JOURNAL
OF EUROPEAN ECONOMY
Vol. 4 (№ 3). September 2005
Publication of Ternopil Academy of National Economy

Financial and Banking Services Market

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MICROFINANCE, EASTERN EUROPE AND UKRAINE

Abstract

The evolutionary features of developing countries predetermine the need for microfinance as an instrument of poverty eradication. The analysis of microfinance proliferation channels and current situation in Eastern European countries allows the author to determine major obstacles to and perspectives of microfinance network development in Ukraine.

Key words:

conventional and non-conventional finance, corruption, developing countries, domestic and foreign capital, microfinance, poverty, small and medium business, Washington consensus.

1. Introduction

There are many developing countries in the world. They suffer from the lack of appropriate finance. The developing countries here are used in a broad sense and include transition countries as well. The poor people in these countries are barred from ordinary banks, with no chance to get small business started successfully. It is inappropriate to ignore them in discussing the stability of the world economy. Are there any finances particularly suitable to poor people in the developing or transition countries? How different are they from the con-

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ventional bank finances of the advanced countries? What are the situations unique to transition economies with regard to microfinance? The purpose of this paper is to try to answer these questions.

2. Conventional vs. Non-Conventional Finance

All economies, either developed or developing, depend upon financial intermediary functions to transfer resources from savers to investors. In the developed market economies, the function is performed conventionally by commercial banks and capital markets. Millions of households in poor countries too want similar financial services. In many developing countries, however, capital markets are still at a rudimentary stage, and conventional commercial banks are reluctant to lend to the poor people. The reasons for their reluctance include high cost of small transactions, lack of traditional collateral, geographic isolation, or simple social prejudice. Even those institutions that provide financial services to the poor are limited in scale. Commercial lenders in rural areas prefer to deal mainly with large-scale farmers. Complicated loan procedures, combined with the lack of accounting experience of capitalism, also limit poor people's access to formal sources of credit.

In most developing countries, conventional financial sectors ignore informal sectors and repress the sustainability of member-based financial institutions at the community level.

It has become clear that the traditional World Bank's and IMF's macro investment strategies based on the «Washington Consensus»[1] theory of economic liberalization, have failed to improve the livelihoods of the poorest communities in the developing countries. This market liberalization approach obstructs community-level investment opportunities, failing to develop small rural financial institutions for the poor. It represents the classic top-down approach to development where local communities have little or no say in the process. These liberalization policies have benefited the urban sector and those people in the top 10% of income distribution in the developing countries; the latter includes bankers, consultants, government bureaucrats, and owners of large businesses.

[1] The term «Washington consensus» was first used in 1989 by the American economist J. Williamson to denote six recommendations (covering tax discipline, «competitive» market course, liberalization of business and foreign investment, privatization, and deregulation) to the countries that wished to reform their economies. They were assumed as a basis for issue of loans by the World Bank and IMF. (Ed.)

Non-Conventional Finance

The absence of commercial banks for poor people has led to a very non-conventional scheme of lending. The recent prominence given to non-conventional finance for poor people owes much to the success of a relatively few microfinance trials. The most prominent of the successes now reaches over 3.7 million people in Bangladesh, South Asia. Similar successful examples are known in Latin America and Africa. These schemes are characterized by relatively small loans. The repayment period is relatively short. Women are major beneficiaries of their activities, and the destination of the funds primarily includes agriculture, distribution, trading, small craft and processing industries.

Many of the micro-finance institutions in the developing countries claim a high rate of repayment. This is attributable to the informal participatory structures, which create an atmosphere in which debtors respect their obligations. Everyone is involved as peer. The administrative structure is generally light, and the entire process is participatory in nature.

Some studies show that there are limits to the use of microfinance as an instrument for poverty eradication. They include difficulties in identifying the poor and targeting credit to reach the poorest of the poor. Added to this is the fact that many people, especially the poorest of the poor, are usually uneducated and not in a position to undertake an economic activity, because they lack business skills, experience and even motivation for business. Nonetheless, the success of this non-conventional finance merits serious consideration of transition economies.

3. Microfinance: Definition, Origin and Spread

Much of the current interest in microfinance stems from the Microfinance Summit (2–4 February 1997, *Washington DC, USA*). The definition of microfinance adopted there was the following: Microfinance is a program designed to extend small loans to very poor people for self-employment projects that generate income, allowing them to care for themselves and their families.

