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The World Bank

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Report No: PGD312

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT
FOR A
PROPOSED LOAN

IN THE AMOUNT OF US$150 MILLION

AND A PROPOSED CREDIT

IN THE AMOUNT OF US$250 MILLION

TO THE

REPUBLIC OF UZBEKISTAN

FOR THE

ACCELERATING UZBEKISTAN'S TRANSITION DEVELOPMENT POLICY OPERATION

November 18, 2021

Macroeconomics, Trade And Investment Global Practice
Europe And Central Asia Region

Republic of Uzbekistan

GOVERNMENT FISCAL YEAR

January, 1 – December, 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of October 31, 2021)

UZS 10,675

US$1.00

ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
CBU	Central Bank of Uzbekistan
CPF	Country Partnership Framework
CRPD	Convention on the Rights of Persons with Disabilities
DPO	Development Policy Operation
DPL	Development Policy Loan
EBRD	European Bank for Reconstruction and Development
EU	European Union
GDP	Gross Domestic Product
GFS	Government Financial Statistics
GRS	Grievance Redress Service
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
ILO	International Labor Organization
IMF	International Monetary Fund
INDC	Intended Nationally Determined Contribution
OECD	Organization for Economic Cooperation and Development
PDO	Program Development Objective
PFM	Public Financial Management
PPG	Public and Publicly Guaranteed (Debt)
PPP	Public-Private Partnership
SCD	Systematic Country Diagnostic
SDG	Sustainable Development Goal
SOE	State-owned Enterprise
UFRD	Uzbekistan Fund for Reconstruction and Development
UN	United Nations
US$	United States Dollar
USAID	United States Agency for International Development
UZS	Uzbekistan som
WB	World Bank
WBG	World Bank Group
WTO	World Trade Organization

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REPUBLIC OF UZBEKISTAN

ACCELERATING UZBEKISTAN'S TRANSITION DEVELOPMENT POLICY OPERATION

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SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Programmatic
P176353	No

Proposed Development Objective(s)

To support a faster and more equitable economic transition through (i) stronger market institutions and better management of state-owned enterprises; (ii) improved fiscal transparency and accountability; and (iii) increased economic and social inclusion, especially of women and persons with disabilities.

Organizations

Borrower:	REPUBLIC OF UZBEKISTAN
Implementing Agency:	MINISTRY OF FINANCE

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Financing	**400.00**

DETAILS

International Bank for Reconstruction and Development (IBRD)	150.00
International Development Association (IDA)	250.00
IDA Credit	250.00

INSTITUTIONAL DATA

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Overall Risk Rating

Moderate

Results[1]

Indicator Name	Baseline	Target
Result Indicator 1: Convergence of prices paid by government for wheat with domestic market prices.	Price set annually by regulatory decree **(January 2021)**	Price paid per ton of wheat by the government for public grain reserves is within a 5% range of the market price determined in the Commodity Exchange **(end-December 2023)**
Result Indicator 2: Improved supervisory oversight of SOEs, as measured by the number of top 30 state-owned enterprises, classified by size of balance sheet assets, for which the State Asset Management Agency has selected and appointed independent supervisory board members, in line with OECD corporate governance principles.	Zero **(January 2021)**	At least 20 **(end-December 2023)**
Result Indicator 3: Improvement in the climate change and environmental governance of state-owned enterprises.	No specific legal requirements for SOE corporate governance to account for environmental and climate change risks. **(January 2021)**	Approved implementation roadmap in place for the transition of SOE operations to more sustainable and climate-friendly business practices, consistent with requirements under the new Asset Management Law. **(end-December 2023)**
Result Indicator 4: Increased alignment of consolidated government spending to government priorities relating to climate change and environment.	No methodology exists for the classification and scoring of public expenditures against government environmental and climate change priorities. **(January 2021)**	Approved methodology in place and being piloted for the classification and scoring of public expenditures against government environmental and climate change priorities. **(end-December 2023)**
Result Indicator 5: Increased parliamentary oversight of the government's medium-term debt strategy.	No Medium-Term Debt Strategy in place. **(January 2021)**	A Medium-Term Debt Strategy has been approved by the government and at least one annual debt report has been submitted to Parliament **(end-December 2023)**
Result Indicator 6: Improvement in climate and environmental related debt reporting.	No regulatory requirements exist for the government to report on purpose-specific impact bonds. **(January 2021)**	Secondary regulations have been approved to require government to produce allocation impact reports for purpose-specific impact bonds, and at least one allocation impact report which includes climate-specific

[1] The closing date for this operation is June 30, 2023.

		objectives has been published. **(end-December 2023)**
Result Indicator 7: Increased enterprise compliance with new labor regulations prohibiting gender and other forms of discrimination, and requiring equal pay for men and women.	Regulations did not exist. **(January 2021)**	At least 60 percent of all labor code compliance audits and investigations conducted by the Ministry of Labor and Employment Relations include checks of new labor code regulations. **(end-December 2023)**
Result Indicator 8: Increased usage of the new poverty line in social assistance programs, as measured by the share of total public expenditure on regular (non-emergency) social assistance programs that are based on program criteria determined by the new poverty line (eligibility thresholds and/or the setting and indexation of benefit amounts).	Zero. **(January 2021)**	At least 80 percent **(end-December 2023)**
Result Indicator 9: Strengthened institutional frameworks that supported greater inclusion of persons with disabilities, and their protection from future vulnerabilities, as measured by the presence of a national implementation plan to progressively realize Uzbekistan's obligations under the United Nations Convention on the Rights of Persons with Disabilities (CRPD).	Uzbekistan's accession to UN CRPD not ratified. **(January 2021)**	A national implementation plan, which includes strategies to reduce the impact of climate change risks on persons with disabilities, has been approved and is under implementation. **(end-December 2023)**

IBRD AND IDA PROGRAM DOCUMENT FOR A
PROPOSED LOAN AND CREDIT TO THE REPUBLIC OF UZBEKISTAN

1. INTRODUCTION AND COUNTRY CONTEXT

1. **This proposed Development Policy Operation (DPO) of US$400 million supports Uzbekistan's transition to a market economy, with higher incomes, inclusion, and government accountability as its principal objectives.** The operation comprises a concessional IDA credit of US$250 million and an IBRD loan of US$150 million. Reforms under this operation will continue to support the implementation of a faster and more equitable economic transition by: (i) strengthening market institutions and improving the management of state-owned enterprises; (ii) making public finances more transparent and accountable; and (iii) increasing economic and social inclusion, especially of women and persons with disabilities. This proposed standalone operation follows three stand-alone DPOs of US$500 million each that were approved by the World Bank Board in June 2018, June 2019, and December 2020.[2] These operations have supported the Government of Uzbekistan in implementing its 2017-2021 Development Strategy, with a people-centric and more sustainable transition to a market economy as the principal policy objective. As with the previous DPOs, this operation continues to anchor the World Bank Group (WBG)'s overall programmatic reform engagement with Uzbekistan as described in the 2016-2020 Country Partnership Framework (CPF).[3]

2. **Uzbekistan has made good progress in its market transition over the last five years.** Since late 2016, Uzbekistan has implemented wide-reaching economic and social reforms.[4] Most prices have been liberalized. Foreign exchange is now fully convertible for current account needs. An overhaul of the tax and regulatory system has substantially lowered barriers that favored state enterprises and suppressed private sector development. State-directed lending at interest rates below the official monetary policy rate has largely ended. Reforms to liberalize horticultural exports and improve cotton and wheat policies have contributed to surges in agricultural output and productivity. These reforms, which were supported through successive DPOs, contributed to record increases in new business and taxpayer registrations, horticultural exports, and tourist arrivals prior to the COVID-19 pandemic. They helped Uzbekistan maintain economic growth in 2020 despite the impact of the pandemic. Crucially, they have supported visible improvements to the lives of citizens: poverty rates are lower, incomes of the bottom 40 percent are considerably higher, and economic freedoms more are readily enjoyed. Importantly, the reforms have also supported a shift in government policies: issues such as poverty, environmental stresses, and the impact of climate change are now the principal focus of the government's medium-term reform program.

3. **Despite the social adjustment costs of the transition, there is broad public and political support for the reforms to continue.** Recent data from the *Listening to Citizens of Uzbekistan* project—a nationally representative survey conducted by the World Bank to monitor reform sentiment, over 85 percent of those surveyed believed that the country was headed in the right direction. A strong anti-crisis response has also helped moderate the pandemic's impact on the population and the economy and fortified public support for continued reforms. Following President Mirziyoyev's re-election in October 2021, a successor to the 2017-2021 Development Strategy will be announced in the coming weeks and is expected to renew the government's commitment to the economic transition. The

[2] The US$500 million Development Policy Loan approved in June 2019 was augmented by a supplementary operation of US$200 million in response to the COVID-19 crisis in April 2020.
[3] The CPF was revised following a Performance and Learning Review in June 2018 (126078-UZ; Discussed by the Board on June 26, 2018).
[4] A forthcoming Uzbekistan Country Economic Memorandum (2021) assesses Uzbekistan's progress to date with its transition.

government's reform program is also being supported extensively by bilateral and multilateral development partners.

