat v. Eminet Tsilahun,*[1] litigation of the parties in a court of law revealed that the genuine interest of the parties was to sell a condominium house. However, as condominium houses cannot be sold by law except in exceptional circumstances, 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 were 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 could not claim for transfer of ownership of the condominium house. The case was finally settled by agreement between both parties, in which the seller would transfer the house to the buyer, and the buyer would drop his charge in court for payment of the loan.

In *Tesfaye Brhanu* and *Weynishet Lema v. Gebeyehu Grma* and *Hiwot Kasaye*,[2] parties used a loan contract of one million Birr to cover an agreement to sell a condominium house by including a term in the loan contract that required the borrower to transfer possession and ownership of the condominium if he defaulted on loan repayments. The court, however, rejected the agreement, stating that the agreement was illegal and unenforceable. In a similar arrangement, in *Lubaba*

[1] *Tadesse Tamirat v. Eminet Tsilahun*, Dessie First Instance Court, File No. 22235. Date of decision 10/03/2010.

[2] *Tesfaye Brhanu and Weynishet Lema v. Gebeyehu Grma and Hiwot Kasaye*, Federal First Instance Court, File No. 199033, Date of decision 7/6/2010.

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G. Yimer, *The Nexus Between Legal Pluralism and Inclusive Finance*,
https://doi.org/10.1007/978-3-031-71653-9_6

Eumer v. Yamrot Ali,[3] the plaintiff sued the defendant for repayment of a loan. The defendant argued that her contract with the plaintiff was only to sell a house, not a loan contract. Witnesses also testified that they knew the loan contract was intended to cover the contract of sale of the house rather than payment. Based on the written agreement, the court rejected the oral testimony and decided it was a loan contract.

In *Hailu Ayele v. Getie Akele*,[4] the plaintiff applied to the First Instance Court of Kombolcha, claiming that the defendant and the plaintiff had made a loan contract. He adduced a written loan contract indicating that 300,000 Birr was provided to the defendant to be repaid within one year. The contract also provides that if the debtor failed to pay as per the agreement, a piece of rural land with a building with two rooms would be transferred to the plaintiff. The plaintiff then asked the court to either order the defendant to repay the 300,000 Birr or request the defendant transfer ownership of the land and building.

The defendant admitted the loan and mentioned to the court that he did not have enough money to pay the loan. He added that he had no objection to the land being transferred to the plaintiff as payment of the loan. After examining the rural land administration laws and the Constitution, the court, as the arbiter of legal order, ruled that the land could not be transferred to the plaintiff. The court's decision, based on the illegality of the part of the contract that provides for the transfer of the rural land, underscores the importance of their role in maintaining legal order.

In *Abas Yimer v. Muhammad Nur* and *Sophia Yasin*,[5] the parties used a loan contract to sell rural land in a two-room building. In this case, the parties made a loan contract and provided in the contract that if the borrower failed to repay the debt on the date specified, the lender would automatically become the owner of the land. Upon the debtor's default, the lender applied to the court, requiring the payment of 264,000 Birr or transfer of the land. The borrower admitted the loan and agreed to give the land as payment. The court, however, rejected the offer to transfer the land, reasoning that it would be illegal to do so; the court ordered the borrower to find another property to satisfy the debtor's debt.

The loan contracts discussed above are all supported by a written agreement and fulfil all formal requirements of the Civil Code. Parties often use paralegals or lawyers, who play a significant role in ensuring that loan contracts can be used as a deterrent to protect against the seller's breach of contract. For example, a substantial increase in land value may cause the seller to reconsider selling the land. This highlights the influence of informal practices on the formal legal system. Ethiopian Civil Code embodies a strict parole evidence rule under Articles 2005 and 2006, which makes it impossible to contradict the written terms of a contract by other

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[3] *Lubaba Eumer v. Yamrot Ali,* Desie First Instance Court, File No. 15029, Date of decision 13/10/2008.

[4] *Hailu Ayele v. Getie Akele*, South-Wello Higher Court, File No. 34730, Date of decision 09/05/2010.

[5] *Abas Yimer v. MuhamdNur and Sophia Yasin*, South-Wello Higher Court, File No. 33831, Date of decision 17/04/2010.

evidence, such as evidence from witnesses. Courts seem to follow this rule strictly, at least about loan contracts, although parties may later try to challenge the nature of the contracts by invoking the absence of intention. Although witnesses may testify that the real intention during the formation of the contract was to motivate parties to respect the concealed agreement—that is, to appreciate a promise not supported by the law—courts, in most cases, have rejected such testimonies.

6.1.2 *Cases of Forms and Other Pitfalls in the Agreements*

The Civil Code requires written evidence to prove loans and repayment of loans that exceed 500 Birr unless the debtor admits the default. However, in practice, parties rarely use written contracts. Most genuine loan contracts in Ethiopia are not written among relatives, friends, and business partners. Loan contracts are commonly made up in written form when they involve higher interest rates that are tantamount to usury or when they are made to cover up the sale of immovable goods or condominiums that are not permitted to be sold by law. Parties use simulated loan contracts for bargaining, as Cooter describes pretrial bargaining.[6] The parties use the loan contract as a bargaining tool to force the other party to honour their obligations as per the hidden agreement, which cannot be enforced in a court of law because of legal restrictions on the particular transaction.

In *Gebru Gebremeskel v. Gebremedhin Reda*,[7] the Federal Cassation Court decided by majority vote that a bank transfer would be sufficient to satisfy the written evidence requirement under Article 2472 of the Civil Code, which requires a loan of more than 500 Birr 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 formal requirements (of a particular document signed by all parties and attested by witnesses) that are provided under Article 1727 in the Civil Code. However, one judge gave a dissenting opinion in this case, stating that the bank receipt should not be considered a valid contract of loan and the court should reject the claim for repayment of the loan as the formal requirements for forming a written contract had not been fulfilled. The fact that judges at the highest court of the land cannot reach a consensus on the interpretation of Article 2472 of the Civil Code highlights the issue's controversial nature, which needs lawmakers' intervention to avoid confusion and promote certainty and predictability in the market.

[6] Cooter et al. (1982), p. 225.

[7] *Gebru Gebremeskel v. Gebremedhin Reda*, Federal Supreme Court, Cassation Court, File No. 31737, Volume 5, (p. 69).

On repayments of loans, the Federal Cassation Court decided in *Mhader Aemro v. Laek Gebremedhin*[8] the return of a check given to secure the loan was sufficient evidence to prove the repayment. The lender argued that repayment of a loan should be proved only by written proof signed by witnesses; the check's return could not be taken as valid evidence to show repayment. However, the Cassation Bench of the Federal Supreme Court stated that the return of the check leads to a strong presumption of repayment. The court also relied on Article 2845 of the Civil Code to support its decisions: a pledged good shall be returned on executing the obligation.

Likewise, the Amhara Regional State High Court ruled that a bank check would be sufficient to prove a contract of loan if it was also supported by oral testimony. In *Engdaw Yimer v. Neka Tsibeb*,[9] the Dessie First Instance Court ruled that oral testimony is acceptable to prove whether a loan is usurious. Furthermore, in *Hailu Ayele v. Getye Akele*,[10] the First Instance Court and the Higher Court neglected the formal laws and accepted oral testimony as sole evidence to decide that there was a loan contract for 7,000 Birr. In *Husen Irecho v. Zenebe Guasil,*[11] a First Instance Court in Oromia regional state accepted oral evidence in a borrower's defence to prove his claim that he had repaid 4,500 Birr to the creditor.

In *Elias Semie* v. *Zenebech Temesgen*,[12] the Cassation Bench in the Federal Supreme Court decided that when ownership of the signature on a contract is denied, the court can rely on witnesses or technical examinations to prove the existence of a contract. However, witnesses can only be called when a written agreement is drawn up by one party but denied by the other party. Regional courts also allow witnesses to be heard if parties disown a written contract. The Cassation Court also decided in *Abrha Berhe v. Brnesh Hluf.*[13] Suppose the signature in a loan contract is disowned and technical examination is impossible. In that case, oral testimony of the witnesses who signed the same contract may be used to prove that the borrower signed the contract.

The cases in the next paragraph show some decisions made by higher and first-instance courts in which the provisions of the Civil Code are not neglected. These show that there is no consensus among judges in Ethiopia on how to deal with loan cases that are not supported by written evidence. Moreover, we can infer from the following decisions that no consensus exists among judges over whether the written

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[8] *MahderAemro v. Laek Gebremedhin*, Federal Supreme Court, Cassation Bench, File No. 41571, Volume 8, (p. 334).

[9] *Engdaw Yimer v. NekaTsibeb*, South-Wello Higher Court, File No. 32624, Date of decision 06/02/2010.

[10] *HailuAyele v. GetyeAkele*, South Wello Higher Court, File No. 011549, Date of decision 21/08/2010.

[11] *HusenIrecho v. ZenebeGuasil*, Adami Tullu District Court, File No. 27616, Date of Decision 16/6/2009.

[12] *Elias Semie v. Zenebech Temesgen*, Federal Supreme Court, Cassation Bench, File No. 114553, Volume 20, (p. 221).

[13] *Abrha Berhe v. Brnesh Hluf*, Federal Supreme Court, Cassation Bench File No. 71927, Volume 13, (p. 15).

evidence should follow the formal requirements set in the general contract or whether any written evidence is acceptable to prove loans.

In *Leteyesus G. Egziahber v. Teklay*,[14] the Supreme Court of Tigray revised the decision of the First Instance Court, reasoning that a loan exceeding 500 Birr could only be proved by written evidence, and the lower courts had erred in accepting oral evidence to decide there was a loan. Similarly, in *Shamble Gebrekidan Berhe v. Gebrehiwot Teklu*,[15] the Tigray Supreme Court ruled that a bank transfer could not be considered written evidence to prove the existence of a loan contract. The Court also strictly interpreted the provisions of the Civil Code, ruling in *Priest Mebrhatu Fantahun v. Tafere Asmlash* and Shtay Tadesse.[16] A loan contract the lender does not sign is void, even if the borrower and two witnesses sign it. This decision implies that the Tigray Supreme Court interprets Article 2472 of the Civil Code as a formal requirement that all loan contracts be made by Article 1723 of the Civil Code, which describes the elements a written agreement should fulfil to be valid.