Some of the defining criteria common to all countries include:

1) size (loans are micro, or very small in size),

2) target users (micro entrepreneurs and low-income households),

3) use of funds (income generation and enterprise development, but also for community use (health, education, etc.)),

4) terms and conditions (most terms and conditions for microfinance loans are flexible and easy to understand, and suited to the local conditions of the community).

Microfinance is thus the extension of small loans to entrepreneurs too poor to qualify for conventional bank loans. It has proven an effective and popular measure in the ongoing struggle against poverty, enabling those without access to traditional lending institutions to borrow and start small business. Microfinance has been used as an 'inducer' in many community development activities, used as an entry point in a community organizing program or as an ingredient in a larger training exercise. It is a bottom-up process of participatory development.

The Origin of Microfinance: the Grameen Bank

Dr. Muhammad Yunus returned to Bangladesh to settle into a life as a professor, after earning a Ph. D. in economics at Vanderbilt University, USA. But a famine in 1974 ravaged the country, leading Dr. Yunus to alter his thinking and his life profoundly: «What good were all my complex theories when people were dying of starvation on the sidewalks and porches across from my lecture hall? Nothing in the economic theories I taught reflected the life around me».

Armed with a lofty dream to end the suffering around him, he started an experimental microfinance enterprise in 1977. It began with a simple loan. After witnessing the cycle of poverty that kept many poor women enslaved to high-interest loan sharks in Bangladesh, Dr. Muhammad Yunus lent the $27 to 42 year-old women, so they could purchase bamboo to make and sell stools. In a short time, the women were able to repay the loans while continuing to support themselves and their families. With that initial eye-opening success, the seeds of the Grameen (named for the Bengali word for «rural») Bank, and the concept of microfinance, were planted. By 1983, the Grameen Bank was officially formed.

The idea behind the Grameen Bank is ingeniously simple: extend credit to poor people, and they will help themselves. This concept strikes at the root of poverty by specifically targeting the poorest of the poor, providing small loans (usually less than $300) to those unable to obtain credit from traditional banks.

At Grameen, a loan is administered to a group of five people, with only two receiving their money up front. As soon as these two make a few regular payments, loans are gradually extended to the rest of the group. In this way, the program builds a sense of community as well as individual self-reliance. Peer pressure works well. Most of the Grameen Bank's loans are given to women, and since its inception, there has been an astonishing loan repayment rate of over 98 percent. The Grameen Bank is now a $2.5 billion banking enterprise in Bangladesh. Ever optimistic, Yunus travels the globe spreading the belief that poverty can be eliminated. Dr. Yunus's efforts prove that hope is a global currency.

The Spread of Microfinance

The microfinance model has spread to over 50 countries including transition countries. It has now become the world's hot idea for reducing poverty. It is difficult to argue with Dr. Muhammad Yunus' achievements. The well-known ability of the Grameen Bank to fight poverty in one of the world's poorest countries has done more than anything else to legitimize the field of micro-finance, which now has a well-coordinated worldwide movement trying to reach 100 million of the world's poorest families by 2005. The International Year of Microcredit is 2005.

Part of the success may be the bank's relentless innovation and flexibility in organizing itself to work in the challenging setting of rural Bangladesh. Part of it may be the bank's co-op structure, where borrowers are called «members» and make up the key block of its shareholders. Part of it may be the desire to be only minimally profitable and return as much of its earnings as possible to those very people. There are probably other parts to add. But the important thing is that the Grameen process as a whole works well. Peer pressure and equal participation unquestionably lead to success. This truth is applicable to any country including a transition country.

The Grameen Bank typically starts off with a non-profit orientation and a desire to fill an important niche in the local development picture, but is intended to convert to a for-profit status within a few years. The best established of these, Grameen Uddog («Rural Initiative»), finances local women's purchases of yarns and dyes to weave on traditional handlooms, then links them with Bangladesh's thriving textile export business. The production capacity is currently a million yards per month. Lately Yunus has used the Grameen Bank as a springboard into other innovative business ventures intended to create new opportunities for poverty reduction.