4. **Uzbekistan's ambition is to halve its poverty rate by 2026 and become an upper-middle-income country by 2030: achieving these goals will require acceleration of an already bold reform agenda.**[5] To attain upper-middle income status by 2030, growth will need to average about ten percent annually. To halve the poverty rate, this high growth will have to be accompanied by the creation of more and better jobs that reduce the high unemployment rate (10.5 percent in 2020) and increase incomes for all citizens. These are ambitious aspirations. But Uzbekistan's strong start to the transition suggests that higher growth rates and faster poverty reduction are achievable. Meaningful progress toward these goals requires resource allocation to be more efficient by loosening state controls over factor markets and thousands of SOEs. It also requires more room for private sector market entry and competition, especially in sectors such as energy, telecommunications, chemicals, and aviation—where considerable private sector investment interest is constrained by the state's dominance. Reforms are needed to increase the contribution of Uzbekistan's services sector, which is one of the smallest (as a share of GDP) relative to regional and income peers. Service sector growth has served as an important driver of job creation in successful economic transitions. Public investments need to deliver better value for money and be more closely aligned to the government's policy priorities. More outward orientation of the economy, through stronger trade and FDI links, will also be critical for high growth. Finally, policies to support the economic inclusion of women, youth, and the disabled will also be important to ensure that the transition is inclusive.

5. **The proposed operation would help deepen reforms to strengthen market institutions, increase public sector transparency and accountability, and promote inclusion—especially of women and persons with disabilities.** The liberalization of the wheat sector is expected to increase the incomes of nearly 40,000 farmers and support more resilient and climate sustainable investments that strengthen food security. New legislation will strengthen the corporate governance of SOEs and increase competitive neutrality between SOEs and the private sector, improve operational efficiency and sustainability, and reduce large quasi-fiscal subsidies (estimated at around six percent of GDP).[6] Revisions to the Budget Code will consolidate all on- and off-budget public spending into a single Budget Law that is subject to parliamentary oversight and support public finances to be better aligned to policy priorities such as climate change (in 2018 total off-budget spending was estimated to be higher than on-budget spending). A new labor code will modernize labor relations and increase the rights and well-being of workers. A new poverty line based on modern practices will improve the adequacy of social protection for poor and vulnerable citizens. Finally, Uzbekistan's ratification of the United Nations Convention on the Rights of Persons with Disabilities (CRPD) provides a strong commitment mechanism to implement ambitious disability rights and equal opportunities legislation that was adopted last year.

6. **With Uzbekistan facing increasing threats from a changing climate, the proposed operation would help reduce climate change risks.** Uzbekistan is highly vulnerable to the impacts of climate change. Anticipated climate impacts include temperature increases, higher variability in rainfall, and increased glacier melting with implications for water availability and river flows. In agriculture, climate change is increasing the risk of droughts and other water shortages, pests, and diseases—with harsh consequences for food security. The energy sector is exposed to risks from climate variability that may impact energy supply (e.g., disruptions due to increased extreme weather events) and demand (e.g., due to a rise in annual number of hot days). Water resource management is expected to become more challenging given associated impacts from climate change. In addition to the impact on physical resources, Uzbekistan's people are also at risk of being forced into poverty by climate change, as evidenced by the

[5] *Strategy for Poverty Reduction: 2021-2030*
[6] PER 1

displacements already seen in areas such as the Republic of Karakalpakstan—the most climate-vulnerable region of Uzbekistan. These areas have received increasing attention and focus from the authorities as part of the overall economic transformation strategy. Over the last year, the World Bank and other development partners have been working closely with the government on its renewed efforts to address climate change risks and ensure a sustainable transition to a greener economic model. An important guiding principle in this work has been to ensure strong alignment between the government's primary development objectives of poverty reduction and income growth and its environmental policy objectives.

7. **Six of seven prior actions in this proposed operation dually contribute to the government's economic development and environmental and climate policy objectives.** These prior actions are foundational reforms that strengthen the ability of Uzbekistan's public institutions to address climate change risks more effectively. They include the liberalization of the wheat sector, which should contribute to increasing the climate resilience of Uzbekistan's most important food commodity (Prior Action 1); new legislation that requires SOEs, which account for over 85 percent of Uzbekistan's greenhouse gas emissions, to adopt more sustainable and climate friendly practices (Prior Action 2); and the consolidation of public finances which will help improve climate impact forecasting and climate change budget performance monitoring (Prior Action 3). They also include new debt legislation that improves the regulatory environment for climate financing and climate-related debt reporting (Prior Action 4), further improvements to the adequacy of social assistance systems that are already in use to support people affected by the materialization of climate change risks (Prior Action 6), and requirements to protect persons with disabilities from the impact of natural and climate change risks (Prior Action 7). Through improved market incentives and institutional reforms, these actions support both mitigation and adaptation of climate change risks. To further align the government's broader economic transition objectives with its environmental and climate change policy objectives, several prior actions in this proposed operation are backed by dual result indicators that support both market and climate change policy outcomes.

8. **An adequate macroeconomic policy framework and continued public and political support for the reforms moderate risks to this operation.** The country has continued to weather the crisis while maintaining strong fiscal and external buffers. A pandemic-induced higher fiscal deficit is expected to return to more sustainable levels through improved revenue collection and consolidation of public spending over the medium term. Though the current account deficit is projected to remain elevated over the medium term, external risks are mitigated by high foreign exchange reserves and continued access to concessional and non-concessional financing. Public debt is projected to stabilize at about 40 percent of GDP within the next two years. The government has continued to implement effective measures to strengthen the transparency and management of the budget and government debt. Slowing credit growth and improving monetary policy transmission are helping to contain inflation risks. Nevertheless, Uzbekistan still faces risks, including continued global supply chain and border disruptions; further pandemic-induced external shocks impacting domestic economic performance and financial sector stability; and adverse weather conditions that affect agricultural output.

9. **With a more complex phase of reforms ahead, the main risks to this operation are likely to emerge from institutional constraints and high administrative centralization.** Uzbekistan's broad and sweeping reform agenda requires administrative capacity and expertise that is thinly stretched. These challenges are compounded by the high level of centralization which creates significant pressures on administrative capacity. These risks are being mitigated through strong technical support from development partners and the government's own efforts to procure international technical expertise and advisory services. Although social discontent with reforms remains low and well managed—largely through effective reforms that have increased incomes quickly and mitigated the most adverse price and economic shocks to vulnerable households—they remain an ever-present risk, especially during periods of reform that involve price and employment adjustments. With utility tariffs still below cost recovery levels and with

the SOE reform process still at a nascent stage, these risks will continue to require careful monitoring and effective mitigation strategies, building on the experience of those deployed over the last five years.

2. MACROECONOMIC POLICY FRAMEWORK

2.1. RECENT ECONOMIC DEVELOPMENTS

10. **Economic growth is projected to rebound in 2021 following a sharp pandemic-induced slowdown in 2020.** Real GDP is projected to increase by 6.2 percent in 2021, a robust pick-up in growth from 1.7 percent in 2020 and higher than the pre-pandemic average of 5.2 percent between 2017 and 2019 (Table 1). On the supply side, the lifting of lockdown restrictions has supported strong growth in manufacturing, construction, and services, each of which contracted in 2020. Agricultural growth, which was strong in 2019 and 2020 and offset contractions in other sectors last year, will be lower this year due to early-season frost damage. On the demand side, a robust recovery in public and private investments and consumption, as well as recovering trading partner demand have supported the rebound in growth. Private consumption growth, which had been strong prior to the pandemic, is expected to recover from its contraction in 2020 that was induced by lockdowns and deferred consumption amidst heightened uncertainties for households. Expanded social assistance, a public sector wage increase, and the resumption of remittances are also expected to support consumption growth in 2021.

11. **Poverty and unemployment rates are falling but a significant gap with pre-pandemic trends remains.** After falling consistently for over two decades, Uzbekistan's poverty is projected to have been about 0.7 percentage points higher in 2020 due solely to the economic impacts of COVID-19. As a result, about 250,000 people fell into poverty. Compounding the situation for the poor households was the sharp fall in remittances due to travel restrictions and economic contractions in Russia and Kazakhstan that stopped hundreds of thousands of seasonal workers from returning to work.[7] In 2021, migration abroad has rebounded as one of the strongest drivers of poverty reduction. The share of households with at least one working member, which fell precipitously by more than 40 percentage points in April 2020, has also since recovered, but short-term disruptions in work remain much more common than 2019 levels. The official unemployment rate is estimated at 10.5 percent, which remains higher than the pre-pandemic level of 9.1 percent in 2019. Rising remittance income and recovering employment income is expected to support continued poverty reduction in 2021, with the end-2021 (World Bank estimated) poverty rate projected at 6.6 percent at the lower-income line, and 29.9 percent at the upper middle-income line.

