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FINANCIAL INCLUSION, REGULATION, AND LITERACY IN UZBEKISTAN

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Abstract

The level of financial inclusion in Uzbekistan remains low: the majority of households and firms, rather than using formal finance, save and borrow informally, and few use digital finance products. Both indicate the high cost of finance as the top reason for not using it. Secondly, households, which are mostly Muslim, declare that religious reasons prevent them from using formal finance, as only conventional finance is available. Unlike households, firms report that complex application procedures and high collateral requirements are the second and third most important reasons for not using formal finance. Financial inclusion is therefore constrained on the supply side. Policy recommendations include: promoting private and foreign capital participation in all segments of finance; removing/limiting the use of direct interest rate controls and administrative policy tools; and facilitating infrastructure development to promote digital finance. Demand-side policies, like improving financial literacy and customer protection, are necessary to supplement these policies. Strikingly, the country needs to create a financial inclusion and education strategy that will enable better-coordinated actions, leading to sustainable results.

Keywords: access to finance, obstacles, liberalization, financial literacy, customer protection

JEL Classification: G21, G28, L22, O16

Contents

1. INTRODUCTION

In his speech at the General Assembly of the United Nations Organization in 2017, the President of Uzbekistan, as one of his key messages, outlined an important principle: "the wealthier are the people, the stronger is the state."[1] Promoting financial inclusion, that is, providing people with access to payment services, savings accounts, loans, and insurance at a reasonable cost, might be instrumental in achieving this goal. Recent evidence from around the world has shown that financial inclusion can contribute to inclusive growth and economic development (Demirgüç-Kunt and Singer 2017). This chapter therefore aims to assess the state of financial inclusion in Uzbekistan as of 2018 and to identify the obstacles and the opportunities to promote it.

This chapter uses a nationally representative household survey, the Life in Transition Survey Wave 3, which the World Bank and the European Bank for Reconstruction and Development (EBRD) administered in 2016. It also uses a firm-level survey called the Business Environment Survey, which the World Bank conducted in 2013. The World Bank also administered the Global Findex Survey among a representative number of individuals in Uzbekistan in 2008 and 2014. The study further uses a range of secondary data from the Central Bank of Uzbekistan (CBU), the World Bank, and the International Monetary Fund (IMF) along with findings from local studies. These are all the most recent sources available on this research topic.

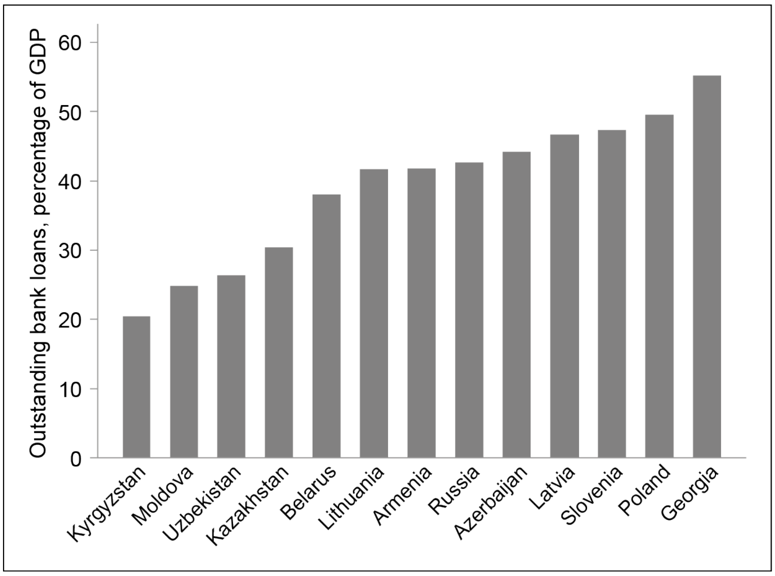
2. OVERVIEW OF UZBEKISTAN'S FINANCIAL SYSTEM

Uzbekistan's financial system is bank based, with commercial banks playing a key role. The other types of financial intermediaries that operate in this market are non-deposit-taking microfinance institutions. These play little or no role. Similarly, no formal crowd finance platform exists, and the financial markets are underdeveloped. The level of financial intermediation has traditionally been low, as the relatively low banking sector credit to GDP ratio compared with other transition economies evidences (see Figure 1). However, with the new President, the country made significant progress in financial liberalization between 2016 and 2018. As a result, financial intermediation has surged; in 2018, as the Central Bank of Uzbekistan reported, the banking sector credit to GDP ratio was 42.2% versus 26% and 19.4%, respectively, in 2016 and 2012.

Table 1 shows that the importance of deposits as a source of funds declined between 2017 and 2018. Thus, the direct borrowing of commercial banks mainly from state funds and to a lesser extent from international credit lines funded the surge in bank lending that the CBU (2018) explained. The CBU (2018) reported that, between 2017 and 2018, the share of borrowed funds of commercial banks in their total liabilities increased from 36% to 50%. Table 1 indicates that the share of deposits in the total liabilities decreased from 48% to 40% between 2017 and 2018. As Table 1 shows, demand deposits dominated, making up more than half of the total deposits. Only 9.2% of deposits had a maturity of one year and more. The funding structure of commercial banks is indicative of two issues: low depositor confidence in banking and the presence of tight constraints on banks' ability to extend loans, especially for long-term periods.

[1] President Shavkat Mirziyoev's speech is available from the online newspaper Gazeta.uz. https://www.gazeta.uz/ru/2017/09/20/un-ga-speech/ (accessed 29 May 2018).

Figure 1: Banking Sector Credit to GDP Ratio in Transition Economies in 2016



Source: IMF Financial Access Survey.

Table 1: Banking Sector Deposits

	2017	**2018**
All deposits as a percentage of bank liabilities	48	40
Demand deposits	54.0	51.9
Saving deposits with maturity		
1 to 30 days	5.5	5.5
30 to 180 days	17.2	17.5
180 to 365 days	10.4	15.8
1 year and more	12.9	9.2
Foreign currency deposits	27.5	49.1

Note: All numbers are given as of 1 January of the corresponding year.

Source: Central Bank of Uzbekistan.

Table 2 shows that banks with state ownership dominate (see Table 2). In 2018, 11 out of 28 banks had direct or indirect state ownership. All these 11 banks jointly controlled over 82% of the total banking sector assets, over 66% and 88%, respectively, of the deposit and loan market shares as of 1 January 2018 (CBU 2018). This is in line with 2012, as the ADB (2014) noted, declaring that state-owned banks controlled 86.8% of the total loan portfolio and 69.4% of all deposits. The market share of state-owned banks in deposit markets has thus been declining.

As the IMF (2013) reported, state-owned banks mainly finance large government programs and projects. The lending rate in these state-led projects is often below the market rate, which impedes banks' risk management and leads to segmentation of the banking market. For instance, the IMF (2018) stated:

> Uzbekistan's credit market is highly segmented, with SOEs [state-owned enterprises] enjoying preferential access to credit. The FX segment of the credit market is dominated by SOEs, which receive FX credit either directly from state banks or through on-lending operations by government entities ... These

> directed FX credits are often granted at highly preferential terms, depressing banks' profitability. By contrast, the private sector is largely confined to the domestic currency segment of the credit market, where loan mark-ups may in part reflect banks' attempt to recoup low margins on concessional lending.