The Grameen Bank (GB) has thus reversed conventional banking practice by removing the need for collateral and created a banking system based on mutual trust, accountability, participation and creativity. GB provides credit to the poorest of the poor in rural Bangladesh without any collateral. It serves as a catalyst in the over-all development of socio-economic conditions of the poor who have been kept outside the banking orbit on the ground that they are poor and hence not bankable. If financial resources were made available to the poor people on terms and conditions that are appropriate, acceptable and reasonable, millions of small people with their millions of small pursuits could add up to create a development wonder. As of July, 2004, it has 3.7 million borrowers, 96 percent of whom are women. With 1267 branches, the GB provides services in 46,000 villages, covering more than 68 percent of the total villages in Bangladesh.

4 Specific Situations Unique to Transition Countries in Eastern Europe

Small business can play an important role in employment and production in any country including a transition country. Experience shows that the small and medium-sized enterprise (SME) sector can be a primary contributor to economic growth and job creation. Small business in general, when compared with big business, has lower barriers to market entry, lower production costs and more focused product mix which allows it to achieve greater efficiency. Small and medium enterprises are key in commercializing new technology.

Noteworthy is the spread of microfinance to some transition countries. In Mongolia, for instance, microfinance is producing some tangible outcome. The Mongolian Government in the early 1990s identified microfinance as an essential tool in eradicating poverty. MicroStart Mongolia project was officially launched in 1997 to build the local capacity to initiate microfinance activities in Mongolia. «Golden Fund for Development» disbursed its first loan in September 1998 and quickly became a pioneer in creating a new structure and a new way to do business in Mongolia. MicroStart Mongolia (X. A. C.) has already expanded its activities to more than 21,700 loans, encompassing a value of more than US$ 5.2 million, all of which were provided to low-income families. The rate of repayment has consistently been maintained at above 97 percent.

Situations Unique to Central and Eastern Europe

Microfinance is new to Central and Eastern Europe (CEE) and the Newly Independent States (NIS), where it was introduced only in the early 1990s. The current literature on microfinance, based on the Asian and Latin American experiences, is said to be less relevant for the transition countries of CEE and the NIS which all share unique and distinctive histories. The unique and distinctive features include legal and regulatory issues. Shortcomings in the legal and regulatory environment feature prominently among the challenges that inhibit smooth development of microfinance institutions. The uniqueness can be detrimental to easy spread of microfinance, although the collapse of the central planning and the closure of state enterprises require rapid development of self-employment and micro-enterprises. It is desired that microfinance plays an important role in smooth economic transition of these countries. Some drastic preparation is needed before setting up a microfinance facility in these transition markets. What is required or desired is different from what is actually possible or probable.

Specificity of Microfinance in Central and Eastern Europe (CEE) and the Newly Independent States(NIS)

The CEE and NIS countries have potentially large markets for microfinance services because of the need to change the economic structure from large-scale state enterprises to small-scale private businesses. While many of the «best practices» of microfinance established in the Asian developing countries are in principle applicable to CEE and the NIS, there remain significant differences in objectives, clients, and environments. In the Asian developing countries, microfinance is a poverty reduction tool that responds to the financial needs of poor people. It promotes responsible entrepreneurship, mutual trust and adherence to commitment.

In CEE and the NIS, by contrast, microfinance tends to be regarded as a broader economic tool that helps privatize the economy «from the bottom up». It is also said to be a psychological tool that helps to change the mentality of leading people from top-down communist to bottom-up market-economy ideas. Potential microfinance clients in CEE and the NIS, unlike the Asian counterparts, share common characteristics: high literacy, weak social network, difficulty in accessing market, weak market network, underdeveloped entrepreneurial and business skills.

These unique environments are shaped by the legacy of the centralized decision making and the forty years of large production units. Most governments continue to think even now in terms of large production units, although many years have passed since the collapse of communism. Some governments still fail to perceive the importance of small business. The old mentality of the communist leaders hampers smooth progress of microfinance activities. In many CEE and NIS countries, the financial markets (especially rural financial markets) exhibit systemic weaknesses including information barriers. These systemic weaknesses, along with unreformed banking systems, result in the scarcity of financial services. Because microfinance relies on non-traditional collateral, it could overcome the traditional systemic weaknesses, if sufficient local cooperation were secured at grass-roots. Microfinance programs have sometimes proved to be the only source of credit, for example, in rural areas of Albania. Most countries in the region also have unsupportive environments for microbusinesses: cumbersome registration requirements, high taxes, lack of office space, etc. There is little or no prior experience with microfinance in CEE and the NIS. These countries have legal and regulatory environments that are unreformed, incomplete, and sometimes conflicting. Ukraine lags especially behind other countries. Its market mechanism remains underdeveloped. Black markets («informal» economy) tend to thrive. A substantial part (about 60 to 70%) of the Ukrainian economy is said to go into the «shadow sector». The Government sees no other ways but legalize «shadow capital» in order to make it work for the economy. Its environments are not always favourable to microfinance.

