

## FOREIGN EXPERIENCE OF DEVELOPMENT OF CREDIT UNIONS AND OPPORTUNITIES OF ITS APPLICATION IN UZBEKISTAN

**Ilkhom Sharipov**

*National University of Uzbekistan named after Mirzo Ulugbek,  
1 University st, 100174, Tashkent, Uzbekistan  
E-mail: ilhomsharipov@gmail.com*

**Abstract.** In the paper considered questions of the theory of credit cooperation, history of formation of institutions of credit unions, foreign experience of development of credit unions, current situation and trends in the development of credit unions in Uzbekistan. Also considered the problems of creation and functioning of a multilevel system of credit unions in different countries. The purpose of consideration and study of issues is the development of scientific suggestions and practical recommendations directed for the sustainable development of credit unions in Uzbekistan and increase their role in sustainable socio-economic development of regions of Uzbekistan. Also, cooperative system of Germany was considered in this paper. During the research were used the principles of a systems approach, the methods of logical, statistical and economic analysis. In conclusion are given the suggestions and recommendations on the development of a multilevel system of credit unions in Uzbekistan, in the light of the positive international experience of developed countries.

**Keywords:** credit union, credit cooperation, cooperative bank, financial cooperative, socio-economic development.

**Jel: G21** - Banks; Other Depository Institutions; Micro Finance Institutions; Mortgages.

### 1. Introduction

In the context of liberalization of Uzbekistan's economy an important role in deepening the economic reforms in the country are playing regions, where concentrated considerable economic potential and financial resources. Sustainable and efficient functioning of the network of financial institutions, which are able to provide the needs of business with banking and non-banking services, creates the preconditions for the development of small businesses and private entrepreneurship. In turn, the development of financial institutions has a positive effect on the sustainable development of national

economy: by accumulating the free cash flow and providing them to the real sector, enhances the effectiveness of the national economy in general.

As noted the President of the Republic of Uzbekistan I. A. Karimov, “the priority task remains to further accelerate the development of services sector and small business as a major factor in securing employment, improving quality of life” (Karimov 2009). Also, He noted that it is necessary “strengthen measures to support small business development and entrepreneurship through a significant expansion of crediting” (Karimov 2010).

Taking into account that the economic complex of the country is heterogeneous and has different levels of self-sufficiency, improving the efficiency of credit unions in the regions could have a positive impact on the development of production (productive) forces, improve employment and welfare, socio-economic development of regions.

For Uzbekistan, credit unions – relatively new and untraditional form of financial institutions. In this regard, the study of international best practice of regulation of development of credit unions systems and the possibility of their creative use in Uzbekistan is a hot topic that needs further investigation.

The methodological basis of research conducted by the author is the principles of the system approach, the methods of logical, statistical and economic analysis.

Objective of research is developing scientific proposals and practical recommendations for the sustainable development of credit unions in Uzbekistan and increase their role in sustainable socio-economic development of regions.

## **2. Formation and development of credit unions institution**

Priority in development of questions of the credit cooperation theory belongs to Western economists. Many leading men of his time, recognizing the need for co-operation for each of the developing society, studied, perfected and introduced co-operative principles in all sectors of the economy. The founders of the cooperative philosophy are Robert Owen (1816), Charles Fourier (1808), Louis Blanc (1839), who uncovered the benefits of cooperation as a form of economic organization and regarded it as an organization of future devoid of contradictions and shortcomings of severe market competition (Bikbaeva 2008a).

An important contribution to the theory and organizational principles of the cooperative movement made by the scientists-economists: Chayanov (1925), Tugan-Baranovsky (1916), etc. In Uzbekistan, to the study of various aspects of the formation of non-market services are devoted works of Tadjibaeva (2010), Muradov (2010), Shamshetov (2008), Bikbaevoy (2008), Pugach (2009).