All state banks specialize in a specific sector and mostly channel state funds. The IMF (2018) declared that 56% of its total loans have been extended to state-owned enterprises and joint ventures. Similarly, the deposits and loans of the Government constitute 51% of the liabilities of banks. The IMF also reported that state-owned enterprises' deposits make up 13% of banking sector liabilities. Thus, banks mainly intermediate between different government-owned enterprises and funds. Each state-owned bank has a specific function. For instance, the National Bank of Uzbekistan for Foreign Economic Activity, the largest bank in the country, specializes, as its name suggests, in financing foreign trade and export facilitation programs. Similarly, the People's Bank, which controlled 3.3% of the banking market share in 2018, is the main state bank for social payments and pensions and for serving public sector payments.

Table 2: Uzbekistan's Banking System Ownership and Concentration

	Market Share (Percentage of Banking Assets)			
	2001	**2014**	**2016**	**2018**
Market share of top three banks	86.6	50.6	49.7	59.9
Market share of top five banks	91.3	63.7	62.9	71.8
State-owned banks	82.2	41.2	41.4	48.8
Shareholding banks with indirect state ownership	6.1	35.5	33.7	33.2
Banks with foreign ownership	0.9	8.7	9.9	7.7

Source: We estimated the market shares using CBU data.

As Table 2 also shows, Uzbekistan's banking sector is highly concentrated. The three largest banks jointly controlled 59.9% of the total banking assets in 2018 versus 86.6% in 2001. Thus, concentration has been declining. In 2001, the National Bank of Uzbekistan alone controlled 76% of the total banking sector assets versus 30.9% as of 1 January 2018. The NBU is still the largest bank, controlling 19.5% and 18.5% of the deposit and loan market shares in 2018.

Foreign bank penetration remains low. As Table 2 shows, banks with foreign ownership jointly controlled 7.7% of the total banking sector assets in 2018. Unlike the situation in other transition economies, like Ukraine, Kazakhstan, and Poland, banks with foreign ownership first entered the country by creating a new institution, that is, through "greenfield investments." The market share of these banks has been small; according to the CBU, it is below 1%, and they have limited their activity to financing businesses from their home countries. The other three banks with foreign ownership resulted from cross-border takeovers, and these control around 9% of the banking sector assets.

Table 2 shows that the share of banks with no state ownership increased from 0.8% of the banking sector assets in 2001 to 13% in 2018. Unlike their peers with state ownership, these banks mainly deal with private sector deposits and loans. Note that the number of private banks has been stable, and this is possibly due to the strict licensing regulations for the entry of new private banks, as Ruziev and Ghosh (2009) noted.

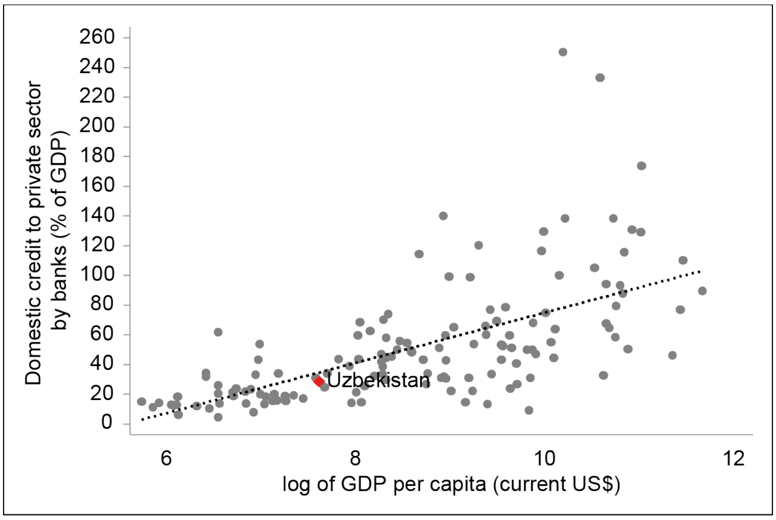
Table 3: Key Performance Indicators of Commercial Banks in Uzbekistan, in Percentages

	2011	2014	2016	2017	2018
Bank capital to risk-adjusted assets	23.4	24.3	14.72	14.73	18.77
Non-performing loans to total loans	1	0.4	1.46	0.74	1.20
Return on assets	1.7	2	2.00	2.00	1.87
Return on equity	12.7	17.2	17.47	17.95	17.13
Net interest margin	34.1	36.4	39.90	39.45	32.55
Non-interest margin	70	64	65.87	64.82	59.30
Liquid assets to total assets	31.2	31.9	23.68	25.36	23.63
Liquid assets to current liabilities	67.3	73.5	43.56	48.36	55.65
Banking capital/assets	13.3	11.2	11.25	10.68	12.41

Source: Data for 2011 and 2012 come from the Centre for Economic Research (2016) and those for 2016 to 2018 come from the Central Bank of Uzbekistan. All figures are as of 1 January of the respective year.

According to the CBU (2018), almost all the banks in Uzbekistan have a credit ranking from international institutions like Moody's and Fitch, and they are all ranked as stable.[2] This is in line with the IMF (2000, 2008, 2013). The high level of capitalization was due to direct state capital injections into state-owned banks (IMF 2013).

Figure 2: Domestic Credit and Gross Domestic Product per Capita



Source: World Development Indicators database.

Table 3 also reports the key financial performance indicators of the Uzbek banking system. The regulatory bank capital to risk-adjusted asset ratio, profitability indicators such as return on assets, and equity are high and improving; the level of non-performing loans is low. Thus, credit rationing seems to be relatively high in Uzbekistan judging from the level of domestic credit to the private sector, which is well below the average compared with countries with a similar level of development, as Figure 2 shows.

[2] Information on credit rankings is available on the Central Bank of Uzbekistan's website. Accessed 8 January 2018. http://www.cbu.uz/en/kreditnye-organizatsii/kommercheskie-banki/reytingovye-otsenki/.

As mentioned earlier, Uzbekistan has no deposit-taking microfinance institutions, such as credit unions, like the Kyrgyz Republic and Tajikistan have. The Credit Union Law came into force in 2002 and led to the rapid entry of new institutions into the financial market: the number of credit unions surged from 20 in 2004 to 163 in 2010 (see Table 3). However, deposit-taking microfinance institutions ceased existence in 2010 with the reversal of the law; they were all turned into non-deposit-taking financial institutions that lend their own funds. The evidence on the quality of credit union services is mixed. Anecdotal evidence suggests that credit unions have been successful in promoting access to finance among micro, small, and medium-sized enterprises (ADB 2009). On the contrary, the Centre for Economic Research (2011) (hereafter: CER), based on the National Income Mobilization Survey, which claims to be a nationally representative survey, reported that in 2010 50% of respondents complained about a delay in accessing their deposits at credit unions and 26% of clients declared that the credit union interest rates were high.

Table 4: Geographic Outreach of Financial Institutions in Uzbekistan

Indicator Name	2004	2006	2008	2010	2012	2014	2016	2018
Number of:								
Commercial banks	31	28	30	31	29	26	27	28
Non-deposit-taking microfin. inst.	1	14	60	93	76	71	76	76
Commercial bank branches/mini banks/units:								
Number	6,701	7,627	7,712	7,900	8,058	8,237	8,263	8,864
Branches per 100,000 adults	39.1	42.3	40.7	39.2	38.0	37.4	36.1	27.7
Branches per 1000 km^2	15.8	18.0	18.2	18.6	19.0	19.4	19.5	19.8
Automated teller machines (ATMs):								
Number	151	171	318	807	1,417	1,870	4,954	
ATMs per 100,000 adults	0.9	0.9	1.7	4.0	6.7	8.5	21.6	
ATMs per 1000 km^2	0.4	0.4	0.7	1.9	3.3	4.4	11.6	

Source: International Monetary Fund, Financial Access Database.