12. **The pandemic's prolonged impact on households has required continued anti-crisis support from the government.** In 2020, the government deployed a rapid, sizeable (4 percent of GDP), and relatively well-targeted anti-crisis support program. The program initially emphasized expanded healthcare services and social protection, and financial support to small- and medium-sized businesses. Most temporary loans to and tax deferrals for business have now been withdrawn and remain in place only for still-affected sectors of the economy, such as tourism, which continues to face significant challenges due to global travel disruptions. Expansions to social safety nets remain in place, and health spending has expanded as part of the government's efforts to accelerate vaccinations.

[7] World Bank simulations suggest that without remittance income Uzbekistan's poverty rate in 2018 would have increased from 9.6 to 16.9 percent of the population.

Table 1: Uzbekistan: Key Macroeconomic and Fiscal Indicators (Estimates – September 2021)

	2017	2018	2019	2020	2021	2022	2023
				(Est)		(Projected)	
National Income and Prices							
Real GDP growth (annual percent change)	4.5	5.4	5.6	1.7	6.2	5.6	5.8
Consumer price inflation (end of period)	18.8	14.3	15.2	12.9	10.7	10.5	8.7
External Accounts ($ millions, unless indicated)							
Export of goods, of which	10,162	11,386	13,899	12,832	15,221	17,328	19,283
Gold	3,260	2,910	4,918	5,804	5,193	5,193	5,193
Merchandise imports, of which	12,377	18,252	21,207	19,048	22,831	25,544	28,044
Services Balance	-1,842	-2,442	-2,266	-1,812	-1,840	-1,651	-1,407
Current account balance (percent of GDP)	2.5	-7.1	-5.6	-5.0	-6.5	-6.0	-5.6
Foreign direct investment, net (US$ millions)	1,788	623	2,313	1,604	1,626	1,808	2,418
Gross international reserves (US$ billion)	28.1	27.1	29.2	34.9	35.3	35.1	35.7
Gross international reserves (months of import cover)	14.4	12.2	15.5	15.6	13.9	12.4	11.4
Gross external debt (percent of GDP)	34.1	34.3	43.9	58.4	62.3	63.8	62.3
Consolidated Fiscal Accounts (% of GDP)							
Revenues	24.7	27.8	27.0	25.6	25.6	25.8	26.1
Expenditures	23.4	26.0	27.2	28.8	29.2	29.2	28.9
Budget Fiscal Balance	**1.3**	**1.8**	**-0.2**	**-3.1**	**-3.5**	**-3.4**	**-2.9**
Policy-lending	3.1	4.0	3.5	1.1	2.5	1.0	0.9
Overall fiscal balance (Including Policy Lending)	-1.8	-2.2	-3.8	-4.3	-6.0	-4.4	-3.8
Total public debt	20.2	20.4	28.3	36.4	40.6	42.5	42.2
Monetary Accounts (Annual percent change)							
Broad money growth	41.0	13.2	13.8	17.9	17.1	17.2	18.0
Credit to the economy	103.0	50.8	48.1	34.4	20.5	18.2	14.0
Memorandum Items							
Nominal GDP (US$ billon)	58.2	50.4	57.9	60.1	66.0	73.1	80.4

13. The pickup in public investment and the continued anti-crisis spending have kept the budget deficit at elevated levels. In 2020, a substantial slowdown in capital and public works spending partially offset increased anti-crisis spending and a 1.4 percentage point fall in total revenues as a share of GDP, leading to a lower-than-expected budget deficit of 3.1 percent of GDP (relative to estimates of 4.4 percent) (Table 2). The 2020 deficit was nonetheless a big jump from the 0.2 percent of GDP deficit in 2019. Slower policy-based lending from the Uzbekistan Fund for Reconstruction and Development (UFRD) helped maintain the overall fiscal deficit (the sum of the budget deficit and policy-based lending operations, largely by the UFRD) at 4.3 percent of GDP in 2020. In 2021, the lifting of local lockdowns and the resumption of capital imports from global suppliers has supported a robust recovery in public investment spending on energy and other infrastructure projects: public investment and UFRD operations combined are projected to increase by 2.6 percentage points in 2021. In addition, anti-crisis spending is projected to be maintained at the same levels as in 2020 as healthcare spending shifts from treatment to vaccine purchases. Though tax collection increased, lower dividends from gold sales—which offset tax shortfalls in 2020—are projected to leave total revenues to GDP in 2021 at the same level as last year. Based on fiscal data for the first nine months of 2021, the full-year budget deficit is projected to be 3.5 percent of GDP, and the overall fiscal deficit (that includes UFRD operations) is projected at 6 percent of GDP in 2021.

Table 2: Uzbekistan: Fiscal Operations (percent of GDP)

	2017	2018	2019	2020	2021	2022	2023
				(Est.)		(Projected)	
Total Revenues, of which:	**24.7**	**27.8**	**27.0**	**25.6**	**25.6**	**25.8**	**26.1**
Tax revenues, of which	15.2	17.4	18.5	18.7	19.0	19.1	19.3
Income and profit taxes	4.3	4.2	6.0	7.5	7.1	7.4	7.6
Value-added taxes	4.9	6.9	6.4	5.5	6.4	6.5	6.6
Excise taxes	2.5	2.4	1.9	1.9	1.8	1.9	1.9
Mining Taxes	1.1	2.1	2.8	2.7	2.0	1.7	1.5
Taxes on international trade	0.7	0.4	0.4	0.6	0.6	0.7	0.7
Other revenues (tax and non-tax)	**2.2**	**3.2**	**3.8**	**3.1**	**2.9**	**3.3**	**3.4**
Funds	**7.3**	**7.2**	**4.7**	**3.8**	**3.7**	**3.4**	**3.4**
Pension fund	5.9	5.9	4.7	3.8	3.7	3.4	3.4
Other	0.4	0.4	0.1	0.4	0.3	0.0	0.0
Total expenditures, of which:	**23.4**	**26.0**	**27.3**	**28.8**	**29.2**	**29.2**	**28.9**
Social safety nets	6.2	5.8	5.9	6.7	6.7	6.9	6.9
Social and cultural expenditure	9.2	10.9	9.6	9.2	8.7	8.9	8.9
Public investment	1.1	1.3	3.7	2.4	3.4	3.5	3.5
Public administration	0.9	1.0	1.1	1.4	1.1	1.1	1.1
Economy	1.7	1.9	1.5	1.7	1.2	1.1	1.1
Interest expenditure	0.0	0.1	0.2	0.3	0.4	0.4	0.4
Externally Financed	-	-	1.2	1.5	1.7	2.0	1.8
Other expenditure	4.3	5.0	4.1	5.6	6	5.3	5.2
Budget Balance	**1.3**	**1.8**	**-0.2**	**-3.1**	**-3.5**	**-3.4**	**-2.9**
Policy lending	**3.1**	**4.0**	**3.5**	**1.1**	**2.5**	**1.0**	**0.9**
Overall fiscal balance	**-1.8**	**-2.2**	**-3.8**	**-4.3**	**-6.0**	**-4.4**	**-3.8**
Statistical discrepancy	**-0.2**	**0.7**	**0.7**	**0.7**	**0.0**	**0.0**	**0.0**
Financing, of which	**1.6**	**2.9**	**4.5**	**4.9**	**6.0**	**4.4**	**3.8**
Domestic	0.2	-1.2	-1.4	-1.2	1.9	0.8	0.8
External	1.4	4.1	5.8	6.2	4.1	3.6	3.0

Note: The authorities are making significant progress to expand fiscal coverage and increase fiscal transparency by bringing fiscal accounts in line with Government Finance Statistics best practices. In the interim, some data presented in this table differs from published budget estimates by the authorities. To provide a clear picture of the State Republican Budget, which represents core budget operations in Uzbekistan, the Budget Fiscal Balance adjusts the government's published consolidated budget data for UFRD financing operations, equity injections, and policy lending. The overall fiscal balance in this table includes these as well as externally financed expenditures to provide the general government fiscal position. *Sources:* Ministry of Finance, IMF and World Bank staff estimates.