Credit unions base their activities on the principles of cooperative philosophy and cooperative democracy. In fact, the birth of first credit unions like the present and wide involvement in the practice of the investigated institutions associated with the activity of well-known German financiers Franz Hermann Schulze-Delitzsch, Friedrich Wilhelm Raiffeisen. Modern credit union history dates to 1850, when Franz Hermann Schulze-Delitzsch consolidated the learning from two pilot projects, one in Eilenburg and the other in Delitzsch in Germany into what are generally recognized as the first credit unions in the world. Activity of Hermann Schulze-Delitzsch was aimed at forming such credit cooperatives which combined small entrepreneurs and craftsmen working in the non-agricultural sector (Panaedova 2006). Friedrich Wilhelm Raiffeisen is well-known as founder of the agricultural credit banks, which in addition to credit operations carried out as a commercial activity in the interests of its members (Bikbaeva 2008b).

Developed in the 21<sup>st</sup> century, on the basis of credit co-operatives principles of mutual aid, laid the foundation of modern ideas about the nature of credit unions. Over time, this form of credit co-operatives emerged as a viable and efficient enough, and therefore has such a rapid spread throughout Europe and then worldwide (Emelyanov 2009a).

In the early 20<sup>th</sup> century, the cooperative credit system has reached the U. S., Canada and Latin America, where it has been further developed (Emelyanov 2009b). Credit unions are the subject of many scientific researches, and positions of scientists differ on many issues, depending on what country they live and what their laws. For example, some define it as non-profit financial organization created to assist its members through the merger of personal savings of the participants of credit union and their use for mutual crediting at reasonable interest rates, as well as providing them with additional services (Shamshetov 2008). Other researchers consider a credit union as a financial institution issuing the loan to its members at low interest rates. In accordance with the Law of the Republic of Uzbekistan (2002) credit union is a credit institution created by legal entities and individuals on a voluntary basis of equal membership in order to provide loans and provide other financial services.

On the principles of credit unions at various times worked many foreign scientists, including scientists from the CIS countries. World Council of Credit Unions (WOC-CU) adopted international operating principles which are based on a philosophy of cooperation and in its core values of equality, justice and mutual assistance. The basis of these principles is the concept of human development and brotherhood expressed by bringing people together to achieve a better life for themselves and their surrounding communities. With these principles, credit unions are the most optimal form of bringing people together, which combines individual and collective interests (Tadjibaeva 2010).

In many countries, conventional wisdom is to consider credit unions as non-profit organizations to provide financial mutual aid exclusively to its members by providing them with savings and credit services. The activities of credit unions is so closed, “internal” in nature and, accordingly, does not have an open market-orientation inherent in business entities. On the one hand, credit unions are inherent features of a commercial organization, but on the other – the goal of operation, namely the provision of social mutual help, do not allow referring it to commercial organization (Shamshetov 2008).

### **3. Foreign experience of the development of credit unions**

The experience of Western countries shows an individual approach in each country on the issue of development of credit cooperation system.

Foreign experience suggests that there are two basic systems of credit cooperation:

- Movement of credit unions;
- System of cooperative banks.

Both systems are based on the same principles of cooperation. The decision in the cooperative movement choices – credit unions or cooperative banks, affect, in general, by various factors. In some countries, there are two systems simultaneously in different organizational forms. In other countries, both forms are mixed and presented as a single organizational form. In general, it should be noted that the credit union system has evolved, especially in the Anglo-American space.

Thus, all three countries, USA, Canada and Ireland have 82.2% of all global assets, 83.9% of global savings and 82.6% of global loans to the credit unions around the world (Statistical Report of World Council of Credit Unions 2010.). Moreover, the degree of involvement of the population in the U.S. and Canada is 44–46%, while in Ireland and 70.7% altogether. Moreover, the degree of penetration of the population in the U.S. and Canada is 44–46%, while in Ireland 70.7% altogether.

