

*TURKMENISTAN THIRD QUARTERLY REPORT TO USAID***THIRD QUARTERLY REPORT****USAID GRANT AWARD NO. 120-0009-A-00-9021-0****I. Executive Summary**

The above referenced grant was awarded from the USAID Mission in Almaty to Mercy Corps International on October 1, 1999 for the operation of a micro credit program in the Republic of Turkmenistan. Through this project, Mercy Corps has partnered with the Central Asian American Enterprise Fund (CAAEF). A Memorandum of Understanding (MOU) between the two organizations was signed on September 17, 1999. A copy of this agreement was enclosed in the original proposal.

In acquittance to the USAID Grant Award and the MOU between CAAEF and MCI, the third quarter of operations was dedicated to credit disbursement in the city of Ashgabat.

This quarterly report covers the period from April of 2000 to the end of June of 2000. In mid-June, CAAEF unilaterally changed the operational procedures and ceiling capital amount committed for this program. An explanation of this situation is included in this report.

II. Program Accomplishments**A. Credit Disbursement and Repayment**

The micro credit program experienced remarkable success during this reporting period. By the end of June, a total of \$289,174 in credit had been approved by CAAEF in the weekly credit committees. The following page demonstrates the status of all approved loans. Repayment of all outstanding loans is 100 percent.

B. MCI Registration

On March 29th, Mercy Corps International received a notice from SAFI stating that the registration of MCI as a legal entity in Turkmenistan will not immediately be approved. SAFI did say that all of the registration documents were in order and correctly presented. While SAFI has agreed that we can continue to operate under the CAAEF license and the Strategic Agreement signed between the Government of Turkmenistan and the Board of Directors for CAAEF, the letter states that registration of Mercy Corps would require a banking license as this would be the primary operational function.

Mercy Corps applied for registration as a representative office under Civil Code No. 56 of the Turkmen law. The registration was denied due to Article 4 and 5 of the Commerical Code stating that a banking license would be required for credit functions. Mercy Corps is not legally performing any function that could be considered as a bank operation. Our role in Turkmenistan has been to work as consultants to clients, review and analyze businesses, present to the credit committee each loan application, and after credit approval we continue to work with clients to ensure prompt repayment of the loans. CAAEF's function has been to sign all loan documents and collateral agreements, open a bank account in their name for micro credit, and give final approval of all loans in the credit committee.

Mercy Corps International is considering other potential options for the purpose of registration and legal operations in Turkmenistan. One of the options is to partner with the Garassyzlyk Bank. The MCI Turkmenistan attorney is legally researching the pros and cons of such an arrangement. SMEDA/the TACIS-funded project, previously registered in a similar manner but has experienced problems with their Turkmenistan partner.

Mercy Corps is also applying for accreditation with the Ministry of Foreign Affairs. Should we receive accreditation in Turkmenistan Mercy Corps would have a legal presence and pay local employee taxes.

Another option would be to meet directly with Mr. Gubanmaranov, the Head of SAFI, and discuss further the matter of registration. If no positive direction is then forthcoming, our attorney has advised us that the registration refusal is legally actionable and we could proceed to address this issue through the judicial system in Turkmenistan. However, it is estimated that such action would further alienate the Turkmenistan Government, as there is really no separation of powers in Turkmenistan.

Nevertheless, Mercy Corps is continuing the process of registration. We would like to point out that CAAEF is registered in Turkmenistan but does not have a banking license to perform lending. They are working only under the Strategic Agreement.

C. Grant and Budget Revision Request

Mercy Corps International detected several discrepancies between some of the details as outlined in the Cooperative Agreement and those of the revised proposal that was submitted to USAID in July of 1999. Due to the extended dialog with the Central Asian American Enterprise Fund, the proposal was edited several times. It appears that USAID worked from an earlier version of the proposal when creating the Cooperative Agreement for Turkmenistan.

Since the Memorandum of Understanding between CAAEF and Mercy Corps has been altered by the Fund, Mercy Corps thought it best to not submit a request for a grant revision until the procedures and operational issues for this program are clarified.

III. Program Obstacles

There have been two major obstacles to program operations in Turkmenistan.