Table 4 shows that the banking sector outreach surged between 2004 and 2018, as the increase in the number of ATMs per 100,000 adults and per 1000 km^2 evidences. In 2004, there were only 0.9 ATMs per 100,000 adults versus 21.6 ATMs in 2016. The banking sector outreach has remained stable in terms of bank branch penetration; for every 100,000 adults, there were 39.1 branches in 2004 versus 36.1 branches in 2016. Table 5 shows the banking outreach and indicates that the use is uneven across regions. In Tashkent City in 2017, users paid 7595.3 thousand UZS in per capita terms using point of sales terminals, and SME loans issued 3076 thousand UZS in per capita terms. In the capital city, there was one ATM/information unmanned kiosk per 821 people. The Navoi region has the second-highest bank penetration indicators; however, it has 2.5 times lower per capita payments through POS and more than 3 times fewer SME loans per capita. In the rest of the regions, as Table 5 shows, banking use is even lower.

Table 5: Banking Outreach and Use in the Regions

	Population	Per Capita Payment through POS Terminals, in Thousand UZS		SME Loans per Capita, in Thousand UZS		Population per ATM and Info. Kiosk	
	2017	2016	2017	2016	2017	2016	2017
Tashkent City	2,352,300	6,544.9	7,595.3	2,403.1	3,076.0	901.6	821.3
Navoi	913,200	2,276.3	2,240.9	670.1	761.1	7,673.9	6,918.2
Tashkent	2,758,300	1,650.6	1,737.9	390.5	501.5	21,718.9	16,717.0
Bukhara	1,785,400	1,819.5	1,690.3	394.7	467.3	7,170.3	6,156.6
Karakalpak	1,763,100	1,437.6	1,462.8	367.6	488.6	15,465.8	11,832.9
Khorezm	1,715,600	1,253.2	1,347.1	377.5	486.4	15,317.9	11,831.7
Syrdarya	777,100	1,307.0	1,302.5	460.2	498.5	16,534.0	9,251.2
Ferghana	3,444,900	1,267.9	1,129.5	310.2	370.0	8,182.7	6,959.4
Andijan	2,857,300	1,193.8	1,089.8	391.9	446.6	15,118.0	13,737.0
Kashkadarya	2,958,900	1,197.7	1,045.6	309.8	378.6	29,589.0	24,253.3
Djizzak	1,250,100	1,109.0	1,022.4	363.6	427.2	20,493.4	17,124.7
Namangan	2,554,200	1,149.8	1,001.5	260.4	334.9	10,135.7	9,220.9
Samarkand	3,514,800	1,139.2	952.5	346.8	402.2	12,332.6	10,337.6
Surkhandarya	2,358,300	1,027.9	874.8	307.9	364.3	8,766.9	8,188.5

Source: The authors based their estimates on CBU data. The population data come from the State Committee on Statistics and include people with permanent residence. For information, readers might use the approximate exchange rate 8000 UZS/USD to convert the numbers into USD.

The country has made progress in creating an infrastructure to support lending. In 2000, the Cabinet of the Minister of Uzbekistan made the decision to create the first credit bureau as part of Uzbekistan's banking association.[3] In 2004, the bureau was turned into a legally independent unit. In 2012, based on the public credit bureau, the decision was made to create a private credit bureau. As Table 6 shows, as of 2016, the private credit bureau covers 27.8% of the adult population. The National Collateral Register commenced operation in 2014.[4]

Table 6: Credit Information Sharing

	Private Credit Bureau Coverage (Percentage of Adults)
2008	2.2
2009	2.1
2010	3.3
2011	3.6
2012	15.7
2013	16.5
2014	17.8
2015	19.4
2016	27.8

Source: World Development Indicators.

[3] The bureau's website describes the history of credit bureau development in Russian. Accessed 8 January 2018. http://infokredit.uz/ru/o-kompanii/istoriya-byuro.

[4] The website of the National Collateral Register states that it was established in 2014. Accessed 3 June 2018. https://garov.uz/ru/about.

In Uzbekistan, the Findex 2017 survey reported that 94% of the adult population has a national identity card (passport); this is high relative to 92% of lower-middle-income countries. In addition, in December 2017, the CBU announced that, during 2018, the country will introduce a common national platform for the remote identification of clients. Specifically, this will involve upgrading the National Database of Depositors by creating unique ID numbers for the people registered in the system. As the CBU reported, the introduction of electronic identification numbers will enable people to access remote banking services, which are increasing day by day.[5]

3. STATUS OF FINANCIAL INCLUSION

3.1 Financial Inclusion of Households

Uzbekistan, as Yoshino and Morgan (2016) also noted, is among the countries with a low bank account penetration rate; according to the 2014 Findex survey, only 26% of people aged 15 and older held an account with a financial institution. Beck and Brown (2011), based on the nationally representative sample of the Life in Transition Survey 2, which the EBRD and the World Bank administered in 2010, listed Uzbekistan among the transition countries with a low level of banking service use. However, the 2017 Findex survey reported that 37% of people aged 15 and older had an account; thus, the account penetration had increased but remained low. Table 7 presents additional evidence on the increase in account penetration, showing that the number of bank cards increased 2.5 times in 2017 relative to 2011. The World Bank World Development Indicators database shows that the account penetration rate in Uzbekistan is higher than in countries with a similar level of GDP per capita. The major driver behind bank card use is the legislation requiring organizations and state-owned companies to pay salaries through a transfer to a bank card. For instance, the ADB (2014) reported that the most common method of paying salaries in the formal sector is through direct transfers to employees' bank cards; this is a result of the government policy aimed at reducing money out of bank circulation and deepening non-cash payments. As a result, more than 19 million bank cards were in use as of January 2017 versus only 32 thousand in 1999.[6] Similarly, according to the Central Bank of Uzbekistan, the total amount of transactions using bank cards reached 53,050 billion Uzbek soms (6.5 billion United States dollars) in January 2016 as opposed to 0.1 billion Uzbek soms in 2004.

Table 7 shows a surge in Internet and mobile use in Uzbekistan. The number of Internet banking users increased from 0.4% of depositors in 2011 to 2.3% in 2017. The use of mobile banking increased from 0.3% of depositors in 2011 to 32.8% in 2017. The CER (2015) reported that the surge in electronic banking products was a result of the regulatory changes. Table 8 shows that most of the laws on the use of information resources and systems, electronic signatures, and commerce came into force from 2004. An important milestone in the development of electronic payments was the Common Republican Processing Centre's and e-payment company Click's introduction of the mobile payment system. As the CER (2015) stated, the adoption of the law on electronic payments provided a strong impetus for the development of the system. However, mobile banking and Internet banking have considerable room to improve. First, the CBU reported that payments for utility services, like the gas and electricity

[5] Information on this is available from the website of the Central Bank of Uzbekistan. Accessed 4 June 2018. http://cbu.uz/ru/press-tsentr/obzori/2017/12/96391/.