The Legal and Regulatory Environment for Microfinance in CEE and the NIS

Certainly, a hospitable legal and regulatory environment has not proved to be a necessary precondition for the development of microfinance. In general, improvements of laws and administrative regulations relevant to microfinance could be undertaken, only after the contribution of microfinance is actually demonstrated by the efforts of local individuals who are honest, responsible and mutually committed. CEE and the NIS as a region manifest a number of distinctive features with respect to microfinance. Among these, two are particularly relevant:

(1) The legal and regulatory provisions of Communism still hold over. The old communist laws are unsupportive of microfinance activities. New laws and regulations for the post-independence new age remain incomplete because they have often been hastily or poorly prepared. It is very difficult to transform the economic system from communism to market economy without friction. Not smooth is the transition from the State-administrated Communist-type economy to the market economy.

(2) Many of the laws and administrative regulations relevant to microfinance – the law on non-profit non-governmental organizations (NGOs), the law on the regulated financial sector and the law on taxation and accounting, to name a few – are still in process of development. Unless the appropriate new laws are actually in place, no microfinance activities will flourish.

5 Problems Specific to Ukraine

Resistance to Economic Reform and Retardation of Microfinance in Ukraine

Ukraine's economy has exciting potential upside, but it is actually accompanied with a great deal of risks. So far this potential remains unrealized as the economy has long been in contraction. The news from this country has been extremely mixed. The optimism about the Ukrainian economy is tempered often by new reports of political instability, brutality and corruption at the highest levels of government. The economic reforms in Ukraine have been retarded behind other transition countries. Soon after independence in December 1991, the Ukrainian Government liberalized most prices and erected a legal framework for privatization, which has not gone well. The post-independence resistance within the Ukrainian government has been stalling the reform efforts. It has led even to some backtracking. Society is corrupt because the vested interests have a big say and reject any drastic democratic reform.

Ukraine used to serve the USSR most among its allies. Ukraine was rightfully considered to be the bread basket of the former Soviet Union, satisfying more than 25% of its agricultural needs. The real role of the Ukrainian economy used to be concealed behind the iron curtain of secrecy. About 60% of the Ukrainian economy was used to operate for the Soviet military-industrial complex, contributing up to 40% of the total Soviet defence industry output. The Military industry obtained all skilled labour, necessary resources, and unlimited finances. The rest of the industry settled for what was left after such allocation of scarce resources. It never produced enough consumer goods of reasonable quality. The fall of the Soviet Empire was not forged in the secret underground facilities. It was an unbearable dead burden of wasteful defence industry that brought the Soviet Economy to a complete halt. Designed, administered and funded from Moscow, the Ukrainian heavy industry was inefficient and wasteful in material and energy consumption.

After the disintegration of the USSR, the Ukrainian economy suffered the most, as it was most involved in its defence industry. Ukraine has to deal with the grave consequences of Moscow's imperial policy. Ukraine's dependence on Russia for energy, as well as the lack of significant structural reforms, has made the Ukrainian economy extremely vulnerable to external shocks. Reforms have been lagging especially in politically sensitive areas of structural reforms and privatization. This explains why small and medium enterprises have been so underdeveloped in Ukraine, with the situation unfavourable to spontaneous growth of microfinance.