Some decisions that follow the provisions of the Civil Code strictly, without any consideration for equity and fairness, result in partially admitting the debtor's testimony when it is against their interest whilst rejecting their words when it benefits them. In *Roman Grmay v. Yemane Gebreyohans*, the court accepted the borrower's testimony as admission and ordered him to repay the loan. However, the court rejected the testimony of the borrower's claim that he had repaid 50% of the loan. In this case, the lender revealed no written or oral evidence. Yet, the court decided the case based purely on the admission of the borrower while rejecting the borrower's defence that he had partly repaid the loan. In *Gebire Tesfay v. Gete Bewketu*,[17] the Desie First Instance Court decided that payment of a loan exceeding 500 Birr should be proved only using written evidence, and the Court of Appeal confirmed the decision.

Courts seem to apply a similar jurisprudence in interpreting that a written loan contract is also sufficient evidence to prove the actual payment of the money provided in the loan contract without needing an additional receipt or payment certificate. The Federal Cassation Court decided in *Asegedech Zergaw v. Ayele Ndanae.*[18] A loan contract duly signed by parties implies the actual money transfer 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;

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[14] *Mrs. Leteyesus G. Egziahber v. Mr. Teklay*, Kedamay Weyane First Instance Court, File No. 77488, Date of decision 22/06/2008.

[15] *Shamble Gebrekidan Brhe v. Gebrehiwot Teklu*, Tigray Supreme Court, File No. 81209, Date of decision 17/09/2008.

[16] *Priest Mebrhatu Fantahun v. Mr. Tafere Asmlash and Mr. Shtay Tadesse*, Supreme Court of Tigray, File No. 67252, Date of decision 16/04/2007.

[17] *Gebirr Tesfay v. GeteBewketu*, Desie First Instance Court, File No. 21490, Date of decision 22/09/2010.

[18] *Asegedech Zergaw v. Ayele Ndnae*, Federal Supreme Court, Cassation Bench, File No. 59882, Volume 12, (p. 157).

however, the money was never given to her. The court rejected her claim that the money had never been given to her and reasoned that she would not have signed the loan contract without taking the money. The court decided that a signed loan contract is conclusive evidence proving the existence of the loan and delivery of the money. Lower courts also seem to follow this decision. In *Dagne Geleta v. Sndew Ejigu*,[19] the Amhara Regional State Supreme Court decided that if a debtor signs a loan contract, it can be assumed they have taken the money.

6.2 Court Decisions in Eqqub Cases

6.2.1 Introduction

This section presents the research findings into how courts in Ethiopia deal with conflicts originating from traditional financial institutions known as Eqqubs.[20] These institutions collect savings from their members regularly while also providing mechanisms to award the collected money to one of the members when they meet as a kind of loan. These traditional institutions are widespread in Ethiopia, as Jacques Vanderlinden observed in the 1970s.[21] They are also known under different names in other developing and developed countries, such as the "stokvels" in South African communities.[22] Following the seminal work of influential anthropologists such as Clifford Geertz in the 1960s,[23] researchers use the generic name "rotating saving and credit associations" (ROSCAs) to refer to institutions that collect savings from their members to provide credits to them on a rotating basis. Further details are provided in Chap. 3.

The operation of Eqqubs relies heavily on traditional understandings of the customary norms of society, which are thought to be age-old. Many Eqqubs have internal dispute resolution mechanisms that favour mediation and conciliation. However, a significant number of disputes in Eqqubs reach the formal courts. Judges in those courts are supposed to base their decisions on the legal norms laid down in the codes or other formal regulations. According to codified laws, traditional financial institutions must adapt their functioning to the formal normative structure. They do not provide specific rules and procedures that are consonant with the existing customs of these traditional institutions.

[19] *DagneGeleta v. SndewEjigu*, Amhara Regional State Supreme Court, File No. 03/8786, Date of decision 03/02/2010.

[20] This is based on the presentation held at the "Séance Commune" of the Royal Academy of Overseas Sciences (KAOWARSOM) on Wednesday 22nd January 2020 in the Palace of the Academies, Brussels. While it contains new case material, it also builds on previous research, viz. Yimer et al. (2018) and Yimer (2019).

[21] Vanderlinden (1977).

[22] Hutchison (2020). For further examples, see Ardener (1964) and Yimer et al. (2018).

[23] Geertz (1962).

The lack of a clear legal framework designed to provide rational, predictable and equitable judicial remedies to disputes arising in traditional institutions confronts the judges in formal courts with significant challenges. In decisions related to Eqqubs, courts apply the official laws and notions of equity, usage, custom, and fairness. In practice, a hybrid and ad hoc application of rules results in a pragmatic mix of informal and formal norms that defy notions of legal certainty and prioritise accommodating a different sense of justice.[24] The most common legal issues concerning Eqqubs are as follows: Can Eqqubs bring legal action in a court of law as a legal person? Can Eqqub leaders represent Eqqub members bringing legal action against defaulting members? Can a member sue the Eqqub leaders for any unpaid money? Do Eqqub leaders have solidarity of liability toward Eqqub members who are unpaid? Can courts rely on the internal agreements of the Eqqub and other records of the Eqqub to decide on cases even when the documents do not meet the form requirements imposed by formal laws? Can guarantors be held responsible when the principal debtor is solvent? Can Eqqub claims be made against guarantors for the principal debtor's default?

6.2.2 Legal Capacity of Eqqub Leaders

Eqqubs are commonly organised by three Eqqub leaders, also called "judges." The members of the Eqqub do not enter into a well-defined and specific contract with Eqqub leaders as borrowers or lenders. Members generally agree to contribute, on a weekly or daily basis, a certain amount of money and draw a lot until everyone has been repaid the total contribution, they made over the Eqqub cycle. Therefore, there is no one-to-one relation in the Eqqub. When someone defaults from paying their contribution according to customary practice, the question arises over who should bring legal action against the defaulting member in a court of law. The three possible scenarios are the unpaid Eqqub member, all members of the Eqqub as joint creditors, or the Eqqub leaders representing the Eqqub members.

These questions are not commonly addressed in the internal rules of the Eqqubs, and the customs do not provide clear answers. Sometimes, the internal rules allow the leaders to take legal action against defaulting members. Still, it is unclear whether this kind of provision can be interpreted as a legitimate form of delegation according to the official laws. Official laws prohibit anyone from being delegated to take legal action in somebody else's name unless that person is a licensed attorney or in a first-degree family relationship with the damaged party. Employees, too, can represent their organisation as an employee without a special license. However, Eqqubs are

[24] From a Euro-centric legal perspective, deeply indebted as it is to Max Weber's notion of legal modernity, this accommodating nature of Ethiopian law in practice could be considered as a sign of a lack of a quality legal system. However, lawyers and legal historians are increasingly pleading for a more positive assessment of the capacity to deal with normative complexity; see Donlan (2015); Duve (2018).

not recognised as legal persons, so it is difficult to justify the validity of internal rules granting their leaders the power to sue defaulting members.

In most cases in court practice, defendants do not object to the case for lack of a locus standi (vested interest) on the part of the plaintiff. However, in some cases, defendants argue that the Eqqub leaders have no legal mandate to sue members for the unpaid money in a court of law. Most frequently, judges decide that the leaders can bring legal action representing all members, citing the internal Eqqub rules and granting such power to Eqqub leaders. Some selected cases are discussed hereunder to indicate how courts deal with this issue.

In *Abdule Yusuf v. Shamsi Aliyi*,[25] an Eqqub leader, acting as a plaintiff, justified his right to bring legal action in a court of law against the defendant, who was a member of the Eqqub. The plaintiff argued that the Eqqub internal rules gave him the right to bring legal action against defaulting members since the internal regulations provide that the Eqqub leader is obligated to pay members the total payment they deserve even if some members fail to contribute. After that, the leader can sue the defaulting members. The plaintiff, therefore, argued that he was delegated by the internal rules to take legal action against defaulting members after he had paid the money to the other Eqqub members according to the internal Eqqub rules. The implicit assumption of the Eqqub leader is that each Eqqub member has a right to bring legal action against any defaulting Eqqub member. The explicit assumption is that once the leader has paid the member who won the lot, they are subrogated to the creditor's rights to claim the unpaid contribution from those who failed to make their obligatory contribution. The court concurred with the plaintiff's reasoning.

In *Frew Ashagre and Frew Ferede v. Solomon Agenaw, Degu Zafu and Gedefaw Agenaw*,[26] the court made a different decision regarding Eqqub leaders' power to bring legal action. The court ruled that the Eqqub leaders lack a vested interest in suing defaulting members and that only members whose interest is directly affected by the non-performance of the specific member should sue them in a court of law. In this case, the plaintiffs, the chair and the secretary of the Eqqub claimed they were running an Eqqub and collecting the Eqqub money weekly. They argued that the first defendant joined the Eqqub and was paid 262,000 Birr from the Eqqub money. The first defendant defaulted and failed to pay his total Eqqub contribution, leaving an outstanding debt of 160,000 Birr to the Eqqub. The second and third defendants joined as defendants in their capacity as guarantors of the first defendant.

The defendants successfully filed a preliminary objection claiming that the plaintiffs had no vested interest in bringing legal action against them. The defendants argued that the plaintiffs could not bring legal action against members since the internal rules of the Eqqub only gave them the responsibility and power to provide the required support to Eqqub members who wanted to sue each other if they

[25] Oromia Supreme Court Eastern Bench, File No. 264670, Date of decision 19/03/2010. All the dates follow the Ethiopian Calendar (EC), which implies a seven- to eight-year difference from the Gregorian calendar used in Europe and the US.

[26] Dessie First Instance Court, File No. 19433, Date of decision 16/01/2010 (EC).

defaulted. According to the internal rules, the leaders cannot sue defaulting members in their name. The defendants argued that only a member whose interest is affected by the non-contribution of another member could bring legal action, not the Eqqub leaders.

The Dessie First Instance Court accepted the defendants' preliminary objection and dismissed the case. The court ruled that the chair and the secretary had no vested interest in bringing legal action and that they did not enjoy a legal mandate to represent the unpaid member since the internal rules did not expressly grant this right to them.

6.2.3 Liability of Eqqub Leaders for Defaulting Members

A second group of critical legal issues arising about Eqqubs revolves around the issue of whether a member can sue the Eqqub leaders for unpaid money. Do Eqqub leaders have solidarity of liability toward Eqqub members who remain unpaid, or should all Eqqub members be sued separately? Commonly, members of traditional financial institutions apply to courts of law seeking a judgment that makes Eqqub leaders responsible for unpaid money. The members do not usually refer to specific provisions in the law codes to support their claim, and they are not expected to do so under Article 222 of the Ethiopian Civil Procedure Code. They usually take it for granted that formal courts admit disputes about contributions to the traditional Eqqub institutions and that those courts will deliver the decision required to support their claim.[27] Hereunder, we discuss selected court cases that illustrate how courts approach these issues.

