

## 1. CAS DATA

**Country:** Republic of Uzbekistan

**CAS Year:** FY08

**CASCR Review Period:** FY02-FY07

**Date of This Review:** May 30, 2008

## 2. ASSESSMENT OF THE CASCR'S COVERAGE OF IFC'S ACTIVITIES

The 2005 CASCR that is reviewed here does not include any coverage of IFC's FY02-FY04 activities in Uzbekistan. The proposed 2008 CAS has a limited coverage of IFC's activities during the period covered by the Interim Strategy Note approved in July 2006. This document will provide information on IFC's role, key activities and operational results during the period FY02-FY07. The 2008 CAS would have benefited from an updated CASCR with an in-depth coverage of how IFC's role and activities can help a transition economy attain greater progress in the private sector through projects designed to provide a combination of investment and advisory services.

## 3. IFC AREAS OF FOCUS DURING THE CAS PERIOD

IFC was to continue its dialogue with the Uzbekistan government and support the Bank's program to improve the business environment for private investment while, at the same time, implement a strategy where IFC would primarily focus on: (a) supporting micro and SMEs through lines of credit to commercial banks and advisory services; (b) capacity building for banking and non-banking financial intermediaries; (c) providing technical and financial support to selected investments in sectors with significant export potential such as natural resources and agri-processing, or where privatization was possible (banks, telecommunications, power, and large SOEs across a range of sectors); (d) providing advisory services leading to new private sector investment, mostly through the Private Enterprise Partnership (PEP) initiative where micro-leasing would be a key focus; and (e) seeking more investment opportunities in the health sector and the private sector insurance industry.

## 4. RELEVANCE OF IFC AREAS OF FOCUS

In the absence of IFC's coverage in the Uzbekistan CASCR, it is nonetheless IEG-IFC's view that IFC's strategic focus as described in section 3 above was appropriate given Uzbekistan's need to develop its emerging private sector and attract foreign investment. The advisory services as identified in the CAS aimed at capacity building and improving the business enabling environment continue to remain relevant in Uzbekistan. As indicated in the FY02 CAS, the pace of privatization would have implications on the scope of its advisory services and potential investments in Uzbekistan. However, the WB Group was overly optimistic regarding the pace of reforms in the country. There were tell-tale signs in the protracted dialogue between the government and the Bank that, at the outset, already signaled the government's lack of commitment to achieve the CAS objectives, and a lack of consensus to undertake the reforms at a faster pace.

**Reviewer:** Victoria Viray-Mendoza

**Stoyan Tenev, Head, Macro Evaluation**

**Peer Reviewer:** Stephen Pirozzi

**Amitava Banerjee, Manager**

## **5. IFC ACTIVITIES DURING THE CAS PERIOD**

### **A. Investment projects**

A comprehensive list of IFC investments is presented in Table 1. Prior to the period under review, IFC had committed 15 projects from FY94-FY01 for a total committed amount of \$42 million. Eight of the 15 projects were in the financial sector, particularly financial intermediaries under SEAF, which comprised 59% of the total volume of commitments for that period. The rest were in one-off projects in the various sectors such as: extractive, agri-business, and general manufacturing & services. The outstanding balance of IFC's portfolio in Uzbekistan as of end FY01 was \$10.08 million.

For the review period FY02-FY07, four projects in Uzbekistan were approved for a total loan commitment of \$10.5 million; plus one regional project with a loan commitment of US\$45 million. Three of the four projects were in the financial sector.

**Uzbek Leasing II** provides medium-term dollar-indexed leases mainly to SMEs for food, transport, textile, oil & gas, chemical, mining, plant and machinery, office equipment and transportation vehicles. Uzbek Leasing is by far the largest and the only dollar-based financier of SMEs. It was the first leasing company in Uzbekistan and served as a model that led others to begin similar operations. The project has had a significant developmental impact by providing financing to SMEs that otherwise would have had little access to credit for the acquisition of capital goods because of the scarcity of term financing to fund imported production equipment to Uzbekistan.