Cheating at School and Corruption in Society

Ukraine has long been mired in corruption and economic hardship. It is said that the Ukrainians don't give it a second thought when they can bribe cops to get out of a traffic infraction. Even the President of the nation often rigs an election. Why is there so much corruption in Ukraine? Because the whole system of higher education is corrupt in my opinion. Ukrainian schools are entirely different from the US or Japanese schools. The difference is remarkable in academic behaviour. University students in Ukraine can easily gain grades by paying a bribe. They do not learn appropriate behaviour of responsible individuals. Ukrainian universities think that having students sign a contract to behave properly will be sufficient. It is not. Students at school must know how to behave honestly, responsibly and considerately, not how to cheat. The academic behaviour is corrupted by the learning structure of the educational institution. They are not trained to be responsible for their own decisions. Graduates receive academic credentials, even if they cheat on exams. No wonder, businessmen can easily behave improperly. University graduates who were not educated to behave properly at school fail to behave properly later on the job. The whole society is corrupt, because the system of higher education is fundamentally corrupt. This is another reason for Ukraine's having unfavourable situation for microfinance.

Academic Corruption in Ukraine

Dr. Ray M. Johns, Fulbright Lecturer in Ukraine, says, «It seems in Ukraine a student could retake the course examination until he/she passed the course. The students have no standard of academic behaviour as a reference point. They also have no limits placed on inappropriate academic behaviour». He then admits that the whole system of higher education is fundamentally corrupt. No wonder, medical doctors cheat on their anatomy exams. Company managers do not accept their own responsibility. Government officials really do not learn any economics, even though they have received academic credentials.

Dr. Johns also says, «The old system was an unchanging process of dispensing politically correct information. This may have functioned adequately with the physical sciences, mathematics, and engineering. But it does not work at all for humanities, social sciences, and business administration». Critical thinking, problem-solving and individual learning are essential in the humanities, social sciences, and business administration. These subjects are the study of humans and their interrelated behaviours. The circumstances around these subjects are constantly changing, with new content, new knowledge, and new perspective. A new course must replace the old. Dr. Johns concludes, «Students have told me they just feel like sheep being herded through an obstacle course. It is thus no surprise that they try to get through the obstacle course with a minimum of effort. It is not a career learning program, but a game to be won by clever manipulation».

The old system of higher education deprived each student of an opportunity to think as a responsible individual. It discouraged critical thinking, responsible learning and independent problem-solving. Teaching was all memorization. It was not teaching people to think, but rather teaching them not to think. It made students robots. It was simply indoctrination, with no individual thinking. Such situation is not favourable to spontaneous growth of microfinance.

Corruption against Economic Progress in Ukraine

Corruption acts as a severe brake on investment and economic performance. Ukraine always ranks among the most corrupt countries. According to Transparency International's 2004 ranking of corrupt nations, Ukraine was one of the worst — No. 128 out of 146, nestled between Sudan and Cameroon. A World Bank study of 2000 ranked Ukraine among the worst Eastern European nations in terms of both administrative and state capture corruption. Administrative corruption is defined as the taking of bribes and other illegal payments. State capture corruption is defined as occurring when politically influential individuals use their power to appropriate for themselves sections of the economy. In a 2000 business survey conducted by the International Financial Corporation (IFC), 100% of firms responding indicated that they had been compelled to pay unauthorized fees to obtain basic government services such as business permits, fire inspection reports, etc. An aggressive campaign instituted by the Ukraine's government to reduce over-regulation is leading to a decrease in administrative corruption, but much remains still to be done. Administrative corruption must be addressed in tandem with the problem of very low government wages. As long as members of the Cabinet of Ministers make only about US$300 per month while police and other inspectors often make as little as $30, stamping out the administrative corruption will remain difficult. State capture corruption represents a more severe threat to economic growth and foreign investment. In Ukraine, a group commonly referred to as «oligarchs» control a significant portion of the economy, particularly in mass media, energy and heavy industries, such as steel and chemicals. Many of these oligarchs enjoy immunity from prosecution due to their seats in the Rada (parliament).

Small Business in Ukraine

Ukraine's industry used to be oversized and disproportionate. Its environmentally hazardous metallurgy, machine manufacturing, and chemical industry used to serve the USSR directly. Authorities failed to pay attention to promotion of individual decisions of small and medium enterprises(SMEs). Ukraine's small and medium enterprises remain relatively underdeveloped, lagging behind other transition economies such as Poland, Czech Republic, Slovenia and the Baltic republics. The experience of these countries proves that a strong small business sector can be developed successfully. Poland, for example, with a population of 39 million, has 2 million small businesses which have contributed greatly to its rapid economic growth. Privatization increases the number of SMEs, which unfortunately is not the case in Ukraine.

