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Microfinance in Uzbekistan: market overview and impact assessment needs

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Microfinance has a strong footing in Uzbekistan, the most populous country in the Central Asian region with a large fraction of inhabitants living in rural areas. Considered one of the key means of alleviating poverty and generating employment, the Uzbek government gave priority to microfinance initiatives, which resulted in the adoption of several microfinance laws. This paper provides an overview of the microfinance market as it has evolved in Uzbekistan, and calls for more comprehensive types of impact evaluation surveys that could benefit further market development.

Market overview

About 1.4 billion¹ people globally live on less than one dollar per day and face extreme poverty as well as social and financial exclusion. Historical evidence shows that not all poverty eradication programs are efficient in reaching the poorest of the poor (Adams et al, 1984). In recent decades, however, microfinance has emerged as a promising means of addressing this problem, as it requires less investment yet still serves a large portion of the poor that traditional banking finds unprofitable. Microfinance is a non-standard provision of a broad range of financial services such as collateral free loans, saving deposits, insurance, remittances, leasing and money transfers to low-income households that are used to support their family business or productive activities (Aghion and Morduch, 2005). The microfinance sector in the Central Asian region is a young and rapidly changing

market exhibiting high demand and necessity for such services (MIX, 2008). Uzbekistan, being the most populous country of the region with the largest fraction of its population in predominantly rural areas, deserves particular attention.

After the break-up of the Soviet Union, Uzbekistan faced hardship as industry, trade and agriculture systems unraveled while transport and energy infrastructure fragmented. To mitigate the unfavorable effects of the transition period the country regulated the speed of change from planned to market economy and undertook a number of policy changes. Not all of the negative effects were eliminated and the incidence of poverty, especially in rural areas, was not fully addressed. In Uzbekistan, where over 60% of the population lives in rural areas, transition measures directed towards agriculture and farm restructuring had short-term adverse effects that required additional measures, such as microfinance (UNDP, 2006).

Once identified as a key means of alleviating poverty, the Uzbek government gave priority to microfinance initiatives, resulting in the adoption of several microfinance laws which became an integral part of the national Welfare Improvement Strategy (2005). Several factors made microfinance an urgent and important initiative for the country (UNDP, CER 2005):

¹ Source: World Bank estimates of poverty line, September 2008.

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- To provide employment and reduce poverty, particularly in rural areas;
- To reduce labor and skills migration by supporting small entrepreneurship and self-employment;
- To boost savings and enhance social stability and cohesion;
- To improve women's role in business;
- Investment into the production potential of local communities;
- Establishment of new segments of the financial market.

Even though Uzbekistan is the largest market in Central Asia, with a total population equal to the combined population of Kyrgyzstan, Kazakhstan and Tajikistan, the banking and microfinance sector is still immature due to the difficult operating environment and rigid regulatory framework (MIX, 2006). In comparison to its neighbors, Uzbekistan has the shallowest microfinance sector and the smallest penetration rate as can be seen from Table 1.

Table 1: **Microfinance market penetration in Central Asia**

Country	Population (million)	Population below the national poverty line	Market Penetration (borrowers of MFIs)
Kazakhstan	15.3	34.1%	3.76%
Kyrgyzstan	5.2	40.6%	8.29%
Tajikistan	6.7	39.1%	2.21%
Uzbekistan	26.5	27.2%	0.83%
Total	53.7	31.9%	2.85%

Source: CAC, MIX Market, WDI, 2008. Poverty line for Tajikistan is estimated based on other macroeconomic data

Among the key factors hindering rapid growth and high penetration rates of the microfinance market are the lack of legislative and regulatory frameworks, and taxation issues (World Bank, 2007).

Institutions engaged in microfinance in Central Asia are among the youngest in the world, with a median age of less than five years, according to experts of the Microfinance Information Exchange (MIX 2006). In Uzbekistan particularly, the first micro-credit programs were initiated by the United Nations Development Program (UNDP) in 1998 through the implementa-

tion of two pilot projects in the Kashkadarya and Karakalpakstan regions which launched the first MFI-NGO type institutions. Objectives of these projects were to improve access to financial resources among the low-income groups to support their trade, small-scale production, and micro-business activities. The success of these projects led to the adoption of a national law "On Measures for the Development of Microfinance in the Republic of Uzbekistan" (Decree # 309 of August 2002).