In *Mulugetea Dame and Bashada Gemechu v. Zeleke Shewazemed*,[28] the defendant admitted that the plaintiffs had been members of the Eqqub and that he had been serving as one of the leaders. However, he argued in court that he should not be held personally liable to pay the unpaid money for the following reasons: first, the money was not paid because some members of the Eqqub had defaulted in their contributions; therefore, he could not pay the plaintiffs, as there was no money in the account of the Eqqub. Second, he has no personal liability for any member if other members default. He added that his responsibility under the internal rules of the Eqqub was limited to bringing legal action against members who defaulted in making their contributions. Third, he argued that he was not the only leader in the Eqqub; another person named Gezhagn Arega was serving as a chairperson of the Eqqub, and he should join him as a defendant.

[27] In an empirical research study that was conducted in Tigray to assess the sources of confidence among Eqqub members, a significant majority of respondents indicated that they were confident that the formal courts would help enforce relations in Eqqub if required; see Yimer et al. (2018), p. 107.

[28] Oromia Supreme Court Eastern Bench, File No. 276783, Date of decision 04/08/10 (EC).

The Arsi Zonal Higher Court decided that the defendant could not be sued as he had no personal liability and dismissed the case for lack of vested interest to be sued as per Article 33(2) of the Civil Procedure Code of Ethiopia. The plaintiffs appealed to the Supreme Court of Oromia, arguing that the defendant should be held responsible in person as he was the Eqqub leader and should be held accountable for collecting the unpaid money from defaulting members. The Supreme Court ruled that the Arsi Higher Court erred in dismissing the case due to a lack of *locus standi*. It referred the case to the Arsi Zonal Higher Court, ordering the court to include the defaulting Eqqub members and the other Eqqub leader as defenders.

This court case clearly shows the transformation of Eqqub from an institution that functions based on trust and confidence between members to an institution in which members' confidence relies on their faith in the Eqqub leaders and not necessarily in each other. The decision of the Arsi Zonal Higher Court is acceptable if we consider the formal laws and the traditional Eqqub system. Yet, the Arsi Zonal Higher Court ignored the fact that members nowadays join Eqqub, believing that the leaders will pay them if other members default. In most commercially oriented Eqqubs, the risk of nonpayment by members is commonly taken on by leaders of the Eqqub. As a result, Eqqub members are not concerned about the trustworthiness and solvency of the other Eqqub members. The Supreme Court seems more progressive in its approach since it acknowledged that members expect Eqqubs to be safe in traditional credit institutions and, therefore, offered protection to the plaintiffs. It also tried to apply formal laws by ordering the Higher Court to include the defaulting members and the other Eqqub leaders as joint defenders.

In *Dajane Kebede v. Abera Zawude Grocery (Genet Sambee: guardian of heirs of Abera Zawude), Wasane Lema and Getinet Tashome*,[29] the court held the heirs of a deceased Eqqub leader liable for unpaid money to Eqqub members. Two important points emerge from this decision. First, the court had not only the Eqqub leader himself but also his heirs as responsible for unpaid money. Second, the plaintiff admitted in the out-of-court conciliation process that the actual unpaid money was less than he claimed in his formal court claim. In formal court litigation, parties consider not only the existence of evidence to prove their claim but also the lack of proof the defendant can cite, and in this way, wittingly exploit formal requirements for evidence. In the out-of-court reconciliation, however, they avoid the formalities and focus on what they think they deserve, considering social values and norms in defining their negotiation ground. In this case, the plaintiff intentionally exaggerated the amount when suing the defendants before the formal court. Still, in the out-of-court reconciliation, he admitted he had already been partly paid, although the defendant could not prove it, and he agreed to be paid the actual unpaid debt.

In *Tadu Eshetu v. Amare Zennebe and Fikadu Abebe*,[30] the court ruled that Eqqub founders and leaders remain liable if they resign from the leadership before everyone gets paid. The first defendant claimed that he had stopped working as one of the

[29] Adama Special Higher Court, File No. 24570, Date of decision 30/03/2009 (EC).

[30] East Shewa Zone High Court, File No. 53816, Date of decision 01/05/2011 (EC).

leaders in the Eqqub in the thirteenth week of the Eqqub due to a lack of confidence in the chairperson and secretary of the Eqqub. He argued in court that he should not be sued as he terminated his Eqqub leadership before the plaintiff acquired a right to be paid by the Eqqub. A witness also testified that he had resigned from his leadership position in the thirteenth week. The second defendant also argued that according to the internal rules of the Eqqub, the responsibility to pay members when they win the lot is the duty of the chairperson and the second leader, who acts as an advocator of the Eqqub. Therefore, the leader should not be sued for nonpayment to members since he had no mandate to pay money in the Eqqub to members. However, the court did not accept these arguments. The decision in this case reaffirms that courts acknowledge the evolution in modern Eqqub practice, considering that members join a particular Eqqub because they trust the leadership rather than the members themselves. Therefore, the decision of the court to hold the founders of the Eqqub responsible even after resigning from the Eqqub leadership makes sense. It corresponds to the evolving nature of the customs in the administration of Eqqubs.

However, in *Shamsu Sabir, Nejib Bilal, and Seid Temam v. Sadik Kedir*,[31] the Oromia Supreme Court reached a different conclusion, deciding that leaders are liable only for the money they collect in person, not for Eqqub money paid to other Eqqub leaders. The court decided that there is no solidarity of liability, and Eqqub leaders are responsible only for what they take directly and in person from members.

In *Abera Tesfaye v. Tseyiba Wbla*,[32] the Federal Higher Court decided that a founding leader of an Eqqub, mentioned in the Eqqub documents as one of the leaders, should not be held responsible for unpaid money if they are not involved in managing the Eqqub. In this case, the Higher Court examined whether the appellant had an active administrative role in the Eqqub in general and in collecting money. The court then freed the appellant from the case, ruling that the appellant was not participating in the effective management of the Eqqub. However, the court overlooked that the appellant's name was used to lure members to join the Eqqub. Eqqub members consider leaders' goodwill and economic condition when deciding whether to join a particular Eqqub. Members believe the leaders are their last resort for repayment of their money if the Eqqub administration fails to pay them according to the internal rules and customs. In this case, the court tacitly suggested that members cannot rely on the list of names mentioned by the Eqqub as founders or leaders of the Eqqub, and they should go further and investigate who the actual leaders of the Eqqub are. This is a difficult task, especially in larger Eqqubs, where members have limited knowledge about other members in the Eqqub.

The Federal Higher Court reasoned differently in an earlier case, Brhanu Teklu v. Tadesse Tekle and Demis Werku. In this case, the Higher Court decided that founders whose names are mentioned in the establishment documents are jointly and severally liable, even if they no longer participate actively in Eqqub's administration. In this case, the court also decided that using an artificial name in Eqqubs is

[31] Oromia Supreme Court East Bench, File No. 276741, Date of decision 11/08/2010 (EC).

[32] Federal Higher Court, File No. 162989, Date of decision 28/03/2008 (EC).

possible and still brings legal action for any unpaid money using one's real name. The court conceded with the appellant that only the amount that the member paid could be reclaimed from the Eqqub. The Higher Court, therefore, rejected the plaintiff's plea that he should be paid 17,850 Birr, which was the amount he initially subscribed to in the Eqqub but did not pay.

In *Grmay Reda v. Kidus Mikeal Eqqub (Kiros Zegeye)*,[33] the Tigray Regional State First Instance Court decided that only the chair of the Eqqub is responsible for claims for unpaid money by members, excluding the liability of other leaders. The court also decided that a chair who resigned from their position would be responsible for the period they served and for the amount of money they collected as a chair. The new chair who replaced them would be responsible for payments made afterward. Yet, in *Letebrhan Tirfu v. Teklay Hadush, Sbhatu Gebremeskel and Gebretenseay Fisha*,[34] the court held that all Eqqub leaders are jointly and severally liable and added that not receiving a benefit from the Eqqub as a leader is not acceptable grounds for exemption from liability. The court released the second defendant, accepting his defense that he had already given his house to the Eqqub to compensate for the damage he had caused to members. Guided by equity considerations, the court released the second defendant from liability. In this case, the court applied customs, Eqqub internal rules, and equity to adjudicate the case rather than formal laws.

6.2.4 Evidence Requirements and Internal Rules of the Association

The third group of legal issues that courts frequently confront concerns the different types of evidence that courts can accept to adjudicate Eqqub cases. Eqqubs operate mainly based on the culture, usage, and norms accepted by society, and they do not always pay proper attention to the formal requirements imposed by codified laws. Most Eqqubs have written internal bylaws, but the legal status of the internal rules is unclear under the law codes. It is challenging to consider the internal rules as bylaws of an "association" in the technical sense of Articles 404–405 of the Civil Code. Under these provisions, groups and associations that intend to satisfy the financial interests of their members are excluded from the definition of "association" in the strict legal sense of the word. They are deemed to be regulated by the Commercial Code instead. The Commercial Code, in its turn, regulates three different kinds of partnerships. Among these, "ordinary partnerships" are closest to Eqqubs. However, it remains difficult for judges to consider Eqqubs from the perspective of ordinary partnerships since they do not fulfil the formal requirements. For example, the

[33] Kedamay Weyane First Instance Court, File No. 11405, Date of decision 09/06/2008 (EC).

[34] Kedamay Weyane First Instance Court, File No. 9338, Date of decision 09/11/2007 (EC).

appropriate government office must register an ordinary partnership in the Commercial Code.

Since the internal Eqqub rules cannot be considered the juridical equivalent of associations' bylaws or ordinary partnerships, the remaining option is to consider the internal rules as simple contracts made among members. However, considering the internal rules as contractual agreements is not entirely clear either. First, in most cases, Eqqub internal rules are not signed by all members, and it is challenging to consider that all members have the required knowledge and understanding to assent freely and adequately to the terms of the internal rules. But regardless of these problems, judges consider internal Eqqub rules binding in formal courts. For example, in *Takir Baede v. Sabsibe Tadgu*,[35] the High Court decided that internal rules of Eqqub are binding in a court of law as a matter of principle while nullifying specific internal rules that laid down a penalty for delay in paying contributions. In this decision, the court considered the internal rules of the Eqqub as binding in a court of law but declined to give reasons for its decision.