A. Registration

The first problem deals with registration of Mercy Corps International as a representative of an international NGO. Mercy Corps applied for registration under Article 56 of the Civil Code. In the denial letter received from the State Agency for Foreign Investment (SAFI), registration of Mercy Corps was not allowed according to Article 4 and Article 5 of the Commercial Code on Banking laws stating that: "Mercy Corps would be performing banking functions and as such registration was refused because Mercy Corps does not have a banking license to operate in Turkmenistan." SAFI did acknowledge that all of the registration documents were prepared and submitted correctly.

The Mercy Corps International micro credit program was designed to function by providing technical assistance and support to small businesses that require access to credit. Our work was to process these clients for CAAEF, which then signed all legal documents and performed any function that could be considered as a banking or credit activity. We believe that SAFI misunderstood the original intention of the program and therefore denied registration.

Action Taken: Mercy Corps is now applying for accreditation with the assistance of the U.S. Ambassador, Mr. S. Mann and Mr. Murl Baker, the USAID Representative in Turkmenistan. This process has not been completed during this reporting period.

B. Partnership between CAAEF and Mercy Corps

The following is an account of program activities:

Dates	Organization	Action Taken
September 1999	Mercy Corps & CAAEF	Signed Memorandum of Understanding for the Turkmenistan Program, which included a Plan of Operation.
October 1999	USAID awards grant to Mercy Corps	Mercy Corps began its program in Turkmenistan in cooperation with CAAEF.
October 1999 to January 2000	Mercy Corps	Mercy Corps Regional Director hired staff and worked with CAAEF to finalize the First Year Plan of Operation and program procedures.
October 1999	Mercy Corps	Mercy Corps submitted to USAID the First Year Plan with CAAEF's cooperation and approval. CAAEF's suggestions and changes were incorporated into the Plan before submission to USAID.
November 1999	SAFI	Program approval letter received.
October-December 1999	Mercy Corps and CAAEF-Turkmenistan	Both organizations interviewed potential staff and hired staff.
January 2000	Central Bank of Turkmenistan	Program approval letter received.
January-February 2000	Mercy Corps – Kyrgyzstan, Kazakhstan and Turkmenistan	Program staff training and transfer of micro credit technology was completed.
January 2000	Mercy Corps and CAAEF - Turkmenistan	Mercy Corps and CAAEF together acquired the necessary approval letters and completed the development work for program start up.
February 2000	Mercy Corps	Mercy Corps' Regional Director moved to Turkmenistan as the Program Director.
February 2000	Mercy Corps & CAAEF	Final program procedures were established, and Mercy Corps begun working with clients.
March 15	Mercy Corps & CAAEF - Turkmenistan	First credit committee and first loan approved for \$5,000. CAAEF disbursed cash directly to client.
March 15 th to June 14 th	Mercy Corps & CAAEF - Turkmenistan	Total amount of loans approved was \$289,174 during this period of time.
April 20 th	CAAEF to MCI	R. Kossman told MCI that after one month of operation, the average loan size was too large. Within two weeks, MCI reduced the average loan size by \$3,000 and the trend of the program was toward working with smaller businesses. After program development in the first six months, the program had 5-6 months to approve and disburse \$500,000 capital for CAAEF. As CAAEF receives all the interest income from these funds and since it was their suggestion that the first six months of micro credit program operations be for development, the staff in Turkmenistan did their best to disburse the allotted \$500,000 in the remaining time of the first year. The program averaged approval of approximately \$60K per week.
June 14 th	CAAEF/R. Kossman V.P. for SMEs in	Sent an e-mail message to MCI Turkmenistan stating that 5 loans had documents missing and would not be