Table 2: **Institutions providing microfinance services in Uzbekistan**

	Total Number	Number of Borrowers	Outstanding Loans, USD mln	Average Borrowers per Institution	Average Loan, USD
EBRD Partner Banks	4	6787	17.9	1697	2637
Mikrokreditbank (specialized bank)	1	13000	39.0	13000	3000
Microfinance Institutions	11	28967	3.8	2633	131
Credit Unions	35	10866	13.8	310	1270
Total	51	59620	74.5	1169	1250

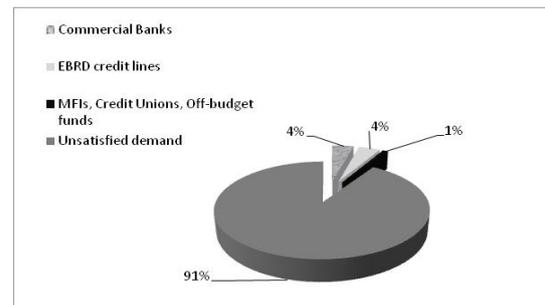
Source: MIX "Central Asia Benchmarking Report, 2006", Japanese - Uzbekistan Small Business Program (EBRD Uzbekistan), Association of MFIs of Uzbekistan (MTA), Association of Credit Unions of Uzbekistan. Figures for Mikrokredit Bank are estimated based on publicly available resources.

Microfinance services are currently provided by commercial banks, savings and credit unions, NGO-MFIs, and credit lines of special off-budget funds (such as the Dehkan and Farming Entities Support Fund, and the State Employment Fund) and from international financial institutions such as EBRD and Asian development Bank (ADB) (Table 2). Interest rates and amounts of credit vary considerably depending on the type of institution.

Until 2006 the range of institutions offering microfinance services in Uzbekistan included banks, credit unions and a number of international NGOs and projects. In mid-2006, two new laws — “On Microfinance” and “On Microcredit Organizations” – were enacted in order to provide a legal basis for the operation of non-bank lending institutions. A general lack of clarity in the legislation, however, created the need for a variety of restrictions (MIX, 2008, p. 5). Hence NGO-type microfinance institutions (MFIs) were required to register under the new legislation. Since then, several MFIs including FINCA, Barakot and FVRM have closed entirely while others have reduced their outreach. Re-registration of remaining MFIs changed their status from NGO to MCO (i.e. Microcredit Organization). Another major development occurred in May 2006 when the government decided to re-organize the state-run Tadbirkor Bank into the first specialized Mikrokreditbank to offer consulting and microfinance services, including loans at a subsidized interest rate of 5%, to a broad range of customers (MIX, 2006, p. 7). Today Mikrokreditbank is the largest bank-type MFI with 78 branches nationwide serving 140,000² clients (as of January 2009) and with total assets of 181 bln UZS³.

Despite these changes and improvements in legislation, the market is still in an embryonic stage. Taken together, all microfinance institutions across the country cover only 9% of the demand, thus leaving a huge untapped potential for growth (Figure 1).

Worldwide microfinance products generally include provision of micro-credits, micro-insurance, micro-leasing, money transfer, and deposit insurance, among others. Due to the immaturity of microfinance in Uzbekistan, credit and leasing services currently dominate. This creates a need for greater product diversification, which would promote further competition and growth of the market.



Source: CAMFA, UNDP 2006

Figure 1. **Microcredit market in Uzbekistan and unsatisfied demand**

Concerning microfinance borrowers, a typical profile in Uzbekistan is quite similar to others worldwide: mostly women (around 80%) with earnings below the national poverty line and willing to maintain their own small business or to generate additional sources of income. The loans are provided both to individuals (mostly by bank-type MFIs) and to groups (by Credit Unions). UNDP and the Center of Economic Research in Uzbekistan (2005) conducted a survey in five regions of the country where microfinance has been active to estimate the demand for microfinance services by MFI clientele. Table 3 illustrates the profiles of potential borrowers.

The loans are predominantly used for live-stock production and trade: i.e. the purchase of dairy cows or cattle for slaughter, or the purchase of sheep and goats for trade. Microfinance loans are also taken for other purposes such as the trading of fruits, vegetables, and rice, reflecting a higher demand for products in rural areas where agriculture dominates. According to law, microfinance loans cannot be used for the repayment of earlier debts, tobacco and liquor production, turnover capital and intermediary businesses, gambling business, or the purchase of office equipment⁴.

² As of January 19, 2009. Retrieved from <http://www.mikrokreditbank.uz/?q=ru/node/139>.