14. **Shallow domestic financial markets require the government to seek fiscal deficit financing from external sources.** Low levels of financial inclusion and intermediation limit the extent to which the government can raise money through domestic debt issuances. In addition, financing from the UFRD is legally prohibited from being used to stabilize the domestic budget—a deliberate government policy since the UFRD's inception to ensure that resources are only used for long-term industrial developmental projects. As a result, about 80 percent of the budget deficit in 2021 will be financed from external sources. This includes a mix of budget support from bilateral (Japan) and multilateral partners (ADB and the World Bank through this proposed operation), and through the issuance of

US Dollar and Uzbekistani Som Eurobonds (Table 3).[8] The remaining (0.8 percent of GDP) will be financed through domestic treasury bill issuances and receipts from privatization.

15. **The sharp rise in public debt in recent years is beginning to moderate following the adoption of new borrowing limits.** Between 2017, when the government resumed its program of external borrowing, and 2020, public and publicly guaranteed (PPG) debt increased rapidly from 20.2 percent to 36.4 percent.[9] Except for 2020, when public debt was used for anti-crisis social spending, most debt and guarantees accrued since 2017 have been used to support large capital projects in the energy and public infrastructure sectors. In 2020, a legally binding annual external borrowing ceiling, determined annually during the budget appropriations process, was introduced to increase debt discipline, and encourage prioritization of debt-financed projects. The unexpected impact of COVID-19 required the government to seek parliamentary authorization to increase the original US$4 billion ceiling to US$5.5 billion (although signed loans amounted to less than that at US$5.35 billion) in 2020. In 2021, the annual borrowing ceiling was expanded to include domestic debt and set at US$5.5 billion. This year, the government is on-track to stay within this ceiling. Additional debt contracted in 2021 to finance the budget deficit and new investment projects is projected to increase the PPG debt to GDP ratio to 40.6 percent.

16. **Inflation is nearing a return to single digits, but high food and fuel prices have slowed the pace of inflation reduction.** Consumer price inflation breached double digits in 2017 and peaked at 20 percent in January 2018, following a large exchange rate devaluation, the liberalization of several regulated prices, and increases in public wages. Since then, and despite occasional spikes linked to further price liberalizations, utility tariff increases, and a depreciating exchange rate, year-on-year inflation has continued to trend downwards as reforms to liberalize the economy and business environment and increase domestic trading activity—especially wholesale trade—have eased supply constraints. The pace of inflation reduction has been aided by tighter monetary policy, a fall in credit growth, and a suspension—until 2022—of utility price increases as part of the government's anti-crisis measures. Consumer price inflation has averaged about 11 percent in 2021 and is projected to fall to 10.9 percent by end-December 2021. The end-year projection is about one percentage point higher than the Central Bank of Uzbekistan's (CBU) intermediate target of 10 percent—mainly the result of higher food and fuel prices.[10] Continued global trading disruptions, domestic livestock supply constraints, and a tepid wheat harvest have raised food prices, while a tightening of global oil supply has increased fuel prices.[11]

17. **The CBU has left its monetary policy reference rate unchanged since two policy rate reductions in 2020 which decreased the rate from 16 to 14 percent.** Credit growth is projected to continue slowing to about 20 percent in 2021, compared with 34.4 percent in 2020 and an annual average of about 67 percent between 2017 and 2019. Weaker demand due to pandemic conditions and reforms to stop nearly all below-policy rate subsidized budget and UFRD lending, and the maintenance of a tight monetary policy stance from the government to reduce inflation and financial system risks, have contributed to slowing credit growth.[12]

[8] In July 2021, the government successfully placed US$635 million and US$235 million (denominated in Uzbekistani soms) in Eurobonds as part of a Sustainable Development Goal bond issuance program where expenditures financed by these resources will be to tagged SDG-supportive activities.

[9] Prior to 2017, the PPG debt to GDP ratio was almost entirely comprised of external debt and had stabilized at about 10 percent, but this reported number was determined at the official (overvalued) exchange rate. The PPG debt to GDP ratio doubled following from about 10 to 20 percent following the devaluation of the official exchange rate in September 2017.

[10] The 10 percent end-2021 target is an intermediate goal towards the end-2023 target of 5 percent.

[11] Especially prices of retail petroleum products, which are now market-determined after all subsidies and price controls were removed in 2020.

[12] Since 2020, nearly all state-directed subsidized lending is required to be at least set at the CBU reference rate. Two

18. **Despite a strong rebound in exports this year, the resumption of large capital imports and high food and fuel import costs have increased the current account deficit.** Since 2018, Uzbekistan's current account has been in deficit following decades of consistent surpluses. The current account deficit in the first half of 2021 was 10 percent of GDP, compared with 7.1 percent in the first half of 2020 and 5 percent for the full year in 2020. After falling by nearly 8 percent in 2020, exports grew by an annual 12 percent in the first half of the year and are projected to increase by about 19 percent in 2021, recovering as a share of GDP to 2019 levels—the highest since 2012. Strong horticultural (vegetables and late-season fruits) exports, a rebound in manufacturing, non-gold metal, and chemical exports, and high gold prices have supported the turnaround in export performance during the first half of the year. Imports, which fell by 10 percent in 2020, increased by annual 14.3 percent in the first half of the year, and are projected to increase by about 20 percent in 2021—the result of sharply higher international food and fuel prices and a resumption in capital imports linked with public and private modernization projects. A recovery in remittances, which increased by an annual 8 percent in the first half of the year and projected to increase by 15 percent in 2021, will partially offset the wider trade deficit, and contain the current account deficit in 2021 at about 5.9 percent of GDP; a percentage point higher than in 2020, but lower than the 6.4 percent average between 2018-2019. The current account deficit is being financed largely through increased borrowing from multilateral and bilateral development partners. Foreign direct investment (FDI) and portfolio investments, which fell by 18 percent in 2020, are expected to remain at about the same level in 2021 as global investment conditions and the slow pace of privatization continue to constrain investment inflows to Uzbekistan.

19. **Banking sector capital buffers, while remaining well above regulatory minimums, will be tested by asset quality and profitability risks.** Following a relatively low and stable level of NPLs between 2018 and 2020 (1-2 percent), problem loans spiked in 2021 to reach 6 percent by September 1, 2021. Both public and private banks experienced worsening of loan portfolios. Loans to individuals, industry and trade sectors contribute the most to the current NPL ratios (28%, 23%, and 16%). Among the loans to individuals, state lending programs for entrepreneurship support and consumer loans deteriorated significantly, with NPL ratios reaching 17-18%. Among loans to legal entities, the construction and trade sectors were the most problematic, with NPL ratios reaching about 12%. In addition to sharp lending increases over the last five years and the COVID-19 crisis, systematic misreporting of NPL information by banks has been an issue. The Central Bank has intensified its supervision to properly identify and ensure the disclosure of NPLs, but some challenges remain—including unfinished reforms of corporate governance in state-owned commercial banks. Banks will have to assess the actual asset quality of the loans that have been restructured following last year's loan repayment deferrals provided by the banks. High share of foreign currency loans, especially by the largest state-owned banks, are a source of credit risk for unhedged borrowers, although the government is implementing measures aimed to reduce the dollarization level in the banking system. Despite these challenges, the aggregate capital adequacy ratio of the banking sector remains strong at 17 percent. In the first nine months of 2021, the (pre-provision) net interest margin of the banking system has narrowed by 0.43 percentage points (at 4.2 percent) compared to 2020 and provides some buffer to absorb any further deterioration in asset quality. The liquidity position of banks has improved, with highly liquid assets (defined under banking regulations) reaching about 14 percent of total assets—largely the result of slower credit growth (at 11 percent).

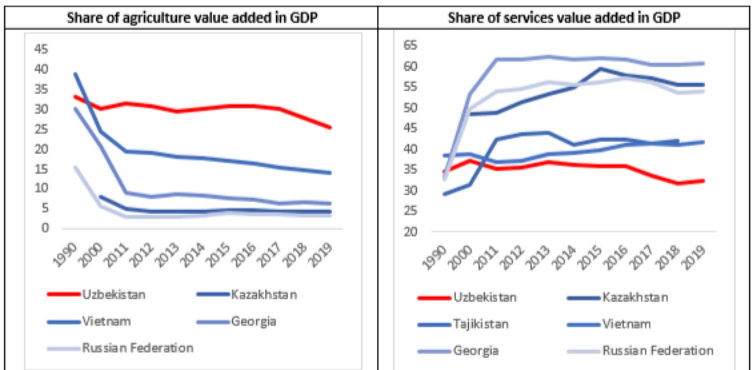
2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

20. **Economic growth is projected to return to pre-crisis levels starting in 2022 due to improving trading partner demand, the impact of structural reforms, and steady progress with vaccinations.** Domestic conditions are

exceptions—certain agricultural loans and low-income mortgages remain exceptions but are also due to be phased into the new requirement by end-2021.

projected to improve, as Uzbekistan has managed to avoid widespread lockdowns in 2021, and as vaccination coverage continues to steadily improve. On the supply side, a better horticultural season and improved wheat yields (recovering from the poor performance this year) are projected to support higher agricultural production. Reforms to improve energy sector infrastructure and the performance of chemicals and non-gold extractive production should support industrial growth. Construction growth is projected to remain strong amidst a substantial shortfall in urban real estate (particularly in Tashkent). On the demand side, public and private investment growth is projected to remain strong on the back of efforts to modernize ageing infrastructure. This will be supported on the consumptions side by the continued strength of remittances, ongoing reforms to expand social protection coverage and levels to address adequacy gaps, and rising labor incomes. Improving global trading conditions, recent efforts to tap new manufacturing export markets, and a tourism revival are expected to contribute to strong gains in export incomes. These projections remain subject to continued uncertainties and downside risks—particularly those arising from global supply constraints and the speed with which cross-border travel links are normalized. Faster progress with reforms offers an upside to this projection—particularly if reforms to privatize state enterprises, deregulate the services sector, and address factor market constraints, are accelerated.