Furthermore, even if Eqqubs are to be considered from the viewpoint of contract law and not the law of associations or commercial partnerships, it is not yet settled whether credits provided in Eqqubs are to be considered as loans under the Civil Code. If they are, all payments to members exceeding 500 Birr should, in principle, be proved following the rules in Article 2472 of the Civil Code.[36] According to this Article, contracts exceeding a value of 500 Birr shall be proved by written evidence or by a confession or oath taken in a court of law. In many Eqqub-related cases, the courts do not always apply these general evidence rules. For example, in *Abdule Yusuf v. Shamsi Aliyi*,[37] the First Instance Court decided that payment to Eqqub could only be proved by written evidence per Article 2472 of the Civil Code. The Higher Court, however, reversed the decision of the First Instance Court and decided that oral testimonies could be used to prove transactions in Eqqub, even when the amount exceeds 500 Birr. The Oromia Supreme Court, in turn, disagreed with the Higher Court. Following the codified rules on evidence, it confirmed the decision of the First Instance Court, arguing that oral evidence is not acceptable to prove payments above 500 Birr.

The Dessie First Instance Court decided in *Hiwot Shiferaw and two others (two guarantors) v. Frew Ayalew*[38] that Eqqub leaders can use oral evidence to prove that a member defaulted on paying their contribution even when the amount due exceeded 500 Birr. In this case, the court considered all evidence without considering itself bound by Article 2472 of the Civil Code. By allowing the Eqqub leaders to prove their claim using proof that did not meet the requirements of the positive law, the court seemed to accept the autonomous normative power of traditional financial institutions. Along the same lines, the Dessie First Instance Court decided in

[35] East Shewa High Court, Adama, File No. 52987, Date of decision 03/11/2010 (EC).

[36] Yimer (2019), pp. 480–482.

[37] Oromia Supreme Court Eastern Bench, File No. 264670, Date of decision 19/03/2010 (EC).

[38] Amhara Regional Supreme Court, File No. 03/20420, Date of decision 10/04/2010 (EC).

Tewodrs Afework v. Sememonalu and four others (guarantors) that Eqqub leaders' decisions are binding and enforceable in a court of law if they are based on the internal rules of the Eqqub. The court reasoned that Eqqubs enjoy the status of traditional institutions, which exempts them from provisions in the Civil Code that require written evidence. In both cases, the Dessie First Instance Court's main objective seems to have been to encourage Eqqubs and protect their internal regulatory mechanisms, even if the internal rules are at variance with codified norms. The court appears to have considered the decision by the Eqqub leaders as final, simply giving official endorsement to the execution of that decision and leaving the factual investigation of the case aside.

Similarly, in *Hailay Gebremedhin and Dinku Ashebir v. Mulugeta Araya*,[39] a First Instance Court in Mekelle decided that Eqqubs are traditional institutions requiring special treatment. The evidence rules of the Civil Code were deemed irrelevant so that oral evidence could be admitted to prove claims related to Eqqub. The court also decided that penalties for delay in making contributions, laid down in the internal Eqqub regulations, are valid and enforceable in a court of law. It refused to apply Article 2489 of the Civil Code, which provides that only a legal interest at the rate of 9% shall be paid for delay in repayment of loans. The same provision provides that any agreement among the parties that increases the debtor's liability is invalid under the law. The court's decision, then, clearly did not observe the provisions of the Civil Code, giving instead precedence to internal Eqqub rules and customary practices.

In *Tsegay Alamrew v. Getahun Asmamaw*,[40] however, the Amhara Regional Supreme Court decided that the return of a pledged check to a member by the Eqqub leader is *prima facie* evidence for payment of the contribution by that member. This case shows that when traditional institutions develop into more significant associations with members who do not know each other personally, courts take that evolution into account by giving more credit to formal written records than to oral testimony. In this particular case, the lower court decided on the case based on oral testimony, but the Supreme Court ordered that the lower court examine the records of transactions of the Eqqub. This decision mirrors the hypothesis that when organisations become more complex, the rules become less flexible and complex, requiring an advanced form of rulemaking, interpretation, and execution. Under such circumstances, observation of the rules of the Code becomes easier.

In *Dawit Brihanu v. Zelalem Asirat*,[41] the court decided that the face value of the check could be challenged by oral testimony if it was given for security purposes in the Eqqub. The plaintiff stated that he was a member of an Eqqub and had sold one of his lots in the Eqqub to the defendant. As a result, the defendant received 515,000 Birr in cash and gave the plaintiff a check of 515,000 Birr numbered QA1440725

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[39] Mekelle Kedamay Weyane First Instance Court, File No. 9603, Date of decision 22/12/2007 (EC).

[40] Amhara Regional State Supreme Court, File No. 09-19967, Date of decision 28/05/2010 (EC).

[41] Oromia Supreme Court East Bench, File No. 225082, Date of decision 30/5/2009 (EC).

that the Business and Construction Bank would fund within six months of the date of issue. He pleaded that the bank informed him that there was no cover available in respect of the check, reclaiming the reimbursement of 515,000 Birr. The defendant argued that he had given the check to the plaintiff for the sole purpose of guaranteeing the repayment of the weekly payment made to the Eqqub (5000 Birr), and under their agreement, he claimed that he had already discharged his obligation to the Eqqub, thereby performing his obligation to the plaintiff via the payments to the Eqqub.

The court ordered the parties to adduce evidence to prove the disputable issue, but the defendant failed to do so. The court based its verdict merely on the testimonies of witnesses produced by the plaintiff. The witnesses testified that they had seen how the defendant borrowed 515,000 Birr from the plaintiff, adding that the defendant had repaid only a partial amount. The court called the Eqqub leaders to testify about the case and how they ran the Eqqub. The Eqqub leaders testified in the plaintiff's name that the defendant had paid 280,000 Birr to the Eqqub and terminated making contributions before paying the full 500,000 Birr required as per his subscription in the Eqqub. In light of this oral evidence, the court ruled that the defendant had not entered into an agreement on a loan and that the check had only been given as a guarantee. The court decided that the defendant was responsible for paying the plaintiff the money he had failed to discharge to the Eqqub or the plaintiff (235,000 Birr).

In other words, the court decided the case following normative practices in Eqqub rather than by the formal laws. The court considered the check security for the continuation of contribution in Eqqub rather than a payment. Based on the evidence, the court decided that there were loan agreements between the parties within the Eqqub and that the check was used to guarantee that the defendant repaid 500 Birr weekly until the end of the Eqqub cycle. The court, therefore, showed no interest in applying the law in a way that would contradict the practice of the Eqqub.

Other instances of flexibility in treating Eqqub cases concern using summary procedures. In the aforementioned *Hiwot Shiferaw and two others (two guarantors) v. Frew Ayalew*,[42] the case was filed in the First Instance Court as per Article 284/1/a/ of the Civil Procedure Code of Ethiopia. A civil case can be submitted in accordance with Article 284 of the Civil Procedure Code if the plaintiff demands to recover a debt that emanates from a simple and clear contract of loan or if a claim is connected to a bill of exchange, promissory note, or check. In the case referred to above, the plaintiffs applied to the court following a summary procedure supported by an *affidavit* claiming that the first defendant defaulted to pay the Eqqub money after he had been paid by the Eqqub. The plaintiffs requested the court to declare the defendants jointly and severally liable to pay the unpaid Eqqub money. The court accepted the request to claim payment in a summary procedure. The deputy registrar of the Federal First Instance Court confirmed during an informal interview with researchers, that originally the Federal First Instance Court allowed plaintiffs to use

[42] Amhara Regional Supreme Court, File No. 03/20420, Date of decision 10/04/2010 (EC).

summary procedures to deal with Eqqub cases. Later, however, the Federal First Instance Court revised its policy, since requests for a full, ordinary trial became common and courts commonly grant defendants a right to a full trial.

6.2.5 Suretyship and Liability of Guarantors

A last type of case concerning Eqqubs, which are frequently dealt with by the courts, relates to the liability of guarantors. Articles 1725 and 1922 of the Civil Code provide that suretyship contracts must be the product of explicit consent and cannot be presumed to have been concluded tacitly. Moreover, a valid suretyship requires a written contract in which the maximum amount of the guarantee is specified. However, in practice, most suretyship contracts used in Eqqubs do not meet these requirements. Further, guarantors sued by Eqqub leaders do not refer to those formal requirements to defend their case in court.

In Debesa Sirreessaa House v. Aregay Gebre, Yidnkachew Asrat, Eyob Tsegaye, and Ashebo Chemso, guarantors were deemed jointly and severally liable.[43] However, in *Aschalew v. Ayimir Ajemu, Mehamad Bushe and Kedir Gemechu*,[44] an Eqqub leader sued a member who defaulted to pay contributions and the two guarantors for payment of 2500 Birr. Incidentally, the defendants did not object to the fact that the Eqqub leader sued them in his capacity as a representative of the other members of the Eqqub. The guarantors argued they should not be held responsible since the principal debtor was not insolvent, and the plaintiff should first sue the principal debtor. The court accepted the guarantors' argument, releasing the second and third defendants and ordering the first defendant, the principal debtor, to pay the plaintiff 2500 Birr. In this case, the court considered the guarantors simple guarantors and accepted their claim according to Article 1935 of the Civil Code.

In *Getiye Tenni, Shimelis Shewa, and Abraham Gezahegn v. Fikadu Shewadeg and Geremew Moshe*,[45] the Eqqub leaders sued both defaulting members and their guarantors through a summary procedure. In this case, the court considered the principal debtor and the guarantor co-debtors and ordered them to be jointly and severally liable to pay 24,400 Birr to the plaintiffs. The court decided the case using a summary procedure without requiring the litigants to follow a full trial. In this particular case, the court seems to have endorsed the norms and usages of Eqqub, showing little interest in applying the official laws.

In *Kidane Gebregzeabher v. Tsegay Hagos, Abrhet Teklu and Hialay Teklu*,[46] the court decided that guarantors in Eqqub are jointly and severally liable to make payments to the Eqqub if a member fails to pay contributions as per the internal

[43] Adama Special Zone High Court, File No. 21437, Date of decision 21/04/2008 (EC).

[44] Adami Tulu District Court East Shewa Zone, File No. 27687, Date of decision 09/06/2009 (EC).

[45] East Shewa Zone High Court, Date of Decision 27/03/2011 (EC).