IFC provided a credit line to **Asaka Bank II**, the second largest bank in Uzbekistan, for on-lending to SMEs and to support the export sector. Asaka Bank, a "Specialized State Joint-Stock Commercial Bank," is majority state-owned but operates on a commercial basis. Since 2003, IFC and EBRD have jointly advised the Government of Uzbekistan on the sale of up to 49 percent of Asaka's shares, in support of the privatization plan.

However, as of end-FY07, Uzbek Leasing and Asaka Bank are experiencing portfolio quality issues and are classified as "projects at risk." Uzbek Leasing experienced delays of payment from lessees with no allowance for doubtful accounts; while Asaka Bank experienced violations of single client exposure as well as profitability issues resulting from over-reliance on non-lending activities.

In FY07, IFC invested \$3 million in a commercial bank, **Hamkorbank II**, to offer micro and SME loans, consumer loans and leasing products. The Hamkorbank project is performing well.

The fourth project, **MFI-Central Asia Facility (PEP)** is a regional project in the microfinance sub-sector. The facility not only on-lends to micro and SMEs, but also provides advisory services to participating institutions in 4 Central Asian countries (Kazakhstan, Kyrgyz Republic, Tajikistan, and Uzbekistan). The facility is financed by IFC for \$45 million, EBRD for \$107 million, and SECO for \$3 million, for a grand total of \$155 million. A total of \$10 million of the funds, of which IFC and EBRD are providing \$5 million each, specifically targets Uzbekistan. The facility is performing successfully in Uzbekistan.

The outstanding balance of IFC's investment portfolio in Uzbekistan as of end-FY07 is \$7.65 million. No IFC investments were realized in sectors with significant privatization activities. No new investments were realized in the other sectors identified as potential areas of investment such as the health care and private insurance sectors. However, it must be noted that an additional US\$0.5 million was added by IFC to the credit line of Uzbek Leasing intended for private dental clinics, which is in line with IFC's strategy to support and strengthen the health care sector, particularly in the area of emerging private dental care.

In summary, the sectoral distribution of IFC's activities is consistent with the priority placed on the financial sector in the FY02 CAS, but overly concentrated in the financial sector. In view of the poor investment climate during the CAS review period, bankable projects in other sectors were difficult to find. The ICCR rating, which is IFC's proxy for a country's investment climate, shows Uzbekistan with

a score of 17.8 in 2002 and 25.2 in 2007, where a score below 30 indicated a *high risk* country. Heritage economic freedom indicators show a score of 37 in 2002 and 52.6 in 2007, where a score of 50-59.9 is *mostly unfree* and below 50 is *repressed*. Although both indicators show a slow incremental improvement in scores from 2002 until 2007, Uzbekistan essentially still remains a *high risk* country.

## B. Advisory Services

The textile sector was formerly the most active sector for advisory programs in Uzbekistan. For the period under review, the financial sector is the most active, particularly in commercial banking, leasing, M-SME lending, and housing finance. The advisory services projects aimed at improving the business environment, and strengthening capacity of SMEs in the banking sector. Eighteen advisory service projects in Uzbekistan have been approved to date, of which 12 are in the period under review. Key results of the FY02-07 advisory services include:

- (1) **Uzbekistan SME Consultants' Training (PEP)** held two training programs for UzInvestProject, a local consulting company with operations throughout Uzbekistan, that focused on strengthening business plan writing, conducting market research, financial analysis skills, and measures to increase awareness of legal norms by both entrepreneurs and inspectors;
- (2) The **PEP Uzbek BEE** assisted the government (a) develop 9 Presidential Decrees; (b) decrease registration time and cost from 21 days and \$240 in 2005 to 11 days and \$68 in 2007; (c) conduct 5 nationwide surveys of the SME sector from 2001-2007, from which 110 out of 170 policy survey recommendations have been adopted; (d) introduce risk-based management at all 33 inspectorates and create 11 inspection checklists for the Fire & Sanitary Inspectorates; (e) provide training for 2,900 government officials on new regulatory procedures; (f) develop and disseminate about 34,000 copies of information inspections materials and business registration procedures to SMEs; and (g) introduce the Regulatory Impact Assessments to monitor and assess results of SME-related regulations enacted;
- (3) **Improving Microfinance Legislation (PEP)** in Tajikistan and Uzbekistan built the capacity of central banks in the countries in the area of microfinance;
- (4) **Plastic Card Program** developed an advisory program consisting of (a) a market study to determine the extent of demand for plastic card payments and identify obstacles to introducing a new system; (b) a business plan to address strategic choices, projected revenue flows and costs, and social attitudes toward the current banking system; (c) a technological review of the most appropriate software and hardware once market data confirms the project's feasibility.
- (5) **Uzbekistan Dairy Sector Supply Chain Development Project** provided advice on agricultural, financial and legal issues directly to Nestle suppliers and potential suppliers in the Namangan Region;
- (6) Through **Uzbek Telecom**, IFC is overseeing a pre-privatization development program;
- (7-8) **Uzbekistan SME Policy Development** (UzbSMEPolicy Phases II & III) assisted the government to improve regulatory policies for the SME sector, as well as to streamline inspections process, improve regulatory framework for permits, and increase legal awareness to stimulate SME growth.
- (9) **Azerbaijan-CA Leasing Facility** (ACALF) helped participating financial institutions (PFIs) implement new policies and procedures on leasing, risk management, asset/liability management, and internal audit/controls thereby strengthening their institutional capacity. The facility currently provides assistance to 2 PFIs engaged in financial leasing in Uzbekistan: **Hamkorbank** and **Uzbekleasing**. At the industry level, ACALF improved the business climate by being a catalyst for outside investment, enabling \$12.3 million of investment. At the individual financial institution level, the Project is a well developed advisory program that built capacity and strengthened systems to ensure sustainable lending operations at each participating bank. Both PFIs are financially successful and performing significantly above the sector average. Among the 5 countries covered by the Facility, the most significant growth was observed in Uzbekistan.

- (10) **Azerbaijan-CA Mortgage Market**, a regional project covering 5 countries, identified legal and regulatory gaps in the housing finance systems, and developed training and action plans for improving affordability and availability of mortgage funding for middle and lower class households, and helped draft and pass the Mortgage Law in Uzbekistan signed by the President in 2006;
- (11) **Uzbekistan SME Policy Development (PEP)** (UzbSMEPolicy Phase IV) - With the project's support, the Uzbek government adopted four decrees signed by the President in order to ensure a better entrepreneurial climate for businesses: (a) decrease the burden of inspections; (b) reduce excessive powers of inspecting agencies; (c) reduce SME reporting requirements; and (d) simplify SME taxation; and
- (12) **Hamkorbank III** used a "twinning" program in which small banks were partnered for two years with Commercial Bank of Ireland and provided hands-on training in all areas of banking operations.

There are three Project Completion Reports (PCRs) (not rated by IEG-IFC) in the TAAS database showing all three as *excellent* projects across three measures (timeliness, financial, M&E). Three XPSRs have been evaluated by IEG-IFC to date: 2 are *mostly successful*; and one is *mostly unsuccessful*. Eight projects have been rated with DOTS DO ratings: 4 are *mostly unsuccessful*; 3 are *mostly successful*; and 1 is *successful*. Therefore, compared with the DOTS ratings, it seems that the results of the self-evaluations contained in the PCRs may potentially be overly positive.

In summary, substantial advisory projects were undertaken by IFC in Uzbekistan, the majority of which were in the financial sector. This focus on the financial sector is in line with IFC's overall strategy for Uzbekistan to assist in the privatization and development of the financial sector. A comprehensive list of all IFC advisory services undertaken in Uzbekistan is presented in Table 2.

## 6. IFC'S CONTRIBUTION TO CAS OBJECTIVES

IFC contributed toward advancing Objective 2 of the CAS – "**continue to improve the policy framework and business environment for private sector investment and trade**" primarily through its advisory services operation.

On the investment side, three projects in the financial sector during FY02-07 helped to improve the business environment by increasing access to finance to SMEs, and to support the export sector.

On the advisory services side, twelve projects that were undertaken in the financial, agribusiness, and telecommunication sectors were generally business enabling environment advisory projects. Seven of these were in the financial markets sector.