The common point of origin of credit co-operatives in most countries is their organization in the first stage in a simple credit institutions and create a horizontal network of primary institutions – credit unions, credit cooperatives, loan and saving banks, mutual loan societies, and various associations (Haylemann 2004). However, their further growth inevitably leads to the formation of vertical structures – regional credit institutions, and in some countries – national. Thus, different countries have developed a two- or three-tier system of credit cooperatives. Three-tier system of credit co-operation has developed in the USA, Germany (see Table 1), France, Peru, two-tier – in Belgium, Holland, Denmark; in Austria there is a combination of first and second choices (Panaedova 2005).

In countries such as Netherlands, Germany, France, Japan, USA, Sweden, at the regional and national levels are formed cooperative banks, which are among the leading banking institutions in these countries and with international recognition. Rabobank (Netherlands), Credit Agricole (France), Norinchukin Bank (Japan), DZ Bank (Germany), American Bank for Cooperatives (Co Bank). In Sweden, for example, regional banks merged into the Union of Cooperative Banks, led by the Central Cooperative Bank. In France, at the national level the interests of co-operative banks are introduced by 2 organizations - public and private (Panaedova 2005).

**Table 1.** Cooperative system in Germany (Source: <http://www.dgrv.de/en/cooperatives.html> 2011)

DGRV (German Cooperative and Raiffeisen Confederation – reg. assoc.)			
BVR (National Association of German Cooperative Banks reg. assoc.)	DRV (German Raiffeisen Federation – reg. assoc.)	ZGV (German Federation of Buying and Marketing Groups – reg. assoc.)	Central Federation of German Consumer Cooperatives – reg.assoc.
8 regional Associations; 6 special auditing federations (EDEKA, FPV, PSD Banken, REWE, Sparda-Banken, PV Hamburg)			
1,138 Cooperative banks	2,604 Raiffeisen commodity, service and agricultural cooperatives	1,622 small-scale industry commodity and service cooperatives	219 consumer and service cooperatives included 16 members of Fachvereinigung Konsumgenossenschaften of the MVG
2 central banks (DZ Bank, WGZ Bank) and specialised institutions	Thereof 6 central cooperatives and other centres (central dairy coop., central livestock and meat coop. etc.)	Thereof 7 centres (BÄKO-Nord, BÄKO-Süd, EDEKA, REWE, SVG, ZEDACH, Zentrag)	Thereof 1 centre (Zentralkonsum)

#### 4. Current status and trends of development of credit unions in Uzbekistan

The extensive development of credit unions in Uzbekistan began in 2002 when it was taken in line with legislation. In the formation of credit unions important role played by the Central Bank of Uzbekistan, which is in accordance with the law of the Republic of

Uzbekistan “On credit unions” (2002) defined as the regulator of credit unions.

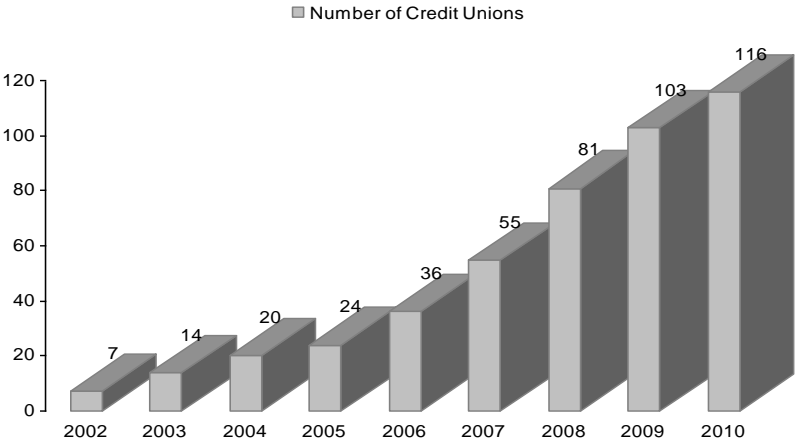
In August 2005, the Association of Credit Unions of Uzbekistan was established, the main activities of which is:

- Support for training and retraining of employees of credit unions;
- Provision of consulting and information services;
- Marketing research and development of new deposit and loan products;
- Preparation and dissemination of information materials, based on international practices and standards of credit unions, including those from other countries.