[6] Central Bank of Uzbekistan. Accessed 3 June 2018. http://www.cbu.uz/ru/platyezhnye-sistemy/29/.

supply, and taxes make up 99% of remote retail banking transactions. The main bottleneck in this development is the low speed of the Internet in the country; for instance, as of January 2018, Uzbekistan ranks 122nd and 119th out of 129 countries in broadband and mobile Internet speed, respectively, in the Speedtest Global Ranking, which compares Internet speed across countries.[7] The countries with the highest rank have high speed and those with a low rank have low speed. Uzbekistan is among the countries with low speed.

Table 7: Bank Card, Internet, and Mobile Banking Use in Uzbekistan

	2011	2015	2016	2017	Ratio of 2017/2011
Bank cards issued (,000)	7,909	15,215	16,316	19,523	2.5
Transaction volume through bank cards (in billion UZS)*	10,192.4	31,324	53,050		5.2
Payment terminals	85,741	169,581	183,060	208,536	2.4
Information points	491	2012	2,345	4,954	10.1
Number of depositors	1,159,890	143,2849	1,515,004	1,638,673	1.4
Number of deposit accounts	3,926,356	503,0704	5,364,838	5,809,172	1.59
Remote banking users					
Number	24,545	53,4800	1,061,022	2,042,111	83.2
Percentage of depositors	0.6	10.6	19.8	35.2	
Internet banking and bank client network users					
Number	14,241	62,227	81,492	135,629	9.5
Percentage of depositors	0.4	1.2	1.5	2.3	
Mobile and SMS banking users					
Number	10,304	47,2573	979,530	1,906,482	185.0
Percentage of depositors	0.3	9.4	18.3	32.8	

Source: Central Bank of Uzbekistan.

Table 8: Major Events in the Development of Electronic Payment Systems

Timeline	Events
December 2003	Law on the use of informatization
December 2003	Law on electronic signatures
April 2004	Law on electronic documents
May 2004	Law on electronic commerce
December 2005	Law on electronic payments
September 2013	First mobile banking system launched jointly with the Common Republican Processing Centre and the e-payment company Click

Source: Authors' compilation based on the law database lex.uz.

Tables 9 and 10 show the percentage of the adult population with an account at a financial institution and debit card ownership, respectively. First, as in the rest of the transition economies in Europe and Central Asia (ECA), account and debit card ownership increased for all groups of adult people in Uzbekistan between 2011 and 2017. Five trends are apparent in the table. First, a relatively lower percentage of females than males have a bank account. Second, the gap in the account ownership

[7] For the country ranks, please visit the website Speedtest Global Index. Accessed 8 January 2018. https://www.speedtest.net/global-index.

between people within and outside the labor force has narrowed. That is because, in 2015 and 2016, the state started to transfer old age pensions and other social payments to a bank card. Third, young adults are relatively more financially excluded, as the relatively low percentage of people in this category who own a bank account evidences. Similarly, the gap is large depending on the education and income level. Table 10 suggests that the proportionate increase in account ownership is greater than that in debit card ownership. Moreover, account ownership is proportionally higher for males relative to females; this gap is smaller than that found in countries in the similar income group. On the contrary, 22.1% of females have a debit card versus only 26.4% of males. Strikingly, in Uzbekistan, the percentages of adult people with an account and a debit card are much lower than those in the rest of the transition economies in Europe and Central Asia, as Tables 9 and 10 show.

Table 9: Formal Account Ownership at a Financial Institution

	Uzbekistan			Europe and Central Asia		
	2011	2014	2017	2011	2014	2017
Have an account:						
All adults	22.5	40.7	37.1	69.3	77.7	81.5
Males	23.8	42.2	38.3	72.6	79.5	83.7
Females	27.0	43.1	38.6	70.5	83.6	88.0
In the labor force	10.5	36.4	34.3	55.5	65.3	71.7
Out of the labor force	21.3	39.3	36.0	66.4	76.1	79.4
Young adults (percentage aged 15–24)	15.0	24.9	20.9	50.9	59.6	63.8
Older adults (percentage aged 25+)	26.0	47.9	43.6	73.1	81.0	84.8
Primary education or less	10.3	24.3	20.9	49.0	56.5	67.9
Secondary education or more	28.1	48.2	43.2	75.5	82.4	85.1
Income, poorest 40%	19.3	35.3	29.7	68.1	73.7	76.3
Income, richest 60%	24.6	44.3	42.0	70.3	80.3	84.8
Rural	22.6	42.7	34.4	60.3	76.4	79.2

Source: Findex database; note that all numbers are percentages of people aged 15+ of the respective category unless otherwise indicated.

Table 10: Debit Card Ownership

	Uzbekistan			Europe and Central Asia		
	2011	2014	2017	2011	2014	2017
Have a debit card						
All adults	20.4	24.6	24.1	54.2	62.5	70.9
Females	19.9	25.8	22.1	51.2	59.2	68.1
Males	21.1	23.3	26.4	57.7	66.2	74.0
Poorest 40%	19.0	17.7	17.6	53.6	55.5	64.4
Young adults (percentage aged 15–24)	13.8	11.2	12.6	39.8	46.2	55.7
Older adults (percentage aged 25+)	23.6	30.7	28.8	57.5	65.5	73.8
Primary education or less	9.4	13.9	9.7	30.6	35.5	55.0
Secondary education or more	25.5	29.5	29.6	61.4	68.6	75.2

Source: Findex database; note that all numbers are percentages of people aged 15+ of the respective category unless otherwise indicated.

Table 11 shows that in 2017 only 1% of female and 3.3% of male adults had ever borrowed from a formal financial institution. These rates are significantly lower than those in ECA countries. Thus, the degree of financial exclusion is high. The CER (2013) explained that banks' supply of consumer loans is low; in 2012 consumer loans in Uzbekistan constituted only 2.4% of the GDP versus 10.2% for the Russian Federation and 6.5% for Azerbaijan. Table 11 also reports that relatives and friends are the largest source of borrowed funds relative to formal financial institutions; more than 12.1% of female and 13.8% of male respondents declared that they had borrowed from friends and relatives in 2017. These figures are comparable to the rest of the ECA countries.

Table 11: Borrowing Behavior in Uzbekistan

	Uzbekistan			Europe and Central Asia		
	2011	2014	2017	2011	2014	2017
Borrowed						
From a financial institution						
Female	1.2	0.7	1.0	9.0	13.1	13.5
Male	1.7	1.9	3.3	11.1	16.4	17.4
From family or friends						
Female	10.4	10.5	12.1	17.7	16.7	18.1
Male	13.0	11.7	13.8	18.4	18.0	18.5

Source: Findex database; note that all the numbers are percentages of people aged 15+ of the respective category unless otherwise indicated.

In Uzbekistan, unlike ECA countries, the proportion of respondents who declared that they saved using a formal financial institution is small (see Table 12). The Findex survey results show that the proportion of households that save using informal saving clubs or persons outside the households is high relative to ECA economies. This in line with the CER (2013), which declared that only 5% of the aggregated savings of households are kept in bank deposits. The CER explained that this limits banks' resource base, which then explains the low supply of loans. The CER (2013) claimed that the low levels of saving are partly due to the low supply of attractive saving products at the banks; as a result, people either save informally or invest in real estate. Additionally, Hiwatari (2010) and Kandiyoti (1998) reported that informal rotating savings and credit associations (RSCAs) among relatives, people in common neighborhoods, or the professional community are popular in Uzbekistan.