In Ukraine, where 50 million people live, there are about 250,000 small businesses, out of which only 100,000 are operational. Since 1994, the pace of overall small business growth has slowed down, a fact which indicates that the environment of Ukraine is not favourable for the growth of small and medium enterprises. According to official data in Table 1, small businesses employ 5.7% of the working population in Ukraine, the lowest among the ten countries. The SMEs' contribution to Ukraine's GDP is close to 10%, which is also very small compared with other transition countries. In Japan, the SMEs' share in total employment is 78%, highest among the ten countries in Table 1. The contribution of the SMEs in Poland is indeed larger than that of Ukraine, but lags behind the advanced countries. This reflects some problems common to Eastern Europe.

Table 1.

Economic Contribution of SMEs in Some Countries

Countries	Number of SMEs per 1000 Residents	SMEs' Share of Total Employment (%)	SMEs' Contribution to GDP (%)
USA	74	54	50–52
Italy	68	73	57–60
Japan	50	78	52–55
UK	46	49	50–53
EU countries	45	78	63–67
Poland	41		30
Germany	37	46	50–54
France	35	54	55–62
Russia	6	9,6	10–11
Ukraine	2	5,7	9,0–9,5

Source: International Finance Corporation (IFC), Obstacles to Small Business Development in Ukraine, October 1997, page 8. (SME = Small and Medium Enterprise).

Deficiency of Domestic Capital and Needed Legal Framework for Foreign Capital

In order to improve the economy by increasing small and medium enterprises, Ukraine needs financial capital from foreign countries. Domestic capital is typically deficient. Ukrainian economy is said to need at least $40 bln in investments to improve the economic situation. With funding unavailable, the very state effort of supporting inefficient and obsolete industries is a clear mistake rooted in the Soviet era mentality. Ukrainian legislators used to fail to realize that the task of economic reform is unfeasible without massive financial injections and that the only source of the financial injection is foreign capital. Inconsistency of reforms and lack of foreign-investor- friendly legislation has kept potential investors at great distance.

Economic reforms are therefore needed to attract foreign capital. One of the solutions in attracting foreign capital and technical expertise is considered to be a joint venture (JV). The number of JVs was growing steadily in the early 1990s. By April 1997, the number exceeded 4,000 (Norma-Press Agency) with the Ukrainians providing cheap labour and manufacturing space. Some JVs paid their workers up to $100.00 a month, while average salary in the state-run industry was $80 (Fax Gazeta, Mar 8, 1997). This is quite noteworthy, in view of the fact that wages were not paid for months in many fields of the economy, including mining, education, health care, and even in the Armed Forces. An example of a fruitful joint ventures is Mexico's maquiladoras, which generated more than $31 bn in revenue and $6bn in income in 1997. Its success is an inspiration for Ukraine.

In 1994, the package of highly important laws was adopted in Ukraine. These laws regulate foreign economic relations, export-import transactions, free-trade zones, joint ventures and foreign investments. Most of them were drafted with the help of foreign experts. In many cases, relevant laws of a certain western country were referred to as models. By August 1994, most of these laws were adopted by the Ukrainian Parliament, thus creating legal foundation for foreign investments and joint ventures. Elimination of one obstacle after another will gradually raise external confidence in the Ukrainian Economy, which will help domestic private business to prosper at grass roots and microfinance to spread throughout the country. This movement will generate bottom-up economic vitalization, further attracting foreign business from the EU and other advanced countries.

Mr. Terry Hallman, People-Centered Economic Development, says, «A significant opportunity exists for the creation of an economic development program in Crimea. This involves the Crimean Tatar community, an ethnic group which has shown a rather remarkable capacity for democratic and market development quite ahead of the time. Crimean Tatars remained largely consistent with commitment to non-violence and democratic principles. There appear to be no formal programs to help this group of people get a financial foothold. The primary barrier is the lack of financial resources, resulting in half of the current Crimean Tatar population in Crimea unable to have a home. It is now widely recognized that a key financial strategy must include microfinance. A new micro-credit program is urgently needed». There is no doubt that the Crimean and other local people in Ukraine are in urgent need of microfinance. The legal arrangements for its success are fortunately being done one by one. Conditions are getting ripe for the bottom-up growth of smaller business here and there in Ukraine.