And in 2009 it was admitted to the World Council of Credit Unions (WOCCU) as a core member (CUA. Analytical Review of Credit Unions System of Uzbekistan 2011).

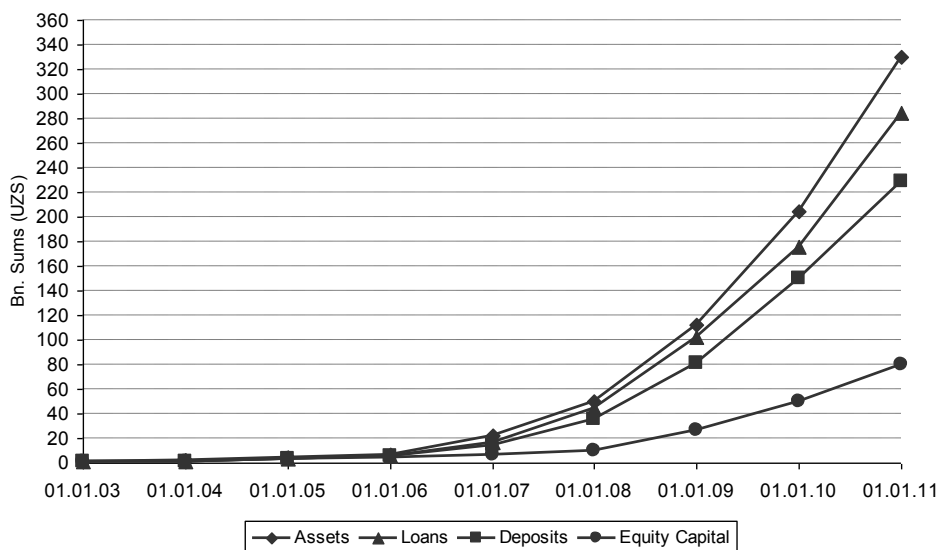
In order to develop a sustainable system of credit unions in the country, as well as the introduction of the deposit guarantee system of individuals and entities, members of the credit unions, to ensure their protection and preservation, Stabilization Fund of the Association was formed “Alliance Guarant” and was launched the deposit guarantee system of members, used in cases of bankruptcy and liquidation of credit unions - the members of Association (Sharipov 2009a).

Credit Unions of Uzbekistan are becoming an important part of financial system of the republic and along with commercial banks provide a wide access of individuals and entities, owners of private farms, small businesses and private enterprises to credit facilities. So, if in 2002 there were only 7, then on January 1, 2011 the number reached 116 (Fig.1).



**Fig. 1.** Dynamics of Growth of Number of Credit Unions in Uzbekistan (Source: The Central Bank of Uzbekistan)

Membership in the credit unions on 1 January 2011 in the whole system has exceeded 212 thousand persons. Total assets of credit unions accounted for 330 billion sums. The main source of the resource base of credit unions are the deposits of their members (Analytical review of credit unions system of Uzbekistan 2011). So, on January 1, 2011, deposits in credit unions reached 229 billion sums. Loan portfolio over the same period amounted to 285 billion sums (Fig.2).



**Fig. 2.** Dynamics of Main Indicators of the Credit Unions System of Uzbekistan (Source: Credit Unions Association of Uzbekistan (CUA) and own calculations)

In the territorial breakdown, the largest number of credit unions located in Tashkent (28 credit unions), Ferghana region (24) and Andijan region (17). Thus 60% of credit unions account for these three areas. In Bukhara and Tashkent regions carry out their activities more 8 and 10 credit unions, respectively. In other regions of the republic development of credit unions is slower.

Also, it should be noted on the Resolution of the President of the Republic of Uzbekistan № PP-1438 on November 26, 2010 which identified the following priority areas for further development of the nonbank financial sector, which includes credit unions:

–further enhancing the role and development of nonbank financial institutions, credit unions, their sustainability and efficiency in accordance with international norms and standards, expanding the range of services, strengthening the institutions of the

financial market infrastructure;

–stimulating the development of microfinance as an important financing tool for small businesses and private entrepreneurship, employment and welfare;

–consolidation of commercial banks and financial institutions of the republic with well trained and skilled professionals.