	Kazakhstan	"approved" until these documents are provided. The documents were not missing per the Plan of Operation as the CAAEF office in Kazakhstan does not have final approval of loans for this program (per the approved Plan of Operation the final approval body for the loans was the Credit Committee in Turkmenistan – the same procedure MCI-CAAEF used in Kazakhstan and in Kyrgyzstan for the past 3 years).
June 16th	MCI/E. Houde phone conversation with CAAEF/R. Kossman	R. Kossman orally informed E. Houde that the new capital ceiling amount for the USAID micro credit program would be \$300,000 and that the loans must be approved in Kazakhstan and not in Turkmenistan.
June 19th	MCI/N.G. (Program Manager) and CAAEF Paul Hamlin	CAAEF requested copies of all loan documents and stated that unless all the documents were received at CAAEF in Kazakhstan, CAAEF would not disburse funds against the approved loans. This is a violation of the approved and agreed upon MOU.
June 19th	MCI Director E. Houde	CAAEF unilaterally changed the procedures of the operation and the total capital committed to the program.
July 4th	MCI Corporate/USA	E-Mail message sent from Steve Zimmerman/MCI's COO to Robert Kossman/CAAEF VP for SME Development. This message requested a response concerning the CAAEF MOU unilateral changes. As of July 25 th , MCI received no response from CAAEF.
July 13th	MCI Turkmenistan	MCI Turkmenistan sent an e-mail to CAAEF requesting a response in writing within two days concerning the release of the \$210,000 unused capital committed by CAAEF for this program and requested in writing any written changes to the program operations and procedures in compliance with the signed MOU. As of July 25 th , MCI received no response from CAAEF.

Summary

1. CAAEF changed procedures unilaterally without written approval of both parties (MCI and CAAEF) as stipulated in the MOU.
2. CAAEF changed the capital amount previously committed to the USAID micro credit program without bilateral discussions or approval (from \$500,000 to \$300,000).
3. CAAEF refused to release the approved funds for loans in a "timely manner" as agreed to in the MOU. It has taken more than 3 months for some funds to be released. Clients have complained.
4. CAAEF changed the approval process for loans unilaterally without written approval of both parties as agreed to in the MOU.
5. CAAEF has not responded to two written requests from MCI personnel concerning MOU changes.

Action Taken: Mercy Corps International has begun discussions with both EBRD and IFC/World Bank concerning sources of capital for the program. The World Bank has asked to review a business plan that demonstrates this program could eventually evolve into a viable commercial entity. This plan will be completed by the end of July.

Several banks in Turkmenistan have requested meetings to structure a program of micro credit in cooperation with Mercy Corps. Such an agreement would provide another avenue for legal disbursement of credit and partnership agreements will be formed should either the World Bank or EBRD agree to provide capital.

One other source of working capital may be the USAID CAR Mission in Kazakhstan. An inquiry will be forthcoming the first week of August concerning such an application.

IV. Program Activities

A. Development Step No. 1 – Implementation of the Program and Resource Capacity

Institutional capacity building began in the first quarter of the grant period. Resources developed under other MCI programs were transferred to the Turkmenistan program, and activation of these resources began in March of 2000.

The following *Development Steps* outline the accomplishments in the third quarter of operation and those steps anticipated during the remaining three months of the first year.

	Month	1	2	3	4	5	6	7	8	9	10	11	12
Development Step #1													
Implementation of Program & Resource Capacity													
Tasks:													
1. Research on Turkmenistan economic and political demands for the program	X	X											
2. Office Set Up	X	X	X										
3. Hire Staff	X	X	X	X									
4. Equip office & Purchase Furniture		X	X										
5. Train Staff			X	X	X	X							
6. SAFI Approval	X												
7. Central Bank Conversion Approval			X										
8. MCI Registration		X	X	X	X	X	X	X	X	X	X	X	X
9. Transfer MCI Computer Technology			X	X	X	X	X			X	X		

Development Step No. 2 – Build Linkages

Most importantly, SMEDA and Mercy Corps worked closely together to develop and conduct the Needs Assessment in Dashoguz. This was submitted to USAID in the Second Quarterly Report. Since developing this assessment, the Turkmenistan Government has ruled that the Dashoguz Velayat around the Uzbekistan border is a defense zone and therefore is off limits for foreigners and/or requires special permits.

During this time frame, Mercy Corps representatives have also cultivated working relationships with IESC, Winrock International and Booz Allen. Winrock has offered to share their office facility and some equipment in Dashoguz should we be allowed to operate in this region. In a meeting with IESC representatives, Mercy Corps agreed to provide our clients with IESC brochures and information.