Some Hope for Ukraine

Business confidence in general has recently been up in Ukraine, as evidenced by strong growth in new business registrations, mostly in the small and medium enterprise. Recent dramatic proliferation of small business startups and new community organizations signal that the country is already on the move, and the people are increasingly taking advantage of their new freedoms. Since achieving independence in 1991, Ukraine has successfully taken some steps toward representative democracy, political pluralism, and a free-market economy, although there still remains much work to be done in the light of the EU standard, because political power is heavily concentrated and the separation of power essential to democracy is not yet well established.

Small business incubators could contribute to vitality and sustainability. The incubators will help build acceptance, recognition, and support of the vital role small businesses will have on the growth of the Ukrainian economy. The focus is on the creation and sustained operation of successful incubators. «A great opportunity in microfinance exists in Ukraine due to the shortcomings of its traditional banking industry and a growing small and medium-sized business community», according to BA 456 of Duke University.

The new Civil Code came into force on 1 January 2004, which significantly influences the legal relationship governing ownership rights of real estate in Ukraine. This provides a good framework to solve the problems of both obsolete legislations and numerous contradictory norms. For the first time since independence, the Ukrainian laws expressly specify the rights of individuals to freely own and dispose of real estate. This is indeed a welcome information for the spread of microfinance.

First Microfinance in Ukraine

The International Finance Corporation (IFC), the private sector development arm of the World Bank Group, provided in 2002 a US$3.5 million loan to the Micro Finance Bank Ukraine (MFB) to help expand its operations to local micro and small enterprises. In 2001, MFB was established with the IFC's support as Ukraine's first microfinance institution. Since its creation, MFB has been successful in providing effective financing for working capital and equipment acquisition to small and micro enterprises in the country. By the end of June 2002, MFB had 3,025 loans outstanding in its portfolio. Edward Nassim, IFC's Director of the Central and Eastern Europe Department, according to IFC Press Release No. 02/0097, says: «IFC is pleased to continue supporting one of the pioneers in providing financing to micro and small entrepreneurs in Ukraine. Our commitment is to encourage the development and growth of a strong private sector in the country, and strengthening the local financial sector is critical to reach this goal».

IFC's investment reflects a key aspect of its global microfinance strategy, focused in supporting the commercial viability of microfinance activities in developing countries. IFC believes that well-managed microfinance institutions can be commercially viable and should provide substantial and sustainable increase in the volume of financial services for micro enterprises. The development of small and medium enterprises in Ukraine is crucial for the growth of its economy. Its success will lead to further expansion of financial services to other enterprises in Ukraine.

7. Summary and Conclusion

The discussion so far leads to the following summary of what are needed for successful microfinance.

Fourteen Conditions for the Success of Microfinance:

1. There should be national consensus for the rule of law, not the rule of humans.

2. Compliance with laws, information disclosure and transparant operation are prerequisites for successful economic democracy.
3. Corruption of the whole society must be reduced. Ukraine always is one of the worst countries in the world in terms of administrative corruption and state capture corruption.
4. The whole system of higher education needs to be corruption-free.
5. Domestic resistance to democratic economic reforms needs to be removed.
6. Many legal systems of the communist era and anything like a mafia dictatorship must be gone forever.
7. Centralized decision making must give way to the decentralized one. Top-down commands must yield to bottom-up initiatives. The central government must allow and help small-scale business with microfinance to crop up and grow here and there.
8. Legal and regulatory arrangements must be supported top-down and bottom-up throughout the nation.
9. Bottom-up grass-roots privatization efforts must be supported consistently by higher authorities. Local authorities must respect and promote community movement to create and manage microfinance schemes.
10. Importance of small companies, informal sectors, and self-employment must be accepted widely.
11. New laws relevant to microfinance need to be enacted, implemented smoothly and observed harmoniously.
12. Unless the higher authorities respect a group decision of microfinance, its attempt will be doomed.
13. Every member is committed to participating equally in the operation of microfinance.
14. Mutual respect, peer pressure and group responsibility need to be secured nationwide for successful microfinance.