³ Avesta Investment Group “The review of main economic events” January 25, 2008. <http://avestagroup.com/lib/ud/08/en/01/ud080125e.pdf>

⁴ “Microfinance in Uzbekistan”, Retrieved February 2, 2009 from <http://www.darvoza.uz/microfinance.php?subtopic=40&lng=1>.

Table 3. Consolidated table of potential MFI clientele:

	Total Number:	of which potential MFI clients
Microfirms	259,300	155,600
Entrepreneurs without legal entity status	4,689,300	1,808,400
Dekhkan farmers	4,500,000	981,600
Unemployment	597,000	287,000
Poor population groups	1,915,000	1,915,000
Labor migrants	1,000,000	480,000
Total:	12,960,600	5,627,600

Source: UNDP, CER 2005.

The loan repayment rate in Uzbekistan is 97% - 100%, which is in line with other microfinance activities worldwide. Loan maturities are on average up to one year. The interest rate charged per month is low in comparison to commercial bank lending: 2.5% from a Credit Union, 4-5% by MCOs, and 1.2% by Mikrokredit Bank. Yet based on international comparison of comparable institutions worldwide, the interest rate levels at Central Asian MFIs are among the highest (MIX, 2006). An interesting fact is that financial revenues of MFIs are highest in Uzbekistan, reaching up to 70% with annual effective⁵ interest rate close to 80% which is "higher than all but few inflationary markets in Africa" (MIX, 2006, p.12). One explanation for such a phenomenon lies in the high cost of microcredit, largely reflecting the higher effective cost of finance in the market and the still limited options for borrowers.

Program Evaluation

Given the importance of microfinance for the development of Uzbekistan, several surveys have been initiated to assess the market, client profile, and level of customer satisfaction. Most surveys have been conducted by International Donor Organizations such as UNDP, ADB, and IFC. Table 4 below summarizes these surveys, their purpose, sample coverage, and methodology.

Nearly all surveys conclude with policy recommendations on the improvement and further development of the microfinance market. In

⁵ Effective here implies annual compounded interest rate in nominal terms.

general, the policy recommendations consist of:

- A regulatory and legislative framework that ensures the transparency, consistency, and sustainability of microfinance programs;
- The extension of preferential taxation status;
- New pilot projects;
- An appropriate interest rate policy.

Based on these and other recommendations the future path of market development is defined and key priorities are established. At the same time there have been no comprehensive program evaluation studies; even though substantial data have been generated from these surveys, these data have only been part of general analysis and used to track common trends but not used for deeper qualitative analysis.

Microfinance impact evaluation studies are important as they help MFIs and policymakers to improve program and product design. Microfinance evaluation encompasses a broad range, including 1) *program evaluation*, which examines the effectiveness of a certain MFI to improve the welfare of its clients; 2) *product/process evaluation*, which measures the particular effectiveness of one product vs. another; 3) macro-level *policy evaluations* of certain bank regulations or policy changes (Karlan and Goldberg, 2007). In large-scale international research, there is plenty of empirical work evaluating microfinance in many developing countries such as India, Bangladesh, Peru, and Mexico. There are, however, no comprehensive attempts to measure the impact of microfinance for Uzbekistan, even though the first microcredit NGO was established a dec-

ade ago in 1998 by UNDP initiative (UNDP, 2006).

Impact assessment is an ambitious undertaking, though given the large unmet potential in Uzbekistan such an assessment could help focus attention on the influence microfinance

has on borrowers' income, employment, education, social and health status, and poverty rate. Good and reliable survey results in turn affect policy recommendations and further decision making.