Figure 1 – Changes to Economic Composition Over Time – Uzbekistan vs. Selected Peers



Source: World Development Indicators

21. For Uzbekistan to achieve its development goals, growth will need to be even higher. In 2021, the government announced its development objectives of halving the poverty rate by 2026 and attaining upper-middle income status by 2030.[13] To achieve this, growth will need to be sustained at an even higher level than what has been achieved over the last two decades. This will require more ambitious reforms. Uzbekistan's structural transformation is still yet to meaningfully take off: agriculture's share in the economy is one of the highest in Europe and Central Asia, and the share of services to GDP was marginally lower last year than it was at independence and is significantly below the share in peers (Figure 1). The share of exports to GDP is the lowest in Central Asia. The legacy of state-led growth and centralized resource allocation still permeates. State controls over factor markets still constrain intra-sectoral resource shifts to higher productivity and more efficient activities. Still-nascent market institutions and state monopolies in important economic sectors constrain private sector entry and competition. A complex regulatory and legal business environment reduces investor appetite, and Uzbekistan's privately owned firms seem to remain smaller for longer relative to peers.[14] The room for private sector growth has increased since the start of the reforms in 2017, including in critical areas such as agriculture where a strong sequence of market reforms has begun to improve productivity and performance. But even there, land market constraints and onerous crop restrictions hold back growth and productivity gains. Addressing these constraints will be critical to unlocking

[13] *Strategy for Poverty Reduction: 2021-2030*
[14] World Bank Country Economic Memorandum (forthcoming 2021)

higher productivity and more efficient resource allocation, and to supporting the high growth and job creation needed for Uzbekistan to achieve its ambitious development objectives.

22. **A fiscal consolidation plan is projected to return the deficit to more sustainable levels over the next three years.** In 2022, fiscal consolidation will begin through a substantial reduction in UFRD policy lending. Such a reduction can be credibly achieved: the most critical capital infrastructure renewal projects have already been funded, and it is unlikely that there is sufficient absorptive capacity to continue UFRD lending at the same pace as over the last few years.[15] The budget deficit as a share of GDP (excluding UFRD lending), however, is expected to remain largely the same in 2022 as in 2021 before declining in 2023 on the back of an anticipated pickup in tax revenues due to improvements in tax compliance and administration. A pick-up in tax collections from stronger domestic economic activity is also expected to offset projected mining revenue reductions from lower projected international prices, leading to a small (0.2 percentage point) increase in total revenues as a share of GDP to around 26 percent in 2022-23. On the expenditure side, the implementation of a medium-term tariff cost recovery adjustment program and the streamlining of about 30 explicit on-budget subsidies for various economic sectors are expected to help reduce budget spending by up to 2 percent of GDP over the medium term. Structural increases in social safety net spending and continued, albeit gradually easing, public investment spending will be offset by the expiration of anti-crisis spending measures, leaving total expenditures as a share of GDP unchanged at around 29 percent of GDP over the forecast period. The budget deficit will be financed through increased borrowing from international financial institutions and development partners, and from domestic and external (local and foreign currency) bond issuances.

23. **Fiscal consolidation will require balancing higher social spending with faster SOE reforms to reduce direct and quasi-fiscal subsidies.** Increased social spending, along with improvements to spending quality, is a priority policy for the government as it attempts to reverse over two decades of declining human capital infrastructure and social protection coverage. In 2021, a new, and significantly higher, minimum consumption level was adopted and will serve as the main reference for the poverty measurement and the determination of social assistance levels. The upward adjustment of social assistance spending will be gradually implemented over the next two years but has already started with the upward revision of pension allowances in June 2021. These increases, along with projected spending increases in education and health, are projected to add close to one percent of GDP per year in additional spending over the medium-term. Sustaining these increases, while also consolidating public finances, will require the government to accelerate reforms that reduce high spending on subsidies, especially to SOEs. Direct budget and quasi-fiscal subsidies, mainly to SOEs, were estimated at about 7 percent of GDP in 2020.[16] Most public investment projects are also implemented by SOEs as executors of large public works and investment programs. Faster progress to reduce the number of SOEs and increase their efficiency, and to improve the weak and fragmented public investment framework guiding capital spending, could help significantly with fiscal consolidation efforts.

24. **Stronger fiscal discipline is supporting the faster stabilization of public and publicly guaranteed debt.** Public and publicly guaranteed (PPG) debt, as a share of GDP, is expected to increase by about 4.2 percentage points in 2021 and a further 1.9 percentage points in 2021, before falling steadily to about 40 percent of GDP by 2025. Most new public debt will continue to be raised externally as domestic capital markets remain underdeveloped.[17] A significant part of external borrowing will continue to be at concessional rates from IFIs and other development partners. Uzbekistan also continues to maintain good access to external financial markets, as evidenced by an improving sovereign credit rating outlook, and heavy oversubscriptions and price reductions (relative to market guidance) on Uzbekistan's external debt issuances—including those issued in local currency. Since 2017, a steady series of reforms

[15] Chapter 2 of the World Bank Uzbekistan Country Economic Memorandum (forthcoming 2021)
[16] Chapter 2 of the World Bank Uzbekistan Country Economic Memorandum (forthcoming 2021)
[17] Furthermore, the UFRD's charter prohibits the use of UFRD funding for short-term budget stabilization needs, as UFRD funding is explicitly intended for long-term development projects.

has been enacted to strengthen debt discipline, including a parliament-approved annual borrowing limit (which the government is on track to meet in 2021 after a temporary increase was authorized by Parliament in 2020 due to COVID pressures) on new PPG external and domestic debt, and reforms to strengthen debt management, transparency, and reporting. A new debt law supported by a prior action under this operation, will further strengthen debt management practices by introducing a long-term limit for PPG debt of 60 percent of GDP. The law also requires the government to implement additional fiscal measures to curtail the deficit when PPG debt reaches 50 percent of GDP—such as through a reduction in public guarantees and more stringent public spending prioritization criteria.

Figure 2 - Debt Sustainability Analysis Charts

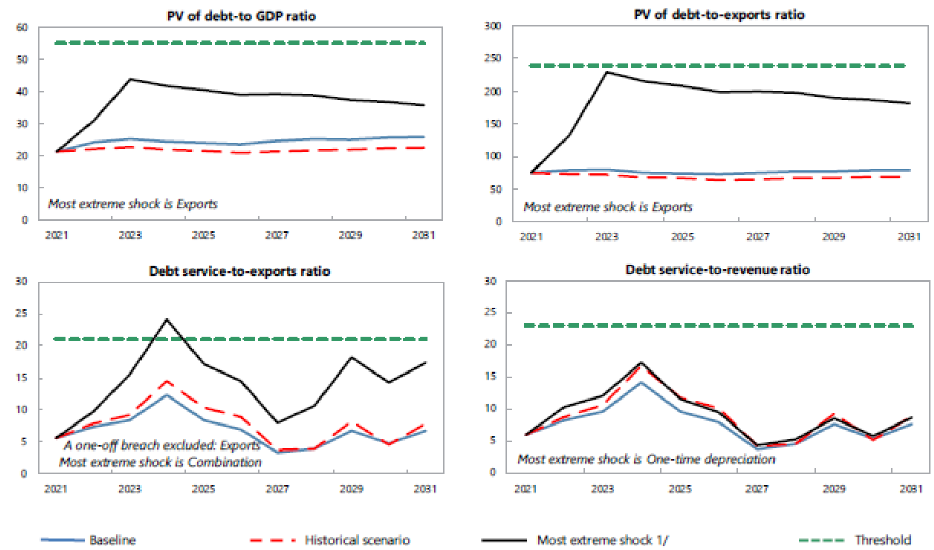


Table 3 – External Financing Requirements and Sources (Percent of GDP)