Conclusion

There are two kinds of banks: conventional and unconventional ones. Conventional commercial banks are usually based on mutual distrust, whereas new unconventional banks are based on mutual trust. The origin of microfinance is deeply rooted in South Asia. In 1976, the Grameen Bank in Bangladesh was founded by Dr. Muhammad Yunus. It reverses conventional banking practice by removing collateral. It creates a new banking system based on accountability, creativity and mutual trust. It revolves around an unshakable personal commitment to fight poverty from the bottom up and an equally strong sense that the established order has little to offer to the poor people. The success of the Grameen Bank is attributable to innovation, flexibility, group responsibility, and return of earnings to participating members. The microfinance develops self-employment, self-reliance and self-responsibility. Every member must be involved without exception. The peer pressure and equal participation unquestionably lead to success. The administrative structure is generally light, and the profit is kept at a minimum just enough to bear total cost. The Grameen Bank typically starts off with a non-profit orientation and a desire to fill an important niche in the local development picture. The Grameen Bank as a whole works quite well. No wonder, there are many replications throughout the poor world. It is applicable to any country where people have similar attributes with similar social backgrounds. Microfinances have been shattering myth after myth. The myth used to be that women are not bankable. The Bangladeshi women have turned out to be productive members of the society. The incredible successes of microfinance programs in Bangladesh and other Asian countries will certainly give hope, courage and optimism to people in other countries.

The transition countries in Eastern Europe could also benefit from microfinance, but its landscape is quite different from that in the Asian developing countries. Microfinance in Eastern Europe is considered to be a broader economic and psychological tool that helps privatize the economy from the bottom up. There is little or no top-down support for bottom-up entrepreneurial movement in Central and Eastern Europe, although in South Asia, the bottom-up movement is actively supported by communities and central governments. The social network is strong in South Asia, but very weak in Eastern Europe. The significant difference arises from the legacy of communism. In many Eastern European countries, rural financial markets exhibit systemic weaknesses, including information barriers and lack of collateral enforcement. Banking systems remain unreformed. These systemic weaknesses result in a scarcity of financial services. Microfinance which needs no collateral could overcome the systemic weaknesses. Microfinance programs are sometimes the only source of credit (for example, in rural areas of Albania.) Eastern European countries have a large potential market for microfinance services, because of the need to change the economic structure from large-scale state enterprises to small-scale private businesses.

After disintegration of the USSR, the newly independent states had to face grave consequences. Ukraine suffered most, its economy being involved in the Soviet military industry most of all. There used to be widespread resistance among vested interests in Ukraine against the democratic economic reform, with even some backtracking done to the old Communism. Many hangovers of the communism are still noticeable. The environment of Ukraine is not favourable for the growth of small and medium enterprises. The governmental support of micro-credit is still weak in Ukraine. It needs to create a strong legal basis for the market economy in order to compete effectively with its neighbours. Its privatization is not as successful as in other transition countries in Eastern Europe. Its economic democratization is retarded. Sound economic management is not in existence. No market mechanism is in store due to many hangovers of the Communism. Persons with vested interests do not welcome a complete shift to the market-guided economy. Their minds are united against joint economic action. No unity in macro and micro economic policy results in the lack of economic progress at every level. There remains general preference of large to small business. No positive background exists for upcoming micro-enterprises. No team spirit prevails unlike South Asia. The success of microfinance requires cooperation, mutual respect, and group responsibility, as witnessed by the Grameen Bank. People must trust one another. The relationships between central and local governments are not mutually supportive. Ukraine has been weak in these respects.

The whole society is said to be corrupt in Ukraine. Students learn how to cheat at school. Students graduate from school with no appreciation of honesty, transparency, and responsibility. Higher education neglects social sciences and humanities, such as economics, business administration and anthropology. These subjects, unlike natural sciences, deal with individual learning, critical thinking and problem-solving. Social sciences and humanities study human behaviours and their interrelationships which are subject to constant change in the global society. Students must each think, judge and decide as responsible individuals, which should be the aim of higher education. These honest students will eventually make the society corruption-free. Transparency is lacking in many areas of the current society. Mafia economy still exists. Shadow economy and illegal transactions are still rampant. The traditional landscape is not necessarily favourable to microfinance movement. Ukraine's entry into the EU is still far away. These shortcomings must be remedied drastically. The problems are mountainous in Ukraine, but the need for microfinance is very great. Great need is increasing for microfinance by nascent small enterprises and poor people in Ukraine. This need is being met gradually, which gives future hope for better Ukraine.

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The article was received on February 16, 2005.