	Month	1	2	3	4	5	6	7	8	9	10	11	12
Development Step #2													
Build Linkages													
Tasks:													
1. SAFI Meetings		X	X										
2. Central Bank Meetings		X	X	X									
3. Business Roundtables		X		X			X			X			X
4. Banking Seminars			X	X		X		X					
5. CAAEF Meetings (Weekly)		X	X	X	X	X	X	X	X	X			
6. SMEDA Meetings (Weekly)		X	X	X	X	X	X	X	X	X			
7. EBRD Meetings/DAI		X	X	X		X		X					
8. Booz and Allen Meetings			X	X	X	X	X						
9. Winrock International Meetings		X	X	X	X	X		X					
10. IESC Meetings		X		X		X		X		X		X	
11. Eurasia Foundation Meetings			X			X			X				X
12. TACIS Meetings (Ag. Credit)		X	X	X		X		X		X		X	
13. Garashsylyk Bank Meetings		X	X	X	X	X	X	X		X			
7. Counterpart Consortium Meetings					X	X		X		X			
7. UNDP Meetings		X	X			X		X		X		X	
8. Global Training Center Meetings						X	X	X					

Development Step No. 3– Promote Civil Society and Policy Reform

Mercy Corps' first trip to Dashoguz was on February 7th. Since then the Program Manager and the SMEDA staff have made two more trips and given two seminars on micro credit. The Turkmenistan Government has decreed that the border between Uzbekistan and Turkmenistan located in the Dashoguz Velayat is a closed region and as such special permits are required for any operations in this region. We are now researching further clarification before moving credit operations to this region.

	Month	1	2	3	4	5	6	7	8	9	10	11	12
Development Step #3													
Promote Civil Society													
Tasks:													
1. Legal Research and Identify Legal Restraints			X	X									
2. Restructure Credit Forms to comply with Turkmenistan Laws				X	X								

3	Discussions Concerning the Structure of a Needs Assessment and RRA		X	X	X								
4.	Training of Assessment Team				X	X							
5.	Trips to Dashoguz				X	X	X						
6.	Needs Assessment Completed						X						

V. Financial Management

A. Portfolio Management

The micro credit program began disbursing loans during the previous reporting period. The loan officers began working with clients in the end of February of 2000 and the first loan was processed on March 15th for \$5,000. This was a cash disbursement. Since this loan, CAAEF and MCI have agreed to limit cash disbursements for the next several months and take a more cautious approach until the Turkmen Government is more comfortable and knowledgeable concerning micro loan functions and processes.

The second credit committee processed and approved loans in the amount of \$50,000. As of the last week of June, a total of \$289,714 in loans was approved in the credit committees. The charts in the attached files show the status of the portfolio during this reporting period.

The program has operated during this timeframe with 100% efficiency and 100% repayment of outstanding loans. Once clients applied for credit, Mercy Corps's staff averaged two weeks to process all applications and to notify the clients of their loan approval or disapproval.

The major obstacles have previously been explained but include: CAAEF not processing loans in a timely manner as previously agreed in the signed MOU between CAAEF and Mercy Corps, CAAEF not releasing the agreed upon capital for the program operations, and CAAEF unilaterally changing the program procedures without discussions with Mercy Corps staff.

VI. Future Activities

During the subsequent reporting period, major program operational changes are expected. These will include the following:

- Signing an MOU for a new source of capital.
- Targeting clients for loans under \$10,000.
- Sign agreements with a minimum of two local banks.
- Begin operations in Dashoguz.
- Business Plan completed and presented to IFC and USAID demonstrating program sustainability.
- USAID grant revision submitted.

VII. Conclusions

This third quarterly report covers the period from April 1, 2000 to June 30, 2000. The major accomplishments include: program operations, credit disbursement underway, and business plan development for sustainability.

The credit program has begun disbursing loans at an alarming rate, and the portfolio grew exponentially within the next 6 months. Credit Committees were held every Wednesday at 2:00 PM. Attending were Paul Hamlin as a representative of CAAEF, Elizabeth Houde as the Program Director, and the Mercy Corps business consultants presenting the clients for credit approval. In nine weeks of operation, one credit application was not approved in the credit committees. The average processing time for each client was approximately two weeks. Since loan disbursement began, 100% of the loans have been repaid on time.

If there are any questions or suggested changes, please contact Elizabeth Houde in the Ashgabat office at (99312) 45-00-92 or the new e-mail address at law3170@online.tn.