	2019	2020	2021	2022	2023
		Est.		Projected	
Gross External Financing Needs, *of which*	**9.0**	**9.5**	**13.6**	**11.7**	**11.0**
Current Account Deficit	5.6	5.0	6.0	5.6	5.3
Amortization payments	3.2	4.3	7.4	5.8	5.3
Short-term debt	0.2	0.2	0.2	0.3	0.4
Financing Sources, *of which*	**9.0**	**9.5**	**13.6**	**11.7**	**11.0**
Net FDI and Portfolio flows	6.1	5.0	5.6	4.9	4.2
Public debt	7.9	5.9	4.4	4.1	3.3
Other flows	0.7	3.3	4.5	4.1	4.4
Use of reserves (- increase)	-2.4	-3.0	-0.9	-1.4	-0.9
Errors and omissions	-3.3	-1.7	0.0	0.0	0.0

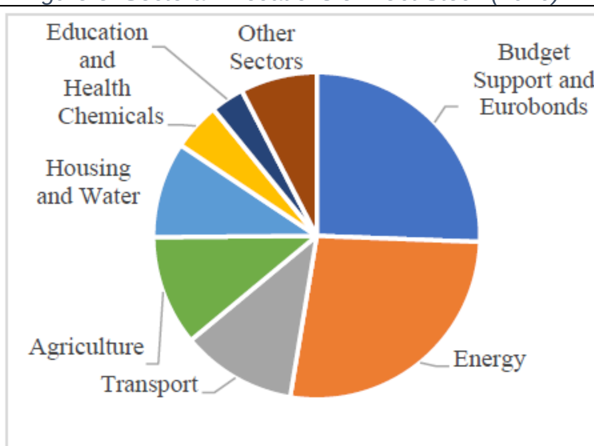
25. **External debt continues to be largely concessional and used predominantly for public investments.** Most external debt is on concessional terms with long maturity profiles. Guarantees are a significant share of external debt, and in 2020 were nearly half of the PPG debt stock. About 70 percent of PPG external debt is denominated in US dollars, and about two percent is denominated in local currency following the successful issuance of two domestic currency Eurobonds in 2020 and 2021 (Table 4). Domestic debt has also reemerged as a financing tool, with a mix of treasury bills and government bonds now being deployed as part of the fiscal financing strategy. Most external debt is earmarked to specific investment projects: just under three quarters of the total PPG debt stock at the end of 2020 was linked to investment projects implemented by International Financial Institutions or SOEs. The remaining quarter

of the debt stock has been raised as Eurobonds and budget support.[18] The distribution of sectors in the economy receiving debt financing are also largely aligned with priority focus areas under the 2017-2021 Development Strategy and the government's SDG financing strategy.[19] For example, nearly half of outstanding external debt is linked to projects in the energy, agriculture, housing, and water (urban and irrigation) sectors (Figure 3).

Table 4 – Uzbekistan: Outstanding Eurobond Issuances

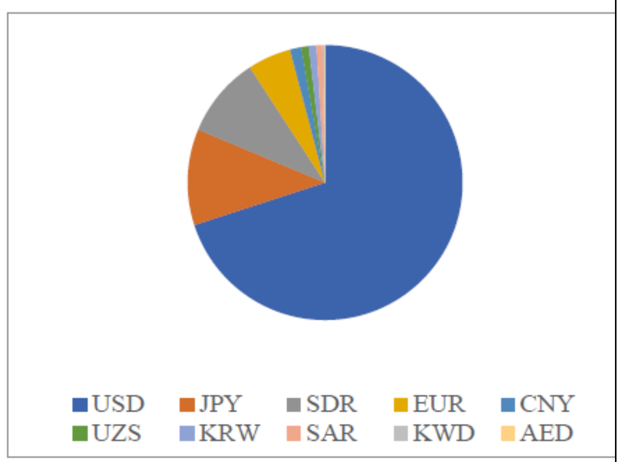
Date of Issuance	Currency	Amount	Due Date	Coupon
February 2019	USD	500 million	February 2024	4.75
February 2019	USD	500 million	February 2029	5.375
November 2020	USD	555 million	November 2030	3.7
November 2020	UZS	2 trillion	November 2023	14.5
July 2021	UZS	2.5 trillion	July 2024	14
July 2021	USD	635 million	October 2031	3.9

Figure 3: Sectoral Allocations of Debt Stock (2020)



Source: Official data.

Figure 4: Currency Composition of Public Debt (2020)



Source: Official Data.

26. Risks to debt sustainability are low. A joint World Bank-IMF Debt Sustainability Analysis (DSA) conducted in April 2021 found that that the most significant risks were worse-than-expected external inflows, mainly exports and remittances (Figure 2). Public debt-to-GDP was projected to peak at just over 43 percent before stabilizing at about 40 percent by 2026. Total external debt was expected to peak at 67 percent before stabilizing over the medium term. Mitigating these risks were low rollover risks and high foreign exchange reserves (Table 4). Since this DSA was conducted, however, a stronger macroeconomic and domestic fiscal outlook, and further regulatory measures to reduce debt growth, are expected to contribute to a peak PPG debt-to-GDP ratio of 42.5 percent in 2021, and a faster

[18] The first Eurobonds issued in 2019 were earmarked for financial sector development. Although budget support is fungible, the government is usually required to soft-tag debt-financed budget spending to specific economic investment projects when seeking approval to withdraw the loan balance from the lender; as part of this process, the government is also usually expected to provide some analysis of benefit cash flows generated by the project that exceed the repayment costs. There are exceptions to this process, but they are applied rarely (e.g. for social projects where such analysis may be more difficult to estimate).
[19] Ministry of Finance Debt Report for 2020

stabilization of public debt at under 40 percent by 2025. External debt is also expected to peak at a lower level of 64 percent in 2021 before steadily trending downwards to about 58 percent by 2025.

27. Uzbekistan has established a good standing in international financial markets and continues to opt out of participation in the G20 Debt Service Suspension Initiative (DSSI). With foreign exchange reserves of about 60 percent of GDP, an untapped domestic market of 34 million people, and a strong track record of reforms, the country continues to attract positive private financial inflows. Being new to sovereign capital markets, having issued its first sovereign Eurobonds only in 2019, and factoring in relatively low level of debt service obligations to G20 while wanting to establish a track record as a credible and creditworthy international borrower, Uzbekistan has continued opting out of the DSSI in 2021.

28. Inflation is projected to continue declining gradually, but the resumption of utility tariff increases, and the persistence of high food and fuel prices will delay the return to single-digit inflation. Inflation is projected to continue moderating as reforms to liberalize horticulture production and improve conditions for domestic trading stimulate supply in the economy. This will be helped by a further slowing in credit growth. The full impact of these increases, however, is likely to be tempered by the persistence of higher prices of wheat, meat, fuel, and imported consumer goods in 2022. In addition, the anti-crisis moratorium on public utility tariff increases will be lifted starting in early 2022, contributing to inflationary pressures over the medium-term. Although the government has not yet decided on the exact path of tariff increases, natural gas and electricity prices remain below cost recovery levels. A substantial cost-recovery shortfall in natural gas tariffs is likely to have an especially strong impact on inflation, with natural gas being the largest input for most electricity and hot water (district heating) production, and for important intermediate inputs such as fertilizers. As a result of these factors, the return of inflation to single-digit levels, which was originally projected for end-2021, is now likely to happen in 2023. In response to these conditions, monetary policy is expected to remain prudent to support the central bank's inflation targeting framework, with real interest rates of about 3 percent and a further slowdown in credit growth—especially from state-directed lending by commercial banks.

29. The persistence of global and domestic supply bottlenecks, and the slower pace of structural reforms to address these constraints, will test the new inflation targeting framework. Significant increases in global shipping costs have acutely hurt Uzbekistan, a double land-locked economy that faced high transportation and shipping costs even prior to the pandemic. These costs have been compounded by the slow pace of structural reforms to reduce border inefficiencies and high transportation and logistics costs. The ongoing inflationary impact from these structural constraints should serve as a strong impetus for deeper and more meaningful reforms to improve intra-regional transportation transit arrangements, customs delays, and trading regulations. The slower pace of reforms to address agricultural land productivity and crop restrictions—which has a notably large impact on the cost of meat and dairy products—are also delaying the economy's ability to respond with increased supply.[20] Reforms to address these constraints are being developed and should eventually help contribute to greater food security and price stability over the medium term.