[46] Kedamay Weyane First Instance Court, File No. 11291, Date of decision 08/06/09 (EC).

rules. In this case, the plaintiff argued that he provided 171,000 Birr to the defendant to be returned when the defendant won the lot in the *Rahwa* Eqqub. In other words, the loan had to be repaid as soon as the debtor won the Eqqub money. Of course, winning the Eqqub money presupposes that a member continues to pay his weekly contribution, as per the bylaws of the Eqqub. Therefore, the debtor's obligations were first to pay the weekly contributions to the Eqqub, and second, to repay the lender upon winning the Eqqub money. However, according to the claim of the plaintiff, the defendant stopped paying his weekly contribution after having paid the Eqqub only 96,000 Birr, while he was supposed to pay 171,000 Birr. The plaintiff therefore requested the court to order the debtor to pay the remaining unpaid 75,000 Birr to the Eqqub and to make interest payments for the delay. The principal debtor, the first defendant in the case, did not attend court and the court ordered the trial to be conducted in his absence. The guarantors, the second and the third defendants in the case, argued that they should not be held responsible for paying the sum, since their obligation was only subsidiary in nature. They argued that the plaintiff should first sue the principal debtor and that they could not be held liable unless the principal debtor was insolvent. The court, however, rejected the argument of the guarantors and decided that they should be held responsible along with the principal debtor.

In *Belay Amare v. Hailemariam Gebrehiwot*,[47] the court was called upon to decide on the power of Eqqub leaders to start claims against guarantors for nonpayment by defaulters. In most Eqqubs, only members who have not yet been paid can be accepted as guarantors expected to make payments to members who have won the lot. Therefore, if a member defaults, the Eqqub leaders automatically seize payments due to the guarantor as compensation for the nonpayment by the member for whom the guarantor agreed to act. The court decided that Eqqubs can seize and use this money to satisfy the obligation of a defaulting debtor. The court also decided that the guarantor can claim the money that the Eqqub seized from the member who defaulted and is the principal debtor.

The defendant contributed 3000 Birr weekly to the Eqqub; when he won the Eqqub lot, he received 144,000 Birr. The plaintiff, another member of the same Eqqub, agreed to guarantee the defendant's repayment of the Eqqub money. The defendant, however, stopped paying his weekly Eqqub contribution after a while. Therefore, The Eqqub leaders claimed 43,000 Birr from the guarantor, the plaintiff in this case. Furthermore, to compensate for the defendant's unpaid Eqqub money, the Eqqub leaders seized 20,000 Birr, which the Eqqub owed to the plaintiff. The Eqqub leaders also required the guarantor to pay the remaining debt of 23,000 Birr under threat of legal action. The plaintiff, therefore, requested the court to order the defendant to pay the 20,000 Birr to the plaintiff as a reimbursement for the money seized by the Eqqub. The plaintiff also wanted the court to order the defendant to pay the remaining 23,000 Birr. The court ruled that the defendant should pay the plaintiff the 20,000 Birr that was seized by the Eqqub leaders. The court ruled that the defendant should not be ordered to pay the 23,000 Birr, as the plaintiff had not yet

[47] Kedemay Weyane First Instance Court, File No. 11725, Date of decision 30/10/09 (EC).

paid the money. In this case, the court indirectly endorsed the action of the Eqqub leaders, who claimed compensation by refusing to pay the Eqqub money they owed to the plaintiff. This practice is widespread in Eqqubs, and some Eqqubs require that only unpaid Eqqub members be accepted as guarantors.

In *Kidane Gebreezgeaber v. Dr. Theodros Haileslassie and Mr. Mulugeta Hailekiros*,[48] the court decided that a member of an Eqqub who provides a loan to another member, under the condition that the member reimburses them as soon as they win the Eqqub lottery, can sue the member and their guarantors in the Eqqub if the debtor quits the Eqqub and no longer pays their contributions. The point here is that the member reneges on their promise. They take in advance from another Eqqub member an amount equal to what they will win through the Eqqub when their turn comes, promising that they will continue to make their regular contributions. The practice is *mutatis mutandis,* similar to a loan that is agreed to be paid in instalments. In this case, the court also endorsed using a right in Eqqub as a pledge to access loans from other loan providers in the informal credit markets. Commonly, the loan is provided by a member of the Eqqub or the leader of the Eqqub. In this case, loan contracts and the modalities used to provide advance payment in the Eqqub are somehow blended with the Eqqub administration. In this case, the defendant tried to argue that he had no loan contract, but without denying that he had taken the payment from the Eqqub. The court considered the case an ordinary loan contract and decided that the defendants, the principal debtor and the guarantor, must repay the loan.

In *Mr. Mulugeta Hailekiros v. Kidane Gebreezgeaber*,[49] a legal action was brought against the *Rahwa* Eqqub. The plaintiff complained that the Eqqub refused to pay the Eqqub money that should be paid to him according to the internal rules. The Eqqub leaders argued that the money was used to compensate for the unpaid money by Dr Theodros, for whom the plaintiff stood as a guarantor. The court rejected the application by Mr Mulugeta, reasoning that the Eqqub has a right to use the Eqqub money of the guarantor in the place of money unpaid by the principal debtor, who defaulted in the Eqqub. Here it is clear that the court applied the prevailing custom and practice in the administration of the Eqqub, since there is no formal law that allows a creditor to claim for compensation against the rights of the guarantors. In another related case, *Mr Muez v. Kiros*,[50] the court decided that a guarantor, whose money was used to pay the debt of another Eqqub member for whom he stood as a guarantor, could legally claim from the principal debtor who failed to pay the Eqqub money. The court in this case decided that the principal debtor who failed to pay the Eqqub money and who caused the guarantor to sustain damage was responsible to pay the guarantor the money and the interest.

[48] Kedamay Weyane First Instance Court, File No. 09140, decision date 24/11/2007 (EC).

[49] Kedamay Weyana First Instance Court, File No. 10614.

[50] Kedamay Weyane First Instance Court, File No. 09573.

In *Marzeneb Eqqub judge Mr Bayu Atsnafu v. V. Wallelign Temesgen and Addisu Tsrune*,[51] the Cassation Bench of the Federal Supreme Court considered a case related to suretyship contracts in Eqqubs. In this case, the Eqqub member had collected 465,000 Birr from the Eqqub. He however failed to pay back 222,000 Birr to the Eqqub. The Eqqub leader sued the two guarantors to pay the member's unpaid money. The guarantors argued in the Higher Court that the Eqqub leader had violated the Eqqub traditions and bylaws, because he had paid the defaulting member with only two guarantors while four persons were required to be guarantors to pay on behalf of the defaulted member. They therefore requested to the court that they pay 50% of the unpaid money to the plaintiff, arguing that the remaining 50% should be covered by the leader of the Eqqub, who failed to follow the Eqqub traditions and norms by agreeing to pay a defaulting member who had only two guarantors. They argued that the leader's negligence should not affect them and therefore he must pay 50% of the unpaid money. The court reviewed the bylaws and heard witnesses to answer the question of whether four guarantors were required according to the Eqqub's traditions. The court concluded that four guarantors were not required according to the bylaws and Eqqub traditions. Hence the court ordered the defendants to pay the money that should have been paid by the defaulting member.

The defendants appealed to the Amhara Regional State Supreme Court. This Court, sidelining the issue of whether guarantors should pay 50% or 100% of the unpaid Eqqub money according to the bylaws and traditions, focused on the formal requirements that the suretyship contract should meet to be considered a legally valid contract. The court concluded that the suretyship contract was invalid because it failed to stipulate specifications provided in the Civil Code. The Cassation Bench of the Amhara Regional Supreme Court approved the decision of the Supreme Court. The plaintiff, who was the Eqqub leader, submitted his complaint to the Federal Supreme Court, Cassation Bench, claiming that the lower courts had committed a fundamental error of law by focusing on the formality issue, which had not been raised by the defendants. The Cessation Bench of the Federal Supreme Court agreed with the plaintiff. The court reasoned that the defendants admitted in a court of law that they were guarantors and they had never denied or challenged that fact. Therefore, the Higher Court had erred in bringing the issue of formality into the case, which had not been an issue in the First Instance Court.

This case shows the lack of agreement over how to harmonise official laws and the traditions of Eqqub. The Higher Court followed the traditions and norms completely and tried to decide the case according to the traditions and bylaws. The Amhara Regional State Supreme Court and its Cassation bench, on the other hand, totally disregarded the bylaws and traditions and tried to apply official laws without compromise. The Federal Supreme Court tried to protect the traditions and practices in Eqqub by wisely avoiding applying official laws.

[51] Federal Supreme Court, Cassation Bench, File No. 112729. Volume 19, (p. 70).

6.3 Court Decisions in Iddir Cases

In this section, we discuss cases that relate to Iddirs. Unlike the Eqqub cases, few disputes reach courts regarding Iddirs. Most are filed by Iddir members who object to the decisions of Iddir leaders to dismiss them from the Iddir. How the courts have handled these cases is described in the following paragraphs.

6.3.1 Traditional v. Legal Concepts of Marriage in Iddir

In *Damma Erecho v. Kidist Mariam Iddir Association*,[52] the court decided that Iddir membership cannot be terminated automatically, even if provided for by the internal bylaws of the Iddir. The court also provided that removing the name of the member from the book of records is a condition to terminate membership. In this case, the plaintiff sued the Kidus Mariam Iddir Association for not paying her 3000 Birr as a member of the Iddir. She claimed that according to the internal rules of the Iddir, she should be paid 3,000 Birr because her mother-in-law died in a place called Harar, 400 km from where the plaintiff resides.

The Iddir leaders admitted that the plaintiff and her husband had been members of the association; however, they argued that she was dismissed from the association because she defaulted in the payment of her contributions for five consecutive terms. The internal rules provide that a member who defaults for more than five consecutive terms should be dismissed from the association automatically. The Iddir leaders also argued that: (1) The mother-in-law was not registered as a family member as per the rules of the Iddir; (2) The plaintiff did not provide notice to the Iddir about the death within 15 days as per the Iddir laws; (3) She was divorced from her husband; therefore, she was no longer a relative of the deceased; and (4) The mother-in-law had died after the plaintiff terminated her membership; therefore, she was not entitled to any payment since the termination of the membership has an immediate effect.

The court framed the following issues to be litigated.

1. Did the plaintiff divorce her husband?
2. Did the plaintiff register her mother-in-law as a family member?
3. Is she still a member of the Iddir?