Table 4: **Surveys on microfinance and SME activities in Uzbekistan:**

Name:	Organization:	Format:	Time span:	Respondents:	Coverage (regions):
"Uzbekistan Regional Household Survey" 2006 (LSMS type)	WB, "Expert Fikri"	household questionnaire and community questionnaires	1) March-April, 2005 2) October-November 2005	households	1) Andijan 2) Kashkadarya 3) Tashkent city
"Family Assets Mobilization Survey" 2003	UNDP, CER, TAHLIL	household questionnaires; in-depth interviews	2003 only	720 households	1) Andijan 2) Samarkand 3) Khoresm
"The World Bank Living Standards Assessment Survey", 2003, Family Budget Survey	WB, National Statistics Authorities	household questionnaires	2000-2001	10 000 households	random sampling country coverage
Development of Microfinancing in Uzbekistan	UNDP, CER, TAHLIL	household questionnaires; in-depth interviews	March-April 2005	620 respondents 1) treatment group - clients of bank and non-bank MFIs 2) control group	1) Kashkadarya 2) Namangan 3) Samarkand 4) Tashkent 5) Fergana
IFC Business Environment Survey	IFC	questionnaire data, more than 100 questions	2000-2006 conducted on annual basis	1500 – 3000 small business owners and managers	country coverage
"Microfinance Clients Satisfaction Survey" by Bernard Cartella - International Consultant ⁶	UNDP, EU funding	one-to-one interviews of individual clients	September - October, 2007	35 current borrowers from Credit Unions	1) Fergana 2) Bagdad 3) Rishton

The literature on microfinance is abundant and varied, focusing on its diverse services, its socio-economic impact, and its overall promise to combat poverty by reaching low-income households. The evidence, though, is fairly mixed and leaves room for further applied research. To obtain robust results regarding microfinance impact evaluation, the choice of method makes a difference:

1) *Empirical tests* suffer from problems of quality, comparable data, and difficulties in designing an appropriate methodology. Self-selection of borrowers, non-random placement of MFIs, difficulty in specifying treatment and control

groups, and endogeneity and other measurement issues create inconsistency in results and misleading conclusions about the ultimate benefit of microfinance programs (Karnani, 2007; Dichter and Harper, 2007; Morduch, 2001).

2) Randomized program implementation is currently seen as the "gold standard" for impact evaluation in a search for the most effective development interventions (Linnemayr and Alderman, 2008). Also called as *Randomized Control Trials (RCT)* they are among the more recent methodological innovations in microfinance evaluation; the methodology is com-

⁶ I am grateful to Usmon Rakhimjanov (UNDP Tashkent) for kindly sharing this report.

monly used in health, education and consumer finance applications. Using RCT method we can measure the desired impact addressing selection bias and thus have robust estimates and at the same time also improve decisions on microfinance product design, policy choice as methodology involves experimentation for a better outcome.

There is a growing body of microfinance research using quasi-experiments and randomized experiments in the field, represented by the work of Pitt and Khandker (1998) in Bangladesh; Armendariz, Karlan and Mullainathan (2007) in South Mexico; Coleman (1999) in Thailand; Cason, Gangadharan, and Maitra (2008) in Australia and India. The core strategy in RCT is to obtain a "what if" counterfactual by introducing a random assignment/experiment.

Even though RCT results are robust, the methodology has a number of practical limitations. First, it is difficult to vary specific properties of MFIs in the field experiment because of problems of replicability, data accessibility and comparability (Bolnik, 1988; Hulme, 2000). Moreover, in the RCT framework some important variables (i.e. monitoring cost in group lending) are left unobserved. Also, the length of the entire trial could be several months and the overall costs are high as the "subject pool" involves real borrowers who need to be compensated more than lab participants (mostly students).

3) Given the above-mentioned limitations of field experiments, *Laboratory Experiments* in microfinance have become a rapidly growing research domain. Laboratory tests have the advantage of controlling for particular external factors and specific parameters, thus enabling experimenters to observe the direct impact of a

simulation. Furthermore, in the laboratory framework one can identify which factors affect decision-making by changing treatment variables and holding other parameters fixed (Abbink et al., 2006). One obvious limitation is that, like RCT, a subject pool of students might not always be justified as a good proxy for real MF borrowers. Therefore, a combination or sequential use of lab and field experiments could be a promising methodological strategy for producing both robust and comparable results.

To summarize, in the current environment of financial crisis that has shattered trust in formal financial intermediaries, the role of microfinance institutions is even more important for low-income populations. In Uzbekistan, where 60% of the population is low-income, microfinance already secured its place in 1998 and since then has gained Government priority as a key means of welfare improvement and poverty reduction. There is large donor community that has facilitated the development of the microfinance market by offering policy recommendations based on various surveys. Despite that fact, though, no comprehensive microfinance program evaluation has yet been done. Based on the example of other developing countries which have implemented microfinancing initiatives, results of such evaluations could have potentially dramatic policy implications. From the methodological perspective, a sequence of diagnostic survey followed by field experiment could be a promising means of conducting a robust program evaluation. By choosing an appropriate methodology, evaluation of MFIs operating in Uzbekistan should prove complementary to existing surveys and practically benefit further development of the country's microfinance market.

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