30. The current account deficit is projected to remain elevated over the medium-term. An expansion in exports of manufactured goods, natural gas, non-metals, and horticultural products is expected to help stabilize goods exports at about 24 percent of GDP over the medium-term. The continuation of large capital imports linked to infrastructure modernization is projected to stabilize merchandise imports at just over 34 percent of GDP. The growth of service exports, particularly through a rebound in tourism, is likely further improve the trade balance over the medium term. Remittances are projected to remain strong at around 10 percent of GDP. As a result, the current account deficit is

[20] For example, substantial improvements in livestock fodder yields could be gained by allowing the substitution of wheat fodder for higher nutritional corn. Both can be grown in similar areas, but mandatory wheat growing restrictions limit this substitution from happening.

expected to fall steadily to about 5 percent of GDP by 2025. This will continue to be financed in the short-term through debt and portfolio inflows, and, over time, through FDI. FDI inflows, which had begun to increase between 2018 and 2019, have been slow to recover from the impact of COVID-19. Significant improvements in the domestic investment climate notwithstanding, FDI inflows remain constrained by the inefficient and heavily controlled factor markets and the gradual pace of reforms to reduce state ownership and monopolies over FDI-attractive sectors, such as telecommunications, banking, chemicals, and aviation.

31. **The implementation of Uzbekistan's Banking Sector Reform Strategy is on track in key areas—despite some COVID-19 induced delays.** Under Uzbekistan's financial sector strategy, the government intends to retain ownership of only three of thirteen state-owned banks and aims to increase private sector ownership of banking assets from 15 percent in 2019 to 60 percent by 2025: by September 2021, private banks had increased their share in the banking system assets to 17.6 percent.[21] This increase can be explained mainly by the rapid expansion of a few private banks, including recently licensed ones. Moreover, the privatization of one large state bank (Ipoteka bank–with 8 percent market share in assets) to the Hungarian OTP bank is at an advanced stage[22] and expected to be finalized by end-2021. Two additional small state-owned banks (Uzagroexport bank and Poytaxt bank) have been auctioned for sale in May 2021, with closing expected by end-2021.[23] The share of preferential (domestic currency) loans continues to fall and stood at 46 percent for the entire banking sector. By October 1, 2021, out of the ten state-owned banks, six have already ensured that independent members form the majority in their board of directors, and two additional state-owned banks will satisfy this requirement by end-2021. Other structural reforms have also continued to advance, with the approval of the 2021-2023 National Financial Inclusion Strategy in June 2021 and the start of parliamentary processes to consider and approve new non-bank credit organizations legislation in September 2021.

32. **Uzbekistan's macroeconomic policy framework remains adequate for the proposed operation.** The country has continued to weather the transition costs and the COVID-19 crisis while maintaining strong fiscal and external buffers. An elevated fiscal deficit is expected to return to more sustainable levels through stronger spending controls over the medium term and slightly higher revenue collection, helping to stabilize government debt at about 40 percent of GDP. Though the current account deficit is projected to remain elevated over the medium term amid strong imports of machinery and equipment for the modernization of industrial enterprises, external risks are mitigated by foreign exchange reserves that are projected to remain above 50 percent of GDP over the medium term and that currently provide import cover of about 14 months. Double-digit inflation generated by the transitional price adjustments is projected to continue moderating (albeit at a gradual pace) due to financial sector reforms to end below-reference rate lending, slower credit growth (including by the UFRD), and increasing autonomy for the CBU to achieve its monetary policy objectives. A well-coordinated policy stance to temper credit growth from excessive levels in recent years will also help reduce financial sector risks. Risks from these imbalances are also being mitigated by continued access to concessional development partner financing and competitive market access to non-concessional financing. As Uzbekistan looks to a post-COVID-19 normal, however, the economy remains vulnerable to further uncertainties and downside risks, including: (i) further pandemic-induced disruptions to global supply and cross-border flows of goods, services, and labor; (ii) the return to high government-directed credit growth; (iii) additional external shocks impacting domestic economic performance and financial sector stability; (iv) adverse weather conditions; and (vi) the occurrence of a major natural disaster.[24]

33. **The World Bank and IMF share a close and collaborative relationship in support of Uzbekistan's reforms.** The IMF is providing extensive technical assistance to the government and has increased staff monitoring. A new Resident

[21] This falls withing the range of 17-20% of this key indicator established in the approved Strategy.
[22] A memorandum was signed with OTP bank on September 29, 2021 on the sale of 75 percent stake in the bank.
[23] The Russian Expobank also signed a memorandum on purchase of Poytaxt bank.
[24] An earthquake in 1966, with its epicenter at the heart of Tashkent, measuring 5.1 on the Richter scale with a depth of 3km,

Representative, covering Uzbekistan and Tajikistan, has been posted in Tashkent. An extensive technical assistance program continues to be delivered, despite the pandemic impact, in the areas of debt and public financial management, stress testing, tax policy and administration, monetary and foreign exchange operations, and statistics (including external sector, government financial statistics, monetary and financial surveys, and national accounts). In May 2020, the IMF Board approved a US$375 million Rapid Credit Facility/Rapid Financing Instrument (50 percent of Uzbekistan's quota).

3. GOVERNMENT PROGRAM

34. **Despite continued challenges posed by the pandemic, the government has sustained the reform momentum in the final year of the 2017–2021 Development Strategy, the guiding framework for Uzbekistan's ambitious structural reform agenda.** Since the onset of the COVID-19 crisis, the government's policy priorities have centered on the preservation of gains from the economic transition, and continued implementation of reforms envisaged in the Development Strategy. Announced by President Mirziyoyev in February 2017, the Development Strategy focuses on expanding economic, social, and political freedoms and on transitioning to a competitive and market-oriented economy. The strategy has five pillars: (i) enhancing state and public institutions; (ii) securing the rule of law and reforming the judicial system; (iii) promoting economic development; (iv) fostering social development; and (v) ensuring personal and public security through inter-ethnic and religious tolerance and constructive foreign policy. In early 2019, the government (with support through the second DPO engagement) adopted a further 2019–2021 "Reform Roadmap" to provide further clarity about its reform priorities. It contains five focus areas: (i) maintaining macroeconomic stability; (ii) accelerating the market transition; (iii) strengthening social protection and citizen services; (iv) transforming the government's role in the market economy; and (v) preserving environmental sustainability. To further align reform implementation to the achievement of Uzbekistan's Sustainable Development Goals (SDGs), the government established a new SDG oversight mechanism in 2018, under the leadership of the Senate, to strengthen monitoring of Uzbekistan's national SDG goals and targets.

35. **Consistent with lessons learned from other successful economic transitions, Uzbekistan's first phase of economic reforms under the Development Strategy focused on the liberalization of prices, an overhaul of the business and trading environment, increased outward orientation, and improved social safety nets.** Since 2017, the government has prioritized efforts to strengthen economic management, lower tax burdens, improve energy supply and trading bottlenecks, remove external and internal price distortions constraining markets, and reduce state control over agricultural production and exports. To increase private sector and entrepreneurial growth, the government has also taken significant steps to remove onerous regulatory constraints that previously sustained SOEs at the cost of private sector growth.

36. **The focus of reforms has now shifted to reducing the state's role in economic production, where reforms have moved less rapidly.** Despite significant reforms to improve the business environment in recent years, private sector growth remains constrained by the state's near-total control over factor and key intermediate input markets and the continued operations of about 2,500 SOEs, including many that continue to benefit from monopoly rights in priority economic sectors (such as energy, mining, telecommunications, and transportation). Efforts to address these issues began in 2017 with an ambitious energy reform program to support a comprehensive reorientation of the sector towards market principles. This program continues to be implemented, and since 2019, the government has

killed between 15 and 200 people, left over 300,000 homeless, and destroyed most buildings in the city including an estimate of between 75,000 and 95,000 homes.

broadened its attention to a wider range of issues and sectors, working closely with the World Bank and other development partners to identify a well-sequenced and prioritized program to reduce the state's presence in the economy as a producer. Ambitious reforms to improve urban and agricultural land markets are under development and are expected to be adopted in the next year. A program to privatize smaller SOEs, the governance process for which was supported by the third DPO, has supported the sale or liquidation of several hundred small enterprises. The government has also approved the partial privatization of most large SOEs via share sales to increase SOE oversight and financial discipline and deepen local capital markets. The process to privatize state banks has also gained momentum.