The court heard witnesses adduced by the plaintiff and by the defendant. The witnesses called by the plaintiff testified that the plaintiff and her husband were married when her husband's mother died. The defence witnesses, however, attested that the plaintiff was not married when her mother-in-law died. The court analysed the evidence and the laws and concluded that the plaintiff's marriage was still binding, although the spouses resided at different places. The court reasoned that

[52] Bole District, First Instance District Court, File No. 30344, Date of decision 18/03/2011 (EC).

courts can only officially dissolve the marriage, and living in different houses does not imply divorce.

The court also rejected the defence that the mother-in-law was not registered since the evidence showed that the deceased was registered as a family member as per the requirements of the Iddir. Most importantly, the court ruled that lack of payment for five consecutive payment periods would not result in termination of membership unless the name of the member were erased from the registry of the Iddir. The court avoided directly ruling that the Iddir rule providing dismissal from Iddir membership as a penalty for failing to make payments for five consecutive periods was invalid in a court of law. However, the court provided a condition that the member's name should be erased from the registry of the Iddir for the termination to be acceptable in a court of law. The court, therefore, decided that the Iddir should pay the plaintiff 3000 Birr as per her plea.

We may infer from this case that the court considers the internal rules of Iddirs as binding and applicable. It also finds Iddirs as organisations with legal personalities, though it is unclear which law the court based its decision on. The court considered the Iddir a recognizable association simply because it is deeply rooted in society. To deny its existence would have been too formalistic and technical an argument, affecting the court's acceptance in society.

In *Nesibu Makuyia v. Genet Sefer Iddir Association and Qidus Rufael Iddir Association*,[53] the court decided that spouses who live separately should be considered as married for Iddir unless the marriage has been dissolved officially by order of the court. In this case, the court disregarded the established norms by ordering Iddirs to strictly consider the official law requirements of divorce in their decisions.

The plaintiff, in this case, had claimed that he used to be a member of two different Iddirs and that they should pay him 11,000 Birr to cover the funeral ceremony of his wife as per the internal rules of the Iddirs. The Iddir leaders argued that the woman who died was not his wife as they were not living together; they claimed that the plaintiff had included the woman's name in the list of relatives of Iddir members maliciously, using his former power as a leader of the Iddir. The defendants also asserted that the written attest of marriage on file had not been signed by witnesses; the document, therefore, lacked legal validity. The Iddirs thus argued that the plaintiff deserved no payment whatsoever as the dead woman was not his wife.

The court accepted the written evidence submitted by the plaintiff as conclusive evidence and rejected the argument that it was not a legally valid document. Furthermore, the court reasoned that the Oromia Regional State Family Law under Article 71(1) indicates that spouses can agree to live separately for a limited or unlimited period and living together is not a requirement for a valid marriage. The court therefore ruled that the Iddirs should pay the plaintiff the money in accordance with the internal rules of the Iddirs. The Genet Sefer Iddir was ordered to pay 5000

[53] Bishoftu City Court of First Instance, File No. 04189, Date of decision 15/09/10 (EC).

Birr and Quidis Rufal Sefer Iddir was ordered to pay 6000 Birr to the plaintiff as per the internal rules of the respective Iddirs.

This case implies that the understanding of marriage in traditional institutions such as Iddirs differs from what the formal law provides for. The traditional Iddir associations consider living together as an important factor for marriage to be considered as relevant to Iddir and they declined to pay the money. Iddirs originated as institutions to provide psychological support to individuals suffering grief from the loss of a close family member; if the society feels the relation between the deceased and the person who claims payment from the Iddir is not close, Iddirs may be reluctant to provide the required support or pay the money. However, with Iddirs becoming more formalized and developing written rules, it is difficult to use this very delicate criterion of the relation between the deceased and the member of the Iddir. The court also obviously prefers the application of the written law objectively and decides accordingly.

In *Kabato Kafanii v. Mogor Village Gebriel Iddir*,[54] the plaintiff claimed that the Iddir should be ordered by the court to pay him 5000 Birr. The ground of his claim was that he lost his wife by death and therefore as a member of the Iddir, he should be given the money as part of the mutual support scheme (Debese). He added that his wife was registered in the book of records of the Iddir and she had died while they were living together.

The Iddir argued that the plaintiff had divorced his wife in a court of law and therefore he was not entitled to be paid the money as mutual support. The Iddir argued that according to the written bylaws of the Iddir, the fact that they reunited without formal marriage was considered as cohabiting rather than marriage. The court endorsed the arguments of the Iddir and dismissed the case. The Higher Court that heard the appeal also dismissed the appeal, confirming the decision of the lower court.

In this case, the Iddir preferred to incorporate the official laws in a very formal manner. The Iddir members or some dominant members may have introduced such rigid rules in the bylaws to avoid misunderstandings and disputes affecting the harmony of the Iddir. Avoiding lacunas in the bylaws may help to avoid or minimize disputes. Incorporating the official laws in the bylaws also creates additional certainty. However, the plaintiff seemed to be shocked by this very rigid approach of the Iddir and he challenged the decision in court. Unfortunately, it is unknown whether the stand which the leaders took was supported by the majority of Iddir members, or whether it was only the opinion of the Iddir leaders.

[54] *Kabato Kafanii v. Mogor Village Gebriel Iddir*, Liben Chukala District Court, File No. 20238, Date of decision 25/3/2013 (EC).

6.3.2 Transparency in Iddir Governance and the Liability of Iddir Leaders

In *Mulu Woldesenbet v. St John Self-Help Iddir Association*,[55] the court decided that Iddirs should apply clear and transparent procedures in making their decisions. The court decided that decisions of Iddirs should be made in writing and should be communicated to the members accordingly. In this case, the plaintiff indicated in her pleadings that she was a member of St John Self-Help Iddir Association and she claimed that the Iddir terminated her membership and prevented her from paying the weekly contribution to the Iddir. She asked the court to deliver a ruling declaring that the termination was illegal. She requested the court to order the Iddir to reinstate her membership. The Iddir, through its lawyer, stated that her membership was terminated because she caused damage to the property of the Iddir by her gross negligence and failed to respect the decisions of the Iddir leadership to pay 200 Birr for the damage. The Iddir, therefore, argued that the termination of membership was enacted according to the internal rules of the Iddir. The court reasoned that the decisions of the Iddir lacked transparency and proper reasoning. The court, therefore, without ordering further investigation or witnesses decided that the termination was illegal and therefore she should be allowed to continue as a member of the Iddir.

In *Yeka Sub-city Kebele 02, Andnet Teramaj Iddir Association v. Tilahun Alemu and Brhanu Kefyalew*,[56] the court decided that Iddir leaders should only be liable if they violate the internal rules effective during their Iddir leadership. The Iddir sued the chairperson and the cashier of the Iddir at the Federal First Instance Court, claiming that they had embezzled Iddir money to the amount of 84,467.33 Birr and used it for personal gain.

The former Iddir leaders and respondents argued that they had honestly served the Iddir and rejected the accusation. They argued that they performed their duties according to the internal rules of the Iddir and passed all documents to the new leadership according to the internal rules. They claimed that the Iddir had been audited, and the general assembly of the Iddir had approved the audit report. They also argued that the court should not consider the new internal rules, because they had performed their duties based on the previous internal rules rather than the new bylaws. They claimed that the money reported as misused had been given as a loan to members, that debtors and guarantors should repay it as per the internal rules effective at the time, and that they should not be sued for money unpaid by debtors. The Federal First Instance Court decided that the Iddir leaders could not be held liable, so they dismissed the case.

The new leadership of the Iddir appealed to the Federal Higher Court, objecting to the decision of the First Instance Court. The Federal Higher Court examined the case and ordered a new independent auditor to examine the financial report of the Iddir.

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[55] Adama District Court, File No. 86488, Date of decision 13/06/2007 (EC).

[56] Federal Higher Court, Lideta Bench, File No. 167046, Date of decision 02/02/2009.

The auditor finished its audit and submitted the report to the court. The court asked for the opinion of the defendants on the audit report. The defendants rejected the report because the audit failed to follow the court order by including reports that were not part of the case. The court then rejected the audit report for not respecting the court order. Finally, the Federal Higher Court confirmed the decision of the First Instance Court reasoning that no evidence proved that the former leaders of the Iddir had embezzled the Iddir and released the defendants from the charge dismissing the appeal.

This case shows that Iddirs are evolving into complex organizations that need a regulatory framework to avoid possible misuse and conflict of interest in the administration of Iddirs. However, the traditional realities relating to Iddirs show that trust in the context of social interdependence is the bondage between Iddir members. During the erosion of such bondages along with urbanization, Iddirs should be given some level of protection by the formal laws, especially by providing gap-filling formal laws that can support Iddirs to amicably resolve disputes within their administrations.

In *Solomon Mebea and Yaekob Ayalew v. Kebelle 38 residents Iddir Association and its leaders*,[57] the court ordered that Iddirs should be guided by principles of transparency, accountability, and freedom to openly question their leadership. The court emphasized that members should be allowed to forward their complaints to leaders and this should not be considered defamation.

In this case, the plaintiffs requested the court to declare their dismissal from the Iddir as illegal and to order their reinstatement as members of the Iddir. They claimed that they were founding members of the Iddir, had been members since 1981, and had been respecting the Iddir bylaws and fulfilling all their duties in good faith. However, they claimed that the Iddir leadership dismissed them for criticizing their leadership, which was an abuse of the Iddir leadership power. They also indicated that they had submitted their complaints to the social affairs office of the sub-city administration in an attempt to resolve the dispute amicably, but the leadership had failed to accept their call for negotiation to solve their differences according to the norms and traditions of the Iddir.

The Iddir leadership (defendants) submitted the following written statement of defense:

1. The court had no jurisdiction to adjudicate the case because Article 49 of the Cooperative Societies Proclamation No. 147/98 gives arbitrators, not courts, the power to adjudicate disputes in the administration and management of cooperatives.
2. The plaintiffs were dismissed from the Iddir according to the internal rules of the Iddir. The Iddir leadership accused the plaintiffs of violating the internal rules of the Iddir by defaming the goodwill of the Iddir and its leadership. The Iddir leadership claimed that the plaintiffs had accused the Iddir leadership of ethnic

[57] Federal First Instance Court, File No. 235073, Date of decision 03/08/2008.

discrimination without any evidence to support their claim. The plaintiffs were also charged with the dissemination of false rumours about the prevalence of corrupt practices in the administration of the Iddir. As a result of this unfounded accusation, the bank account of the Iddir was blocked by a court order, which affected its normal functioning. The Iddir leadership, therefore, argued that the plaintiffs should be dismissed according to the internal rules of the Iddir, and the general assembly of the Iddir also approved this decision.