In line with IFC's strategy for Uzbekistan, IFC's investment and advisory projects were very supportive of the financial sector by making leasing and long-term financing accessible to SMEs through financial intermediaries, in light of the fact that IFC no longer finances directly the M-SMEs in Uzbekistan.

It is worth highlighting the two joint investment-advisory projects that delivered positive results. In the leasing sector, advisory assistance in developing legislation on leasing, and management and accounting training for local entrepreneurs was provided through the **CA Leasing Facility**, from which lease financing was made available to SMEs as a result of IFC's credit line.

IFC also provided a senior credit line to **Hamkorbank II** for sub-lending to small entrepreneurs in Uzbekistan, as well as advisory assistance on treasury operations, risk management, corporate lending, branch management, and human resource development. Advisory assistance was provided towards institutional capacity building through essential training and dissemination to consultants, entrepreneurs, and government officials.

The WB group cooperates with financial institutions of Uzbekistan mainly through IFC. IFC's assistance in advising the government to privatize **Asaka Bank** and **Uzbek Telecom** could increase

the likelihood of progress on other privatizations.

In summary, through investment and advisory projects, IFC contributed to the development of Uzbekistan's financial sector, particularly through leasing, mortgage finance, consumer finance, and micro-finance. IFC also helped improve several aspects of these finance sub-sectors particularly through assisting the government in developing and passing the needed regulations and legislation to build a better business climate in the country. The enactment of these laws has increased legal awareness and has reduced the business risks associated with inefficiencies in the inspections processes and regulatory framework for permits. IFC also conducted surveys to monitor the development of the SME sector. IFC has found it more effective to target SMEs by using the lending windows of financial intermediaries rather than targeting SMEs directly. This, in fact, has been an IFC corporate-wide trend. However, IFC was unable to develop investment projects in the health care and insurance sectors, and other sectors that had the potential to be privatized. It is apparent that inappropriate policies, inadequate legislation in basic commercial areas, and the slow pace of privatization contributed to the difficulty for IFC in finding other bankable projects outside the financial sector.

## 7. LESSONS AND CHALLENGES FROM PAST EXPERIENCE

In Uzbekistan, the growth of the SME sector is particularly constrained by inappropriate government regulation, inadequate legislation, and poorly managed implementation mechanisms. By providing investment and advisory services to address these issues, IFC supports the growth of SMEs which is critical in the development of Uzbekistan's economy. The 2005 CASCR states that the Uzbekistan government is very appreciative of IFC's SME surveys and Private Enterprise Partnership (PEP) TA services, and has been encouraged by this work to make improvements to the business environment for SMEs.

Efforts to ensure coordination of investment and advisory assistance work among WB, IFC and the EBRD as exemplified in the pre-privatization development plans for Uzbek Telecom and Asaka Bank will continue to be important to exemplify the benefits of privatization to the authorities and other state-owned entities.

Furthermore, as IFC seeks to explore investments beyond the financial sector into private provision of social services (health care, private insurance), there is considerable necessity to work closely with the Bank and the government to agree on the pace of reforms and the key activities to be undertaken in the following CAS program. The reform process in Uzbekistan has been historically slow and incomplete. Government buy-in and commitment can be had with continuous dialogue to derive a realistic time frame and an agreed strategy to mitigate the effects of the slow pace of privatization, regulatory policy and legislative reforms that ultimately result in a poor business climate. In order to fully engage the government; and consequently have its overall government commitment and adherence to the reform process, it is important to have jointly prepared results-oriented goals and targets, as it is also important to make known the incentives down the road when government performance and adherence to these goals are met.