37. **An ambitious social and political reform process continues to complement the economic reforms.** Since 2015, the World Bank has partnered with the International Labor Organization (ILO) to conduct third party monitoring of the cotton harvest. The ILO's report for the 2020 harvest continued to confirm that systematic forced and child labor has come to an end, and that Uzbekistan continues to make significant progress to strengthen the fundamental labor rights of harvest workers. The reports note, however, that sporadic recruitment of staff from state institutions, agencies, and enterprises at the local level, continued, although the number of pickers forced to work was estimated to have reduced by 33 percent compared to 2019, to about 68,000 people (out of 1.8 million cotton pickers). The report also noted that cotton pickers' wages had increased in line with ILO and World Bank recommendations, with most workers reporting that working conditions had improved compared with the previous year. Since 2017, the government has also initiated several other social reforms to modernize social safety nets, improve education and health care services, expand access to public services, increase religious freedoms, and relax severely restrictive internal migration controls. Political reforms have focused on increased regional and international people-to-people and trade links, increased press and media freedoms, and the establishment of elected regional and local governance. Collectively, these reforms have helped underpin substantial social support for the reforms, which continues to be strong.[25]

38. **Reforms to increase public sector transparency have been accelerated over the last two years.** Learning from the experiences of other transition economies, especially on complex policy issues such as land reform and privatization, the government has continued to implement measures to strengthen public sector transparency. Over the last two years, this has included new public procurement legislation and regulations that place stringent requirements for competitive and transparent tendering processes, a transparent electronic auction system for the sale of government land and assets, and continued increased fiscal, debt, and data transparency.

39. **Uzbekistan's development strategy also includes strong commitments to improving energy efficiency and reducing fossil fuel use intensity—as demonstrated by its increased commitment to greenhouse gas reduction.** Uzbekistan's voluntary commitments on climate change mitigation and adaptation under its Intended Nationally Determined Contribution (INDC), the first version of which was submitted to the United Nations Framework Convention on Climate Change in 2017, focused on improving energy efficiency and reducing the fossil fuel intensity of the economy. In a revision to its INDC, submitted at COP26 in November 2021, Uzbekistan has substantially expanded its commitment to decrease specific emissions of greenhouse gases per unit of GDP by 35 percent by 2030 (relative to 2010 levels).[26] This commitment assumes financial and technical support from international organizations and financial institutions, access to advanced energy-saving and environmentally-sound technologies, and climate finance. Uzbekistan also committed to continuing efforts toward climate change adaptation, to reduce the risk of

[25] Data from the August 2020 Listening to the Citizens of Uzbekistan conducted by the World Bank show that 86 percent of the population agreed with the statement that "the country is generally on the right track on political, social, and economic reforms." A similar share of respondents expressed their optimism for the economic future of the country, although risks of rising prices and job losses remain the most important concerns (and reforms linked to those risks are the least popular).
[26] Previously, this was 10 percent.

adverse climate change impacts on various economic sectors, the social sector, and the Aral Sea coastal zone. Measures adopted by the government in recent years to mitigate climate change have included the removal of fossil fuel subsidies, energy sector reforms to reduce technical losses and increase tariffs to remove subsidies, and the approval of a long-term electricity strategy that commits to non-hydro renewable energy increasing from zero to 30 percent of the total electricity generation mix by 2030.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

40. **Consistent with the government's reform priorities, the Program Development Objectives (PDO) of the proposed operation are to support a faster and more equitable economic transition through (i) stronger market institutions and better management of state-owned enterprises; (ii) improved fiscal transparency and accountability; and (iii) increased economic and social inclusion, especially of women and persons with disabilities.** Under the first pillar, the operation supports measures to liberalize wheat markets and strengthen the corporate governance of state-owned enterprises. Under the second pillar, the operation supports measures to fully consolidate all public sector spending into the budget and establish new public debt legislation that would allow for more transparent and systematic debt management. Under the third pillar, the operation supports measures to align social assistance spending with improved poverty measures, overhaul and modernize Soviet-era labor market regulations, and improve equal opportunities and protections for the disabled.

41. **The use of standalone DPOs has continued to support the World Bank's agile approach to supporting a dynamic and fast-evolving reform program, while anchoring a strong and programmatic broader reform policy engagement.** With major reforms occurring across the breadth of the economy and society, the pace and sequence of reforms has tended to vary across different areas, depending on the level of administrative capacity, the availability of technical assistance and expertise, and the level of political support. Reform opportunities in these still early stages of Uzbekistan transition are shaped by internal political dynamics that are often hard to anticipate. The emergence of these opportunities creates unanticipated windows for the World Bank and other development partners to help advance important reforms, but this requires greater operational agility—of the kind provided by standalone DPOs. The core objective of each of the Bank's DPOs continues to be on sustaining an inclusive market transition and each DPO has maintained a sustained and sequenced reform engagement in sectors that are critical to this objective such as agriculture, energy, SOE reforms, fiscal transparency, and social protection reforms. Through this approach, the DPOs have helped anchor the WBG's broader country engagements in a strong and programmatic policy dialogue centered on key transitional issues.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Pillar 1: Stronger market institutions and better management of state-owned enterprises

Agriculture

42. **Background:** **Despite favorable resource endowments, Uzbekistan's agriculture sector is characterized by significant production and market distortions that lead to low productivity and farmer incomes.** Agriculture accounts for about a quarter of GDP and the workforce. Many agricultural workers are women and youth who live in rural areas, where the poorest are located. Since the early 1990s, farmers have operated under a centrally planned

state production system that allocates farmland for cotton and wheat production. Under this system, farmers were subject to production targets and mandatory procurement rules—in the case of wheat, up to 50 percent of production is still surrendered to the state under mandatory procurement. Farmers had no say in what seeds and technology to use on their fields, being forced to use blanket input use recommendations developed centrally, untailored to local environmental, soil, and water conditions. Prior to 2017, more than 70 percent of arable land was administratively allocated for state-controlled production of cotton and wheat, commodities that generate lower profits, are more labor intensive, and have lower labor productivity (and farmer incomes) than most horticulture products suitable for production in Uzbekistan.

43. **Uzbekistan's agriculture sector is highly vulnerable to climate change.** Increases in extreme temperatures and rainfall events due to climate change are increasing the risk regarding water availability, as well as the incidence of pests, insects, and diseases. The impact on irrigated agriculture is expected to reduce crop yields by 20 to 50 percent through 2050,[27] and increase water scarcity and deficit and the desertification and water/soil salinity of the Aral Sea region. Changes in precipitation and water availability are expected to exacerbate the impacts of droughts and extreme weather events, affecting around 20 percent of the population.

44. **Since 2017, a steady reform program, supported by the first three DPOs, has helped dismantle the state-led system and support a recovery in agricultural growth.** Starting with incremental reductions in cotton and wheat growing areas (supported by the first DPO), a big wave of reforms in 2018 removed almost all export restrictions on horticulture products and liberalized bread prices (supported by the second DPO). Further reductions in cotton and wheat growing areas have since been enacted, along with the gradual easing of land restrictions, and transfer of almost all areas assigned for cotton production to private textile companies that facilitate raw cotton production through contract farming and process the cotton into higher-value products such as yarn and textiles. Uzbekistan is now close to its target of ending exports of raw cotton in favor of processed exports. By 2019, wheat and cotton farmgate prices, set by the state, were nearing convergence to market prices. After years of stagnant outcomes, and reflecting the strong supply response to reforms, the sector grew by 2.5 percent in 2019, despite a reduction in total sown area by 2.2 percent. In 2020, following the adoption of an ambitious agricultural modernization strategy, the government ended the state cotton order system which imposed stringent production targets on farmers and required all cotton to be sold to the state (supported by the third DPO).

45. **<u>Objective of the prior action</u>: The removal of the state wheat order system is an important next step towards the modernization and market liberalization of agriculture.** In November 2021, the government abrogated the remaining state wheat procurement requirements, which previously had required up to half of wheat produced in the country to be surrendered to the state.[28] Historically, the severe penalties (including the loss of land ownership) levied against farmers who did not adhere to the mandatory state procurement requirements curtailed the economic freedoms of farmers and reduced their incomes. It also discouraged farmers from investing in productivity increases, resulting in declining wheat production.[29] With the end of mandatory state procurement, farmers will be able to determine, based on market conditions, to whom and at what price to sell their wheat. The Presidential Resolution also requires the state to procure its wheat (for strategic food security reserves, which will help reduce excessive wheat price volatility) through the market and at market prices.

46. **To support an orderly market transition and to ensure the state's ability to maintain food security during its own transition to becoming a market participant, the Resolution requires farmers—for a period of three years—**

[27] Reducing the Vulnerability of Uzbekistan's Agricultural Systems to Climate Change (World Bank 2013).
[28] Presidential Resolution PP-10, dated November 15, 2021
[29] In 2015-2017, the country's wheat production averaged 6.9 million tons, according to the estimates of the US Department of Agriculture. It declined to 6.8 million tons in 2019, 6.5 million tons in 2020, and 6.0 million tons in 2021.

to sell a share of their production through the public commodity exchange.[30] This temporary requirement to use the commodity exchange is consistent with the approach followed by the government in nearly all other major price liberalizations since 2017, and is intended to ensure that a sufficient volume of trade occurs through a transparent