The plaintiffs responded orally to the allegation that the Iddir leadership denied the accusation against them. They argued that they were dismissed mainly for demanding transparency and accountability in the Iddir administration. They particularly mentioned that they required the Iddir administration to explain how a garage had been rented out to individuals without an open auction process. They added that as most members of the Iddir were housewives with limited access to information, the leadership was abusing its power for personal benefits.

The court rejected the preliminary objection and ruled it had jurisdiction to decide on the case. The court did not give a detailed explanation of its claim to have jurisdiction over the case. The issue framed by the court was whether the plaintiffs exercised their freedom of speech or whether they had committed a crime of defamation. The court ordered the social affairs office of the sub-city to comment on the issue, and the office provided a written statement stating that the dismissal should be reversed. The court finally decided that the dismissal was not by the internal rules of the Iddir, stating that the quorum required for making decisions had not been fulfilled because only 121 out of 253 members had signed the decision to dismiss the plaintiffs. The court added that the plaintiffs exercised their right to freedom of speech as enshrined in the country's constitution, and the Iddirs should not limit this fundamental right. The court added that Iddirs should promote a culture of democracy and freedom of speech, and they should not punish their members for demanding transparency and accountability.

The case highlights critical issues that many Iddirs encounter. Commonly, the internal rules fail to provide detailed provisions on the required discipline of the members and how the members can check and control the leadership. In many cases, if members have doubts about the integrity and honesty of the leaders, they bring the case to the general assembly and decide on the case.

In *Sodo Mutual Support Iddir v. Mekonnin Seifu*,[58] the new Iddir leaders sued the former chair of the Iddir for 142,049 Birr based on an audit finding. The Iddir claimed that the chair had collected payments from members and used the money for his gain. The chair was also accused of collecting other incomes on behalf of the Iddir and using them for his benefit. The defendant argued that the audit had not been appropriately conducted as it extended back to years when he had not served as a chair. The court rejected the statement of defense and ordered the former chair of the

[58] *Sodo supporting Iddir No. 1 v. Mekonnin Seifu*, Adama Town District Court, File No. 24208, Date of decision, 08/04/2013.

Iddir to repay the money with 9% interest. The court also ordered the defendant to pay a lump sum of 5,000 Birr to compensate the Iddir.

This case clearly shows that Iddirs are exposed to possible abuse and misuse by those who control the administration. The court's decision for a 5000 Birr payment as compensation also seems to contradict Article 2489 of the Civil Code, which specifies that no penalties other than interest payments may be awarded. If the 5000 Birr is a fine, it should be paid to the government, not to the Iddir and of course, this is the jurisdiction of the criminal bench, not that of the civil bench. The court seems to order the 5000 Birr as compensation for the Iddir and the 9% interest out of fairness to the Iddir. The 9% interest may almost be an incentive for "borrowing" funds if Iddir leaders only need to pay 9% interest rates for using Iddir savings. The most logical way to regulate embezzlement in Iddirs is to use criminal laws, particularly Article 702 of the Criminal Code.

In *Sorecha Belda v. Fantale Kurma Balewold Iddir*,[59] the plaintiff sued the Iddir on two grounds: for unlawful termination of his 42-year-long membership and for using duress to collect 30,000 Birr from him. He claimed that the Iddir leaders warned him that if he refused to pay the 30,000 Birr, they would terminate his membership and exclude him from other social events. He therefore requested the court to order the Iddir to reinstate him as a member and pay back the 30,000 Birr that they had collected from him using duress. The Iddir argued that they terminated him from membership because he refused to return Iddir property that had been stored in a shelter built by the Iddir on the land of the plaintiff. Regarding the 30,000 Birr, they explained to the court that the plaintiff had collected 34,263 Birr as compensation from the Ethiopian Road Authority (ERA) for damage caused to the shelter. As the shelter was Iddir's property, he should act in good faith and give 34,263 Birr to the Iddir. They requested the court to dismiss the case and to order him to pay the remaining balance of 4263 Birr to the Iddir.

The plaintiff denied Iddir's statement of defense. He claimed that he had already returned everything belonging to the Iddir. He also claimed that the ERA paid compensation money not for the damage to the shelter but for his personal houses, which were demolished by the government agent.

The court heard the opinion of the government office that paid the money as compensation and listened to the testimony of other witnesses on the issue. The court then decided that the money should be paid back to him, and he must be enlisted again as a member of the Iddir.

[59] *Sorecha Belda v. Fantale Kurma Balewold supporting Iddir*, Lume District Court, File No. 81714, Date of decision 17/04/2011 (EC).

6.3.3 Legal Personality of Iddirs and the Jurisdiction of Iddirs

In *St Balewold Edir v. Birhanu Mengistu*,[60] the court was called to decide on a dispute between the Iddir and a third party who was not a member of the Iddir. In this case, St Balewold Iddir Association signed a contract to buy a marquee from the defendant. However, the Iddir leadership claimed the defendant failed to deliver the marquee per the contract. The Iddir, therefore, sued the defendant, requiring specific performance of the contract or termination with payment of damage. It is important to note here that the Iddir initiated the case using its Iddir name and not the name of its leaders.

The defendant pleaded that he performed the contract on time and as per the specifications provided in the contract. He further argued that Iddir failed to take the marquee at the agreed time and date when it was ready as per the contract; therefore, he sold the tent to another client. The court heard oral testimonies to decide the case. Relying on oral testimony, the court agreed that the defendant breached the contract and should pay 9000 Birr to the Iddir. This case is included to show that Iddirs commonly enter into binding contracts with third parties similar to other legal entities. However, they are not legal entities from the viewpoint of the official law. Furthermore, Iddirs take legal action against third parties using the name of the Iddir, just like any other legal person. This indicates that they are considered legal persons by courts and other government bodies, although they do not meet the official laws' requirements.

In *Dori Golo v. Borite and Milo Villege Mariyam Iddi*r,[61] the plaintiff sued the Iddir for unlawful termination of membership and social exclusion. He claimed that he offered to pay the monthly contributions; however, the Iddir leaders declined to accept the payment and expelled him from the Iddir. He also claimed that all Iddir members excluded him from all social activities and stopped shaking hands with him.

The Iddir argued that he was expelled because he violated the Iddir laws and refused to accept the punishment for his fault as per the bylaws. He violated the bylaws by giving false testimony against another Iddir member. He testified against a member of the Iddir in a court of law; the Iddir learned that his testimony had been false and ordered him to pay 1000 Birr as a penalty. According to the Iddir bylaws, the punishment for perjury is 1000 Birr. He declined to be bound by the bylaws of the Iddir, so his membership was terminated.

The court ruled that the plaintiff had given testimony in an official court according to the applicable official laws and procedures. His testimony was not challenged in the court of law and was not declared perjury. Therefore, the court declared the decision of the Iddir leaders unacceptable and ordered the Iddir to

[60] Adama District Court, File No. 102915, Date of decision 16/9/2009 (EC).

[61] *Dori Golo v. Borite and Milo Villege Mariyam*, Iddir Liben Chukala District Court, File No. 20119, Date of decision 13/02/2013.

reinstate his membership. The Iddir appealed to the Higher Court; however, the court dismissed the appeal and thereby confirmed the lower court's decision.

This case shows that Iddirs use their social power to shape the behaviour of their members in the community. They impose penalties on behaviours that they consider are not acceptable. In this case, the court applied the official laws and seems to claim jurisdiction on the issue. Indirectly, the court decided that the Iddir had no authority to impose a penalty for an action in a court of law. However, since Iddirs have a better chance of effectively investigating and learning about such misbehaviours than the formal judicial sector, motivating them to continue using their social powers may benefit the community. However, some support is required to avoid actions compromising members' fundamental human rights and ensure they are recognised as judicial persons in the strict sense of the law.

6.4 Chapter Summary

Credit from relatives and friends is an important source of credit in Ethiopia and is commonly made orally, without precautions required by law. It can be assumed that most borrowers pay lenders back without requiring courts to intervene to enforce the contract. However, in some cases, lenders may need the help of courts to retrieve their money. The cases discussed in this chapter illustrate that the courts are not consistent or predictable in their decisions concerning loan contracts. The first uncertainty is that courts sometimes require plaintiffs to adduce written evidence attested by two witnesses. In contrast, in other cases, courts accept oral evidence to prove loans that exceed 500 Birr. Another source of uncertainty is that in civil cases, courts refuse to acknowledge any oral evidence that contradicts the content of written evidence, and they strictly apply Article 2005 of the Civil Code. However, the courts accept oral proof that contradicts the written evidence if the case is moved from the civil to the criminal bench. It may be possible for the civil bench to admit evidence dropped by the criminal bench, but for the criminal bench to accept evidence dropped by the civil bench is difficult to justify by any means.

Various Cassation Court decisions indicate the negative perceptions predominant in Ethiopian courts against collecting interest on loans in the informal credit markets.[62] Although the reasons for the courts' inclination need further research, it may be argued that judges' religious and moral values play a large role in how the judges interpret the provisions of the Civil Code rather than rational, legal, financial, and economic arguments. The availability of effective, clear and enforceable legal remedy for a breach of contractual obligations is a significant variable that lenders consider when deciding to provide loans.[63] The lack of an effective legal remedy

[62] Yimer (2019), pp. 472–494. See also the Report of the Ministry of Justice, Commercial Code Revision Council, on March 24–25, 2016; Yimer (2017), pp. 248–294.

[63] Jappelli et al. (2005), pp. 223–245.

encourages unscrupulous debtors to escape contractual obligations, partially or fully. On the other hand, creditors try to compensate for the risks introduced by a lack of effective enforcement mechanisms or possible criminal prosecution under the usury laws by increasing interest rates to hedge the legal risk.[64]

From the findings in this chapter, we can first infer a vivid encounter between the formal legal system and the normative practices developed by traditional financial institutions known as Eqqubs. This is not self-evident. As the South African example reveals, traditional institutions often operate alongside the formal legal system, with members of stokvels showing a solid aversion to litigation before the courts.[65] In other contexts, too, traditional institutions have been seen to fall "beyond the reach of the usual instruments of coercion, both political and legal."[66] However, this is not the case for ROSCAs in Ethiopia, which are the subject of many cases brought before the official courts. Both Eqqub leaders and members seem to realise that they need formal courts to enforce the internal rules and to minimise default. Especially considering the growth of Eqqubs as devices for financing more significant projects and their capacity to bring together more and more people who do not know each other personally, reputation mechanisms alone no longer suffice to maintain member obedience. Interestingly, litigation about Eqqubs is often introduced before the courts by lawyers who have completed university training and become experts in codified norms; however, they then defend normative practices that challenge the letter of the official law.