Table 12: Saving Behavior in Uzbekistan

	Uzbekistan			Europe and Central Asia		
	2011	2014	2017	2011	2014	2017
Saved at a financial institution						
Female	0.5	1.6	1.6	23.2	28.2	31.7
Male	1.1	2.1	3.1	26.3	33.7	37.1
Poorest 40%	0.7	0.8	0.7	24.0	22.9	24.6
Younger adults	0.0	0.6	1.1	19.4	25.0	22.1
Older adults (percentage aged 25+)	1.2	2.4	2.8	25.9	31.9	36.6
Primary education or less	0.6	0.8	1.2	10.0	13.4	21.9
Secondary education or more	0.9	2.3	2.8	29.2	34.7	37.7

Note: All the numbers are percentages of people aged 15+ of the respective category unless otherwise indicated.

Source: Findex database.

The use of insurance services remains even lower than the use of banking services. The Ministry of Finance of Uzbekistan (2017) reported that 26 institutions operate in the insurance market of Uzbekistan, of which 23 are companies that provide general insurance and 3 are life insurance providers. In 2016 the three largest institutions, all of which are state owned, controlled 47.4% of the insurance market (MFU 2017). The total volume of insurance premiums collected in 2016 constituted 629 billion Uzbek soms (that is, 77.6 million USD, based on the exchange rate 8100 UZS/USD, or 0.12% of the GDP). Of the total insurance premiums, 52.2% were collected in the capital city Tashkent, with a population of over 3 million people, and the rest came from the regions (MFU 2017). Thus, the urban–rural gap in the access to and use of insurance services is large.

The CER (2015) explained that Uzbekistan's pension system consists of mandatory and accumulated pensions. An extra-budgetary pension fund runs the mandatory pension, whereas the state-owned bank Halk Bank operates the accumulated pension. In 2013, according to the CER, 90% of pension funds were with the extra-budgetary pension fund and the rest were with Halk Bank. Like other former Soviet Union transition economies, Uzbekistan has high pension coverage; in 2013 it was 79%. The CER (2015) indicated that this is a legacy of the Soviet past, when full employment and thus pension coverage were the norm. However, as other similar countries' coverage is declining as a result of the structural transformation of the country, with an increasing role of the private sector and declining employment in the public sector, high informality exists (CER 2015). The CER (2015) also reported that the basic-level mandatory monthly pension payments are set at 55% of the monthly average salary and must always be higher than the minimum wage.

3.2 Financial Inclusion of Micro, Small, Medium-Sized, and Large Enterprises

Table 13 shows the overall increase in the percentage of firms with a bank account: 97.3% of firms declared that they had a bank account in 2013 versus 93.8 in 2008. Bank account ownership is almost universal, independent of the industry, enterprise size, business location, and gender of the business manager.

In 2013, 26.4% of firms declared that they had a bank loan or line of credit versus only 10.5% in 2008; thus, financial inclusion has doubled, but it is still low compared with countries with a similar GDP level (see Table 13). As Table 13 shows, the gaps in having loans/lines of credit are significant depending on the establishment size, business location, and exporter status. The proportion of firms is smaller for small firms, firms located in the capital city, and non-exporters. Strikingly, the proportion of firms with a line of credit/loan is independent of the gender of the top manager. Despite these changes, the proportion of businesses that declared that they needed no loan has also doubled. The collateral requirements remain high, as the high percentage of loans that require collateral and the value of collateral evidence. Women-managed businesses have to give a higher value of collateral than men-managed businesses.

Table 13: Financial Inclusion Indicators for Small, Medium, and Large Enterprises in Uzbekistan

	Percentage of Firms with a Checking or Savings Account		Percentage of Firms with a Bank Loan/Line of Credit		Proportion of Loans Requiring Collateral (Percentage)		Value of Collateral Needed for a Loan (Percentage of the Loan Amount)		Percentage of Firms not Needing a Loan	
Sector	**2008**	**2013**	**2008**	**2013**	**2008**	**2013**	**2008**	**2013**	**2008**	**2013**
All	93.8	97.3	10.5	26.4	98.7	96.5	129.7	175.7	38.1	74.7
Industry										
Manufacturing	95.6	92.6	9.0	26.8	97.5	98.1	122.2	171.9	28.6	68.0
Services all	93.1	99.8	11.0	26.2	99.0	95.7	131.4	177.9	41.7	78.2
Retail	90.5	99.4	18.2	338.6	99.1	90.8	127.7	199.9	46.9	76.3
Other services	94.9	100.0	6.0	20.5	98.8	99.9	139.6	156.7	38.1	79.1
Size										
Medium (20–99)	99.5	99.5	9.9	24.5	94.6	99.6	146.0	168.6	49.0	66.3
Small (5–19)	92.0	96.5	9.5	26.3	100.0	96.1	125.6	178.2	35.5	78.0
Large (100+)	97.8	98.0	29.3	41.4	97.7	88.9	127.8	162.9	30.4	70.0
Location										
Tashkent	90.8	96.2	9.3	20.8	99.1	90.8	121.6	259.7	47.4	54.6
Outside the capital city	97.9	95.8	12.0	49.3	100.0	99.6	137.5	144.9	29.8	90.6
Exporter status										
Exporter	97.1	100.0	42.4	42.5		92.7		119.2	28.0	91.4
Non-exporter	93.7	97.3	10.1	26.2	98.6	96.6	129.8	176.8	38.2	74.5
Gender of the top manager										
Female	86.8	100.0	9.2	27.1	100.0	99.4		207.3	42.3	79.4
Male	94.7	96.9	10.7	26.3	98.5	96.1	129.9	170.0	37.4	74.0
Ownership type										
Domestic	93.5	98.4	9.3	26.6	99.1	96.3	129.7	174.8	38.3	76.1
Foreign	100.5	85.8	36.4	24.5	96.2	98.9	130.6	185.9	32.8	59.5

Source: Enterprise surveys (2013).

4. BARRIERS TO FINANCIAL INCLUSION

Column (a) of Table 14 presents the major reasons for not using formal financial services in Uzbekistan. The high costs of financial services are reported as the top reason for households not using formal finance in 2014. Indeed, as Figure 3 shows, the interest rates on commercial loans for individuals (panel a) and businesses (panels b and c) are high given that the ADB has published figures of 16% inflation and 4% GDP per capita growth. Blondel (2015) mentioned that the government policy to restrict access to cash and cash transactions translated into additional informal transaction costs that entrepreneurs had to pay to cash their bank loans in 2015.

Table 14: Major Reasons for Not Using Formal Financial Services and Reasons for Having No Bank Account

		Major Reason for Not Using Formal Financial Services (a)	Major Reason for Having No Bank Account (b)
1	Insufficient money to use financial institutions	0.4	35.9
2	Lack of the necessary documentation	21	17.6
3	Someone else in the family already has an account	30	16.6
4	Financial institutions are too far away	12	11.8
5	Financial services are too expensive	44	11.2
6	Lack of trust in financial institutions	10	9.8
7	Religious reasons	30	2.0

Source: Columns a and b are based on the Findex database from 2014 and 2017, respectively.

Importantly, private domestic and foreign banks charge relatively high interest rates. Until 2018, the Central Bank of Uzbekistan set the commission fees on the use of bank cards centrally. Anecdotal evidence suggests that the amount of fees charged to private individuals did not enable private banks to offer their services to private individuals. However, in 2018, the CBU started to publish recommended commission fees for the use of bankcards.

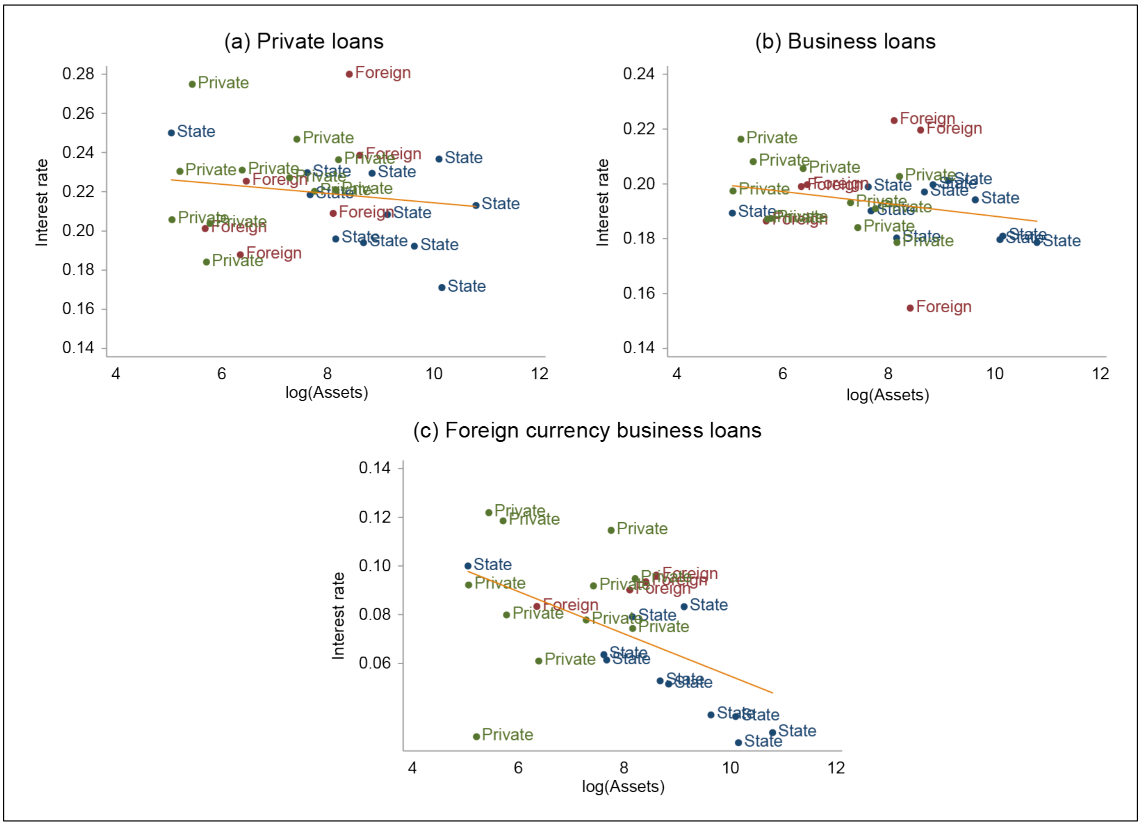
Religious reasons are the second most important reason for people not using financial services. The CIA Factbook reports that 88% of the members of Uzbekistan's population are Muslims; however, the banks offer no Islamic banking products.[8] This is partly a legacy of the former Soviet Union and a cautious approach to reforms in Uzbekistan. In May 2018, a number of news websites announced that, with the support of the Islamic Development Bank, the Ministry of Finance was preparing a presidential decree on creating a legislative base and infrastructure to support Islamic finance.[9]

A lack of documentation and the inability to obtain an account are the next important reasons for not using formal financial services. A total of 10% of the respondents reported that they do not trust financial institutions. This is in line with the CER (2011), which reported, based on a 2010 Uzbekistan national survey, that 78% of their respondents indicated that they do not save with banks because they cannot withdraw cash when needed.

[8] The website of the CIA contains information on the religious composition of the Uzbek population. Accessed 3 June 2018. https://www.cia.gov/library/publications/the-world-factbook/geos/print_uz.html.

[9] The news website Gazeta.uz contains information on this. Accessed 3 June 2018. https://www.gazeta.uz/ru/2018/05/16/islamic-banking/.

Figure 3: Weighted Average Interest Rates on Loans as of May 2018



Source: Central Bank of Uzbekistan.

Note that Findex 2017 asked about the reasons for not having a bank account, which is different from Findex 2014, which asked about the reasons for not using financial services in general. Therefore, columns (a) and (b) in Table 14 are not comparable. A lack of money to use an account, a lack of documentation, the long distance to a bank branch, and the high cost of using a bank account are the major reasons for not using formal finance.

Table 15 describes the top reasons for firms not using bank loans/line of credit. They ranked high interest rates and complex application procedures as the two major reasons for not applying for a formal loan/line of credit. The cost of borrowing from a financial institution increased between 2008 and 2013. Indeed, Blondel (2015), based on a field study in Uzbekistan, also reported that entrepreneurs declared that the paperwork needed to obtain a loan was among the most difficult.

Table 15: Top Reasons for Not Using Bank Loans/Lines of Credit

	2008	2013
High interest rates	0.24	0.42
Complex application process	0.37	0.33
High collateral requirements	0.18	0.22
Insufficient loan size and maturity	0.11	0.03
Won’t be approved	0.08	0.00

Source: Enterprise surveys.

The third-largest group, containing 22% of firms, reported high collateral requirements as the major reason behind their decision not to use formal finance. Blondel (2015) stated, for the sample of firms that her study covered, that the collateral values ranged from 130% to 500% of the loan values, with a median of 175%.

5. FINANCIAL REGULATION AND SUPERVISION

The Central Bank of Uzbekistan (CBU) is responsible for the regulation and supervision of commercial banks and microfinance institutions.[10] The IMF (2008), mentioned that the CBU's on- and off-site supervision is adequate. The IMF (2008, 2013) reported that direct intervention in commercial banks' activity, through for instance, asking banks directly to finance state-owned projects and programs, is widespread, and this hampers competition among banks.

Moreover, banks were burdened with the obligation to report clients' transactions to tax and customs authorities and conduct financial oversight of the cash management of business entities. Commercial banks thus had non-core functions. IFC (2006, p. 38) gives examples of these based on focus group interviews with entrepreneurs, and we list the ones that are relevant today:

> … Each registered export (barter) contract must be monitored by the authorized bank in terms of the operations related to contract enforcement.
>
> … in case of failure to receive the export earnings completely or goods within the time frame established by the law (based on the date of border crossing or completion of works), the authorized bank [must] inform the local tax and customs authorities in writing to take measures according to the law.
>
> … upon the request of the tax authorities the banks must provide the transaction data of their customers required for monitoring the integrity and completeness of all due tax payments.

All these non-core functions destroyed the trust in banks and increased their costs. Direct intervention in pricing loans and the presence of state direct loans also damaged banks' risk management practices.

In addition, the CBU maintained a heavily overvalued UZS exchange rate by restricting the availability of foreign currency to finance imports; it also required exporters of cotton and gold to sell 100% of their foreign currency earnings at this distorted exchange rate. It required other exporters to sell 50% of their foreign currency earnings at a distorted price (IMF 2000, 2008, 2013). Small businesses and private individuals thus have had restricted access to international payment instruments and foreign currency, which then created an unofficial black market for foreign currency. Figure 4 shows that, until the second quarter of 2017, the gap between the official and the black market exchange rate widened. From September 2017, the Government of Uzbekistan liberalized the access to foreign exchange and devalued Uzbek soms twice, which narrowed this gap.