**Table 1: IEG- IFC List of Uzbekistan Investments**

Project ID	Project Short Name	Approval Date	Commitment Date	Project Size	Regions - Seven	Country	IFC Sector Group	ToTal Net Commitment (US\$'000)
004323	AMANTAYTAU GOLD	03/17/94	12/12/94	6,400	SECA	Uzbekistan	Extractive	\$930
004535	ULCL LTD	06/28/95	08/28/95	24,000	SECA	Uzbekistan	Finance	\$600
004760	ABN-AMRO Uzbek	04/09/96	06/12/96	10,000	SECA	Uzbekistan	Finance	\$1,000
007835	UZCASEMASH	06/17/97	04/15/98	28,400	SECA	Uzbekistan	Industrial Products	\$0
007848	UzCase Agrolease	06/17/97	04/15/98	17,490	SECA	Uzbekistan	Finance	\$0
007934	UzCaseService	06/17/97	04/15/98	24,600	SECA	Uzbekistan	Technical Services	\$0
008077	SEF Fayz	04/18/97	04/15/98	4,800	SECA	Uzbekistan	Industrial Products	\$2,400
008164	Core Pharmaceuticals	06/30/97	10/01/97	12,200	SECA	Uzbekistan	Chemicals	\$3,850
008700	NBU-SME	06/21/99	02/29/00	15,000	SECA	Uzbekistan	Finance	\$10,858
008701	Asaka Bank	06/21/99	12/31/99	10,000	SECA	Uzbekistan	Finance	\$10,000
008832	SEF Elma Cheese	06/28/99	11/30/99	1,460	SECA	Uzbekistan	Agribusiness	\$584
009582	SEF Asia Granite	12/22/99	09/06/00	5,914	SECA	Uzbekistan	Construction & Materials	\$1,650
010124	Uzbek Leasing Rights Issue	12/30/99	07/12/00	2,900	SECA	Uzbekistan	Finance	\$300
010252	SEF Hamkorbank	09/22/00	04/16/01	2,000	SECA	Uzbekistan	Finance	\$1,000
010253	SEF Parvina Credit Line	09/28/00	03/30/01	2,500	SECA	Uzbekistan	Finance	\$1,000
010355	Uzbek Leasing 2	10/18/02	12/30/02	6,500	SECA	Uzbekistan	Finance	\$2,500
011545	Asaka Bank II	09/25/02	11/29/02	5,000	SECA	Uzbekistan	Finance	\$5,000
023990	Hamkorbank II	07/28/06	11/10/06	1,000	SECA	Uzbekistan	Finance	\$3,000
025470	Fayz Equity sale		05/05/06	0	SECA	Uzbekistan	Industrial Products	\$0
REGIONAL INVESTMENT								
011426	MFI-Central Asia Facility (\$45 million total)	06/28/02	02/06/03	118,000	SECA	Central Asia Region	Finance	\$10,000
<b>TOTAL COMMITMENTS</b>								<b>\$54,672</b>