The second conclusion, which we can draw from the cases discussed in this chapter, is that in the courts, the tension between the normative practices by which Eqqubs abide, and legal provisions in the official codes are very real. Moreover, in most cases, the courts prefer to give legal protection through the official justice system to practices in Eqqubs that are at variance with official norms. From a broader perspective, the judges seem to reason that Eqqubs are essential institutions for society. As a result, their functioning based on customary rules should be promoted and maintained. In principle, this is not problematic from the formal legal system's point of view since Article 3347 of the Ethiopian Civil Code is considered to accept the validity of customary norms as subsidiary laws as long as they are not at variance with the formal laws. However, that is exactly what is happening in reality: in most cases, judges accept customary practices, and internal rules of Eqqubs, even if this leads to violations of codified, official legal provisions. More than half a century after the introduction of codifications in Ethiopia, we can still repeat the conclusion reached by Jacques Vanderlinden in 1966,[67] namely that Ethiopian court judges appeal to the notion of equity to give precedence to the sense of fairness that lives in the local community instead of following official norms, even if such practice leads to contradictory outcomes.

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[64] Fabbri and Padula (2004).

[65] Hutchison (2020), p. 18.

[66] Anderson et al. (2009), pp. 14–23.

[67] Vanderlinden (1966), pp. 250–266.

A third lesson that can be taken from Eqqub cases is how the lack of predictability in court dealings with Eqqubs negatively affects their evolution. One negative effect is that Eqqubs often turn to legal fiction to ensure their transactions receive legal protection from the formal courts. We propose two ways for policymakers to try to solve this problem. The first option is to rigorously reject any deviation from the official laws and require Eqqubs to comply with official norms strictly. Such a modernist policy might encourage Eqqubs to adapt their dealings to the official laws by changing their internal rules. Still, it also risks pushing them underground and weakening their status as important traditional financial institutions. Therefore, another and perhaps better option would be to give Eqqubs the autonomy to regulate their internal affairs while providing legal protection when enforcing decisions. Technically speaking, decisions taken by Eqqub leaders could be equivalent to decisions made by arbitrators, who are subjected to real but limited scrutiny by official courts. Eventually, intervention by the legislator would be appropriate since achieving legal certainty, and judicial predictability will remain hard if courts continue to be allowed to decide on a case-by-case basis.

The cases that relate to Iddirs indicated that in their decisions, courts are very cautious to avoid transgressing the independence and autonomy of these highly regarded social institutions. However, when they are called to intervene by members who consider the decision of the Iddir leadership unacceptable or illegal, the courts do not hesitate to take the case and provide a solution that they think is in line with the norms and traditions in society and with the internal rules of the Iddir, and the official laws.

Generally, courts, in their dealings with Iddirs, have inclined towards giving full recognition to the internal by-laws of the Iddirs, but with a clear message that Iddir leaders should not violate members' rights. In one case, the court expressly declared that Iddirs should promote transparency and accountability, that members should be empowered to question leaders' decisions, and that they should not face any disciplinary measures for questioning the leadership's decisions. This is, we think, the right approach. Courts should recognise and support traditional institutions with some general scrutiny to avoid abuse of power. Still, their internal independence and autonomy should not be compromised, as this may erode their social grounding and acceptance.

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Chapter 7
Conclusion

Finance is considered one of the critical inputs needed to create opportunities for people. Individuals, rich or poor, need financial services. Access to financial services is a key element that people need to improve their quality of life. As the state's legal system becomes more centralised and controlled, access to finance has also been limited to people with better information, education and capital. Official financial institutions have become inaccessible to many people. This results from legal and nonlegal conditions that restrict access to finance to those with adequate property to be used as collateral, official documents to identify themselves and meet other criteria to be included by the official financial system. This limitation has been recognised, and international and national development agents, as has the private sector, have taken many positive actions. However, the legal issues that need to be addressed mainly remain untouched. The laws that determine the conditions and the formalities that need to be fulfilled to provide financial services give little attention to the condition of the poor people.

Recently, access to finance has become one of the main objectives in financial regulation, and countries are paying more attention to improving access to finance in their jurisdiction. Inclusive finance is connected to at least eight of the 17 goals of the UNSDG of 2030. Inclusive finance is directly associated with the UN's goal of ending poverty. The no-poverty movement cannot be achieved without giving people access to finance. People need access to finance to deal with poverty, use their knowledge, skill and entrepreneurship to end poverty and manage national and manmade risks that expose people to poverty. The objective of creating decent jobs is also directly linked with access to finance. In most poor countries, the most important employers for poor people are small and medium enterprises and informal economies. Lack of finance is the main challenge for most people when creating jobs for themselves and others. The goal to eradicate hunger is also linked with inclusive finance, as inclusive finance minimises the risk of hunger. Inclusive finance is also

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G. Yimer, *The Nexus Between Legal Pluralism and Inclusive Finance*,
https://doi.org/10.1007/978-3-031-71653-9_7

an important determining factor that helps to achieve other goals like sound health, gender equality, economic growth, industry, and innovation.[1]

Informal credit markets in Ethiopia and South Africa are governed by official state laws and myriad non-state laws, known as 'legal pluralism'. This unique feature is a crucial determinant in the diverse operations of these markets, as official and non-state laws influence them. The strategies and regulations implemented by the formal sector also significantly shape the operations of the informal credit markets.[2] The informal sector is not separate but intricately intertwined with the formal financial sector. To provide an equitable, accessible, efficient, and sustainable financial service, adopting a pluralistic approach in policies and law is imperative, recognising these sectors' interdependence and mutual influence.

The informal credit markets appear to operate very creatively by blending the local norms and traditions with what they observe from the official laws. The actors in the informal credit markets are not resistant to new norms that they learn from the official laws if they find them practically applicable and serve their purposes well. This incorporation of official laws is the result of many interactions. The fact that some of the leaders and actors in the informal credit markets are educated in official laws and work in government offices has contributed to the incorporation of the official laws into bylaws and into the practices that people use in the informal credit markets. The courts have also helped facilitate interaction between official laws, social norms, and customary laws in two ways. First, when they decide on cases that relate to traditional financial institutions, they usually endorse these norms and usages, thereby giving due recognition to the continuation of the norms and usages. Second, when official laws are applied, and the norms and practices in the informal credit markets are rejected, the actors in the informal credit markets respond by amending their laws and practices to avoid problems of enforcing them in courts of law.

Ethiopian and South African seem to follow similar policies regarding informal credit markets. The two countries allow traditional institutions to operate as providers of financial services without significant government intervention. The fact that the traditional institutions are permitted to apply their laws and customs indicates that legal pluralism is accepted as a matter of policy by the legislator. The courts also have supported legal pluralism by enforcing the bylaws and customs as binding and enforceable laws. The court provides necessary confidence to members of the traditional financial institutions by lending their hand whenever the traditional financial institutions require their support.

The fact that nonstate laws are recognised by the courts and enforced by the courts has allowed traditional financial institutions to provide financial services to people other financial institutions exclude. One important caveat is that the definition of inclusive finance by international financial institutions and regulators like the World Bank is so narrow that it excludes the financial services these institutions

[1] Chitimira and Warikandwa (2023), pp. 1–22.

[2] Zewedu (2014).

provide. These institutions' definitions disregard pluralism and require a centralised and universalised approach. The requirement that states regulate and supervise institutions is biased against the realities in developing countries where the state is not the only regulator in many areas of the economy, including the financial sector. What must be considered important is not who regulates the transaction but rather how transparent, open, and fair the system is for the people, especially those economically disadvantaged.

In this book, an attempt has been made to indicate the critical role legal pluralism can play in enhancing inclusive finance for all. A universalised and centralised approach to financial regulation makes financing access difficult in developing countries. Therefore, we argue that the right approach to promoting an inclusive financial system in developing countries is to embrace pluralism and to allow states to create legal and policy systems that consider the reality on the ground. The international actors, including influential policymakers, should support pluralism in their approach. Pluralism makes these institutions' rules and regulations effective in bringing financial stability and promoting inclusive finance.

In Ethiopia, the legislature does not seriously consider regulating small and microloans. The National Bank of Ethiopia (NBE) has shown no interest in dealing with this issue, though it has a legal mandate to regulate the sector. The introduction of a comprehensive legal framework that governs the provision of small-scale loans for individuals is required to mobilise sufficient resources to provide access to credit for most of the population. The law may provide a legal framework for underground moneylenders to become registered and licensed operators. Once they are registered and licensed, it may be possible to provide the required protection to borrowers.

The law could allow regional governments to register, regulate, and supervise credit providers. Credit providers no longer need to travel to the capital to report or complete other administrative activities. The law could impose a maximum amount private credit providers may provide as a loan and a total amount of credit they may give annually. The law could also establish authorities at federal and regional levels to regulate and supervise private credit providers and provide the required support to customers.

The NBE could control the overall process to ensure alignment with other countries' policies and avoid any general systemic risk to the financial sector. The National Credit Act of South Africa could serve as a model for the new laws. However, it must be modified significantly and adapted to incorporate Ethiopia's existing norms, usages, and practices. The National Credit Act of South Africa has a lot of complications that make it inaccessible to many. So, Ethiopia should avoid making the same mistake. Ethiopia may pay great attention to clarity and simplicity as most people who use them may not have an advanced educational background to understand the laws.

To sum up, one size fits all is a thing of the past. Law is meant to serve the people; therefore, it must be developed considering the social and economic realities of the people and the aspirations of the people. The law must reflect the balance between the past, the present, and the future. Legal pluralism enables regulators and courts to maintain the balance between the past, the present and the future. Financial laws that

depend only on formalities and hard information exclude people with different norms and cultures. The experiences of the informal credit markets in Ethiopia and South Africa indicate that different approaches work very well to provide accessible, affordable and sustainable financial services to the people. Therefore, policymakers and regulators should consider pluralism rather than unilateralism in their approach to financial regulation. International development organisations, financial institutions, international financial rule makers and standard setters should be aware that universalism and unilateralism have limitations. Pluralism is not a magic bluet that solves all problems. However, pluralism is a virtue that enhances financial stability and helps fight international financial-related crimes. Pluralism better recognises local innovation and creativity, which is vital for an inclusive financial system to flourish.

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