It was decided that a phased implementation in 2011–2012 of the new recommendations of the Basel Committee to improve the oversight of nonbank financial institutions, including providing for the introduction of additional prudential regulations for non-bank credit institutions.

## **5. Conclusions**

To further enhance the role of credit unions in the socio-economic development of regions, it is necessary to create a tiered (multilevel) system of credit unions. This will allow dynamically develop this type of institutions in the regions, in both quantitative and qualitative terms. If the quantitative growth of credit unions will promote spreading credit cooperatives in the country, the quality of their improvement will increase the number of their shareholders and will contribute to the development of small business and entrepreneurship, that is development of production (productive) forces in the regions of the country, the welfare of the population, and socio-economic development of the country as a whole.

Also, more work is needed in the following areas:

1. Create a legal framework for the development of a multilevel system of credit unions in Uzbekistan, given the positive international experience of developed countries like Germany, USA, Canada, Ireland and others.
2. Efficient use of indirect methods of influence, in the form of stimulating activities of credit unions with benefits and privileges.
3. Legislate a mandatory part of the existing and newly established credit unions in the stabilization fund of the Association “Alliance Guarant”, in order to guarantee the deposits of individuals and legal entities, the members of credit unions.
4. Credit Unions Association of Uzbekistan and Central Bank of Uzbekistan, with support from international organizations and institutions should widely publicize the cooperative movement and carry out explanatory work among the population, entrepreneurs and small businesses, provide training and improve the skills of employees of credit unions.



5. Taking into account that about 60% of the population lives in rural areas, especially necessary intensify propaganda work among farmers, among the rest of the population of villages in the regions.

In conclusion it is worth noting that the UN General Assembly proclaimed 2012 – International Year of Cooperatives that without doubt will have a positive influence in the sharing of best practices and further strengthening of trends in the financial sector, will contribute to the sustainable expansion of credit co-operatives worldwide (Resolution of the UN 64/136, 2009).

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## UŽSIENIO ŠALIŲ PATIRTIS PLĖTOJANT KREDITO UNIJAS IR JŲ PRITAIKYMO GALIMYBĖS UZBEKISTANE

**I. Sharipov**

Santrauka

Straipsnyje keliami probleminiai klausimai: kredito kooperacijos teorija, kredito unijų institucijų formavimosi istorija, užsienio šalių patirtis plėtojant kredito unijas, dabartinė situacija ir kryptis plėtojant kredito unijas Uzbekistane. Keliamos daugiapakopių kredito unijų sistemų funkcionavimo įvairiose šalyse problemos. Tyrimo tikslas – pasiūlyti mokslinius sprendimus ir praktines rekomendacijas, kurios padėtų plėtoti kredito unijoms Uzbekistane bei padidintų jų vaidmenį tvariai socioekonominei regionų plėtrai Uzbekistane.

**Reikšminiai žodžiai:** kredito unijos, kredito kooperacija, kooperaciniai bankai, finansinės kooperacijos, socioekonominė plėtra.

**Ilkhom SHARIPOV**, Ph.D student, National University of Uzbekistan named after Mirzo Ulugbek (home university). Was born on the 8 December 1981 in Tashkent (Uzbekistan). In 2002 graduated from Tashkent State Technical University with major in Automotive Engineering. Also graduated from National University of Uzbekistan with the second major in World Economy and International Economic Relations. From 2005 till 2008 worked at the National bank of Uzbekistan in positions of Leading specialist and Chief specialist of International Loans Department, Project Finance Centre. Since 2008 has been working as researcher and doing his Ph.D in economics at the National University of Uzbekistan. He is conducting research on development of credit unions in Uzbekistan. Has published over 10 scientific works.

Research areas: finance, microfinance, regional economics and banking system.