**Table 2: IEG- IFC List of Uzbekistan Technical Assistance Advisory Services**

Project ID	Facility / Donor	Project	CY	Access to Finance	Region	Country	Sector	Advisory Type	Dept	Funding Committed
TF021307	Switzerland	UZBEKTURISM: 3-Hotel Study	1994	N	SECA	Uzbekistan	Tourism	Business Enabling Environment: BEE Policy, Regulation and Institutions	CSE	100,000
TF021313	Switzerland	BESHARYK Spinners Privatization: Market/ Marketing Study	1995	N	SECA	Uzbekistan	Textiles	Business Enabling Environment: BEE Policy, Regulation and Institutions	CSE	30,000
TF021313	Switzerland	BESHARYK Spinners Privatization: Market/ Marketing Study	1995	N	SECA	Uzbekistan	Textiles	Business Enabling Environment: BEE Policy, Regulation and Institutions	CSE	15,000
TF023114	Norway	Uznor- F/S for Establishing a Business Consulting Company	1997	N	SECA	Uzbekistan	Technical Assistance	Business Enabling Environment: BEE Policy, Regulation and Institutions	CSE	30,000
TF025024	Japan	Automotive Farm Machinery Sector Study	1997	N	SECA	Uzbekistan	Agribusiness	Business Enabling Environment: BEE Policy, Regulation and Institutions	CSE	200,000
TF022284	Italy	Poplar Wood Processing Sector Review	1997	N	SECA	Uzbekistan	General Manufacturing	Business Enabling Environment: BEE Policy, Regulation and Institutions	CTE	110,000
587	FIAS	Diagnostic review of foreign direct investment environment	1997	N	SECA	Uzbekistan	Technical Assistance	Diagnostic review of foreign direct investment environment	CIC	\$117,022
TF023837	TATF	Accounting and MIS Diagnosis for SMEs (Kazakhstan, Kyrgyz Republic, Uzbekistan, and Tajikistan)	2000	N	SECA	Uzbekistan	Microfinance	Diagnostic review of accounting and MIS for SMEs	CSE	\$58,000
TF023962	Switzerland	Textile Sector Survey	2000	N	SECA	Uzbekistan	Textiles	Business Enabling Environment: BEE Policy, Regulation and Institutions	CSEDR	\$50,000
TF024284	FMTAAS	Institutional Strengthening for Parvina Bank and Andijan Bank and Enterprise Support for Borrowing SME	2000	Y	SECA	Uzbekistan	Microfinance	Business Enabling Environment: BEE Policy, Regulation and Institutions	CSEDR	\$400,000
506388; TF029786	FMTAAS	Parvina Bank & Hamkorbank II - TA	2001	Y	SECA	Uzbekistan	Commercial Bank	Access To Finance: Agri-Banking	CSEDR	\$93,900
TF027804	Switzerland	Textile Seminar	2001	N	SECA	Uzbekistan	Textiles	Business Enabling Environment: BEE Policy, Regulation and Institutions	CSEDR	\$40,000
521921/ 503607	PEP/SECO/ USAID	Uzbekistan SME Consultants' Training (PEP)	2001	N	SECA	Uzbekistan	Technical Assistance	Business Enabling Environment: BEE Policy, Regulation and Institutions; Financial markets development	CSEBB	\$324,425
559085	PEP	PEP Uzbek BEE	2002	N	SECA	Uzbekistan	Technical Assistance	Business Enabling Environment: BEE Policy, Regulation and Institutions	CEUEP	\$1,267,162
521152	PEP/USAID	Improving Microfinance Legislation in Tajikistan and Uzbekistan (IFC PEP)	2002	Y	SECA	Uzbekistan	Microfinance	Access To Finance: Microfinance; Regulation	CEUEP	\$80,000
TF050059	Finland	Plastic Card Program	2003	N	SECA	Uzbekistan	Technical Assistance	Business Enabling Environment: BEE Policy, Regulation and Institutions	CSE	\$190,000
520685	SECO	Uzbekistan Dairy Sector Supply Chain Development Project	2003	N	SECA	Uzbekistan	Agribusiness	Business Enabling Environment: BEE Policy, Regulation and Institutions	CEUEP	\$30,000
505873 / 530428 / TF05928 / 522360	TATF	Development of Pre-privatization business plan for Uzbektelecom (UT)	2003	N	SECA	Uzbekistan	Telecommunications	Pre-privatization program	CITTM	\$320,000
520677	FMTAAS	Uzbekistan SME Policy Development Project, Phase III (UzbSMEPolicyII)	2004	Y	SECA	Uzbekistan	Microfinance	Business Enabling Environment: BEE Policy, Regulation and Institutions	CEUEP	\$382,000
530587	FMTAAS	Uzbekistan SME Policy Development Project, Phase III (UzbSMEPolicyIII)	2004	Y	SECA	Uzbekistan	Microfinance	Business Enabling Environment: BEE Policy, Regulation and Institutions	CEUEP	\$200,000
54117 / 522754 / 537726	ACALF	Azerbaijan & Central Asia Leasing Facility project (ACALF)	2005	Y	SECA	Uzbekistan	Leasing	Access To Finance: Leasing	CGF	\$10,000,000
542784 / 547630	PEP/SECO	Azerbaijan & Central Asia Mortgage Market - UZB (Phases I & II)	2005	Y	SECA	Uzbekistan	Housing Finance	Access To Finance: Housing and Property Finance	CEUEP	\$1,578,100
542564	PEP	Uzbekistan SME Policy Development Project, Phase IV (UzbSMEPolicyIV)	2006	N	SECA	Uzbekistan	Microfinance	Business Enabling Environment: BEE Policy, Regulation and Institutions	CEUEP	\$918,907
552528	SEED	Advisory Services to Hamkorbank III	2007	Y	SECA	Uzbekistan/Belgrade	Commercial Bank	Access To Finance: Banking	CSEBY	\$320,000
<b>25</b>	<b>Total Advisory Services</b>									<b>\$16,852,516</b>