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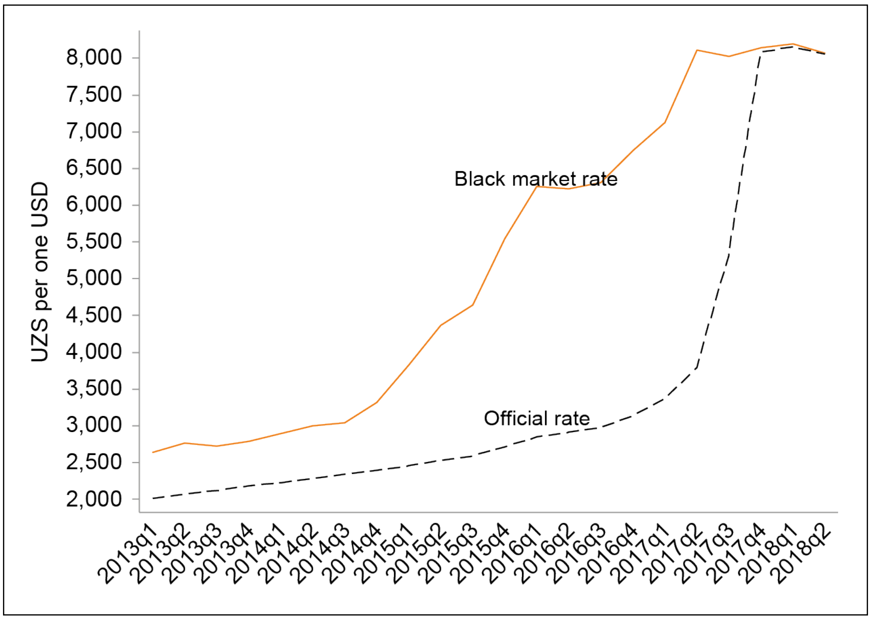
[10] Law of the Republic of Uzbekistan on "Banks and Banking". Accessed 10 January 2018. http://lex.uz/pages/getpage.aspx?lact_id=12011.

Figure 4: Official and Black Market Exchange Rates (UZS/USD)



Source: The official exchange rate data come from the Central Bank of Uzbekistan. The black market exchange rate data come from the telegram bot Tash, which a community of people living in Uzbekistan runs.

The Law of the Republic of Uzbekistan "On Protection of Consumer Rights" has regulated consumer protection since 1996. Article 28 states that all financial service providers need to insure their liabilities for the case of bankruptcy or liquidation. This article also requires financial service providers to inform their customers about the existence of insurance. The main organization for implementing this law is the State Committee on Privatization, Demonopolization and Promotion of Competition and Agency Uzbek Standard. In addition, from the start of 2017, the Office of the President of Uzbekistan started to receive direct complaints from individuals on all kinds of issues through hotline and online channels. In one period, this office received over one million complaints, and the fifth-largest number of complaints addressed the CBU and commercial banks.[11] Financial deepening will thus require a more rigorous approach to consumer protection than is necessary now.

Uzbekistan has had explicit deposit insurance that covers all the banks in the country since 2002. Initially the deposit insurance was partial. However, since 28 November 2008, a new Presidential Decree has announced a blanket guarantee on deposits, and since October 2009 it has been replaced by a statutory limit of 250 times the minimum wage (Demirgüç-Kunt, Kane, and Laeven 2014). Note that, in December 2017, the minimum wage for 2018 was 172,240 UZS, which is approximately 21 USD at the exchange rate 8,000 UZS/USD. This means deposits up to 5,382.5 USD.[12] Besides these, there are no regulations protecting depositors or related to fintech products.

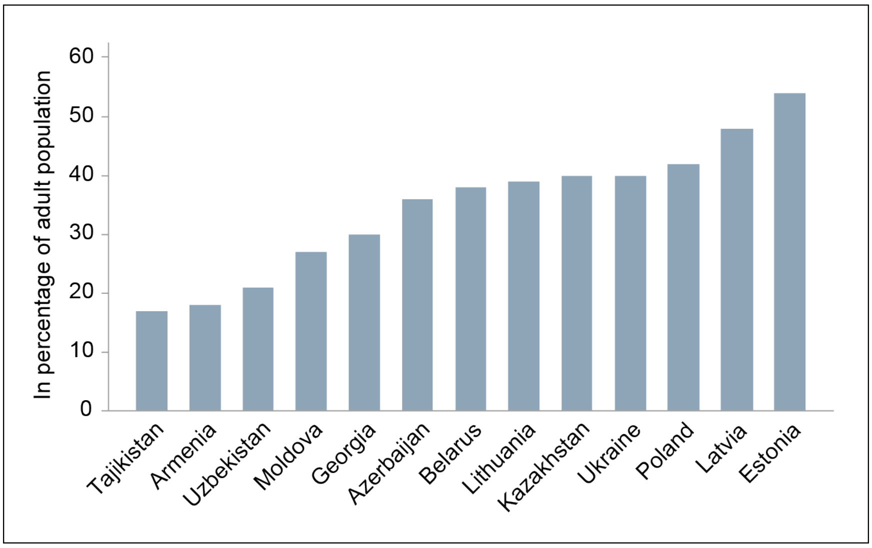
[11] Information on this is available on the virtual reception website of the President of Uzbekistan's office. Accessed 10 January 2018. https://pm.gov.uz/uz/news/view?id=34.

[12] Information on minimum wages is available on the information directory website Golden Pages of Uzbekistan. Accessed 4 June 2018. https://www.goldenpages.uz/zarplata/.

6. FINANCIAL LITERACY AND EDUCATION

Assessing the level of financial literacy in Uzbekistan is a challenge due to missing micro-data. The only evidence comes from Standard & Poor's 2014 Global Financial Literacy Survey, which only published aggregated results. Interestingly, Figure 5 shows that Uzbekistan has a much lower financial literacy rate than other transition economies.

Figure 5: Financially Literate Adult Population in Transition Economies



Source: Standard and Poor's 2014 Global Financial Literacy Survey.

Uzbekistan has no national strategy for promoting financial literacy. However, the Sparkassen-Finanzgruppe reported that, jointly with the ministries of Uzbekistan, it had developed such plan, which was pending ratification. On its website, the Sparkassen-Finanzgruppe reported[13]:

> Based on an analysis of general financial literacy in Uzbekistan, a gender-specific national strategy was developed to raise the level of basic financial education of the Uzbek population. This 5-year strategy details the objectives, structures, methods and target groups of financial education in Uzbekistan. Furthermore, a two-year action plan was devised, listing specific activities, responsibilities, a timeframe and budget for the strategy's implementation. Sparkassenstiftung completed all of this work by the close of 2016. In all, some 13 Uzbek ministries and institutions helped co-design the action roadmap and the financial and cost plans as well as the monitoring concept. Project activities for the year under review also include several further training inputs for different actors. Courses for local trainers featuring simulations for financial budget planning and the promotion of small-scale enterprises have proven particularly successful in this context. Despite the delay in the adoption of a gender-specific strategy due to the elections of December 2016, the project is continuing to meet the high demand for its further training measures.

[13] Information on this is available from the website of Sparkassen-Finanzgruppe. Accessed 4 June 2018. http://www.sparkassenstiftung.de/index.php?id=34&L=1&tx_ttnews%5Btt_news%5D=1394&cHash=0f8b88b56f943f2f86f02ac167927f2e.

In May 2017, the CBU reported that, jointly with the International Finance Corporation (part of World Bank Group), the Association of Banks of Uzbekistan, and the Chamber of Commerce of Uzbekistan, it had started to implement a new program on financial literacy. The program consists of two parts: the first targets owners of small and medium-sized businesses, and the second aims to educate the general population. It is not clear whether the financial literacy program will be included in the school curriculum. Importantly, this is not the first financial literacy program.[14] A few other programs exist, like the German Agency GIZ project, within which the Sparkassen-Finanzgruppe currently also focuses on financial literacy; for instance, the program operates a train the trainer program with a state financial institute. Additionally, the National Association of Microfinance Institutions of Uzbekistan, in partnership with the Microfinance Centre, has implemented a finance literacy program by directly training 633 low-income people and preparing 34 trainers on financial literacy. However, the scale of the current programs is small, and no assessment is available to judge the impact of these programs on financial literacy.

In addition to low financial literacy, the degree of independent decision making with regard to saving and borrowing can affect the access to finance in Uzbekistan. Table 16 shows that almost one-fourth of adults reported that someone else makes their financial decisions.

Table 16: Who Makes the Decisions about the Savings, Investment, and Borrowing in Your Household?

	Male	Female	Total
Shared equally between me and my partner	32.39	37.85	34.38
Mostly me	28.87	27.69	28.44
Shared equally between me and someone else in the household	13.91	11.38	12.99
	75.20	76.90	75.80
Mostly my partner	14.08	10.77	12.88
Mostly someone else in the household	10.21	12.00	10.86
Mostly someone else not in the household	0.53	0.31	0.45
	24.83	23.08	24.19

Source: Authors' estimates based on the Life in Transition Survey 3.

7. CONCLUSIONS AND POLICY RECOMMENDATION

This chapter demonstrates that household and firm financial inclusion in Uzbekistan remains low. First, the majority of households, rather than using formal finance, save and borrow informally. Low-income households have less access to finance than their peers in high-income groups. Although most households are increasingly using a bank account, few borrow/save with a formal financial institution. Pension coverage is high but mainly limited to public sector employment; people employed informally have no pension coverage. The use of insurance services is even lower. Internet and mobile payments have spiked in recent years; however, the usage level remains low relative to that in other countries, like the People's Republic of China, India, and the Russian Federation. Almost all firms use a bank account, but few borrow from a financial institution. Few firms use e-payments. The low banking sector penetration rate in

[14] Information on this is available on the Central Bank of Uzbekistan's website. Accessed 4 June 2018. http://www.cbu.uz/ru/press-tsentr/press-relizy/2017/11/95839/.

Uzbekistan relative to countries with a similar level of development also suggests that financial inclusion is low. Uzbekistan thus needs to increase the level of financial inclusion for firms and households to achieve equitable and rapid growth of income per capita, which is one of the key goals of all economic reforms.

Survey-based evidence suggests that both households and firms indicated the high cost of using finance as the top reason for not using it. As the second most important reason for not using formal finance, households declared that religious reasons stop them from using formal finance. Indeed, given that 88% of the members of the population of Uzbekistan are Muslims, the fact that no banks offer an Islamic banking product indicates a clear gap in the supply. Unlike households, firms reported that the complex application procedures and high collateral requirements are the second and third most important reasons for not using formal finance. These reasons thus suggest that financial inclusion in Uzbekistan is mainly constrained by supply-side factors.

On the supply side, the financial system is highly concentrated, with five commercial banks controlling more than half of the banking sector assets. This is in line with Beck, Demirgüç-Kunt, and Maksimovic (2004), who, based on a comparison of international evidence, concluded that, in countries with higher banking concentration, firms face greater obstacles in accessing finance. All these large banks are state owned and mainly focus on financing government-led projects and programs. The lending rate for these state projects is often below the market rate, which undermines the risk management practices of banks and limits the availability of finance to the private sector. The limited supply of finance to the private sector and limited competition in the sector make finance expensive for private-sector players and constrain financial innovation. This is in line with Beck, Demirgüç-Kunt, and Maksimovic (2004), who reported that state ownership of banks and direct intervention in banking activities worsen access to finance.

Strikingly, although the level of financial inclusion is low, the country has no financial inclusion strategy, and, even more surprisingly, we detected no ongoing discussions about such a document. The first policy recommendation, therefore, is that the country needs to formulate a national financial inclusion strategy to enable a strategic approach to the matter. Second, based on international experience, it should promote private and foreign capital participation in banking, insurance, and other segments of the financial markets. Third, financial liberalization, which has accelerated since 2017, though removing most of the restrictions in access to foreign exchange, needs to continue; market-based interest rates and commission fees on financial services are essential for the efficiency and inclusiveness of the system.

The liberalization of the banking system will also require the Central Bank of Uzbekistan to move towards the use of market-based instruments to regulate and supervise financial institutions: the current heavy reliance on the use on non-market-based instruments needs to cease. The regulator, to foster competition among financial institutions, may also want to license fintech and telecom companies and promote the legal framework to enable peer-to-peer lending. At the practical level, promoting non-conventional financial institutions and products might not be an easy task. For such cases, countries like Singapore and others have devised clear procedures that financial institutions can apply for a regulatory sandbox.[15] As the Consultative Group to Assist the Poor (CGAP) explained, a regulatory sandbox is "a framework set up by a

[15] Information on the procedures to apply a Fintech regulatory sandbox in Singapore is available from the website of the Monetary Authority of Singapore. Accessed 16 January 2018. http://www.mas.gov.sg/Singapore-Financial-Centre/Smart-Financial-Centre/FinTech-Regulatory-Sandbox.aspx.

regulator that allows FinTech startups and other innovators to conduct live experiments in a controlled environment under a regulator's supervision."[16]

The promotion of financial inclusion might occur through the use of digital finance, including the promotion of mobile and Internet banking. To encourage these in additional to financial liberalization and the use of market-based tools of regulation and supervision, the Government needs to facilitate infrastructure development, like the creation of remote identification facilities.

The country needs to improve its financial consumer protection. The current institutional structure, which pools financial and general consumer protection together, may not provide adequate safeguards. Rutledge (2010), based on six transition economies, explained that the financial crises of 2008 and 2009 demonstrated that the sustainability of financial systems is highly dependent on the existence of adequate consumer protection. Rutledge also explained that such protection should put systems in place that ensure that consumers make fully informed decisions when deciding to buy financial services and while using them along with easy and provide less costly mechanisms for settling conflicts with financial institutions. Finally, consumers need to have access to resources that enable them to gain financial education in any form and at the most convenient time. To achieve this, the Government needs to adjust the Law on "Consumer Protection" to fit the specific needs of financial services. Moreover, institution wise, the country needs specific institutions that focus on financial consumer protection.

The evidence on the level of financial literacy in Uzbekistan remains limited. The available sources imply that the level of financial literacy is low. The existing studies, like that by Klapper, Lusardi, and Panos (2013), have suggested, based on the Russian Federation, that financially literate people are more likely to use formal finance rather than informal finance compared with financially illiterate people; the ability of individuals to avoid negative income shocks and have higher spending capacity increases with their level of financial literacy. Thus, to promote financial inclusion, the country needs to promote financial literacy.

[16] Website of the Consultative Group to Assist the Poor. Accessed 23 January 2018. http://www.cgap.org/blog/regulatory-sandboxes-potential-financial-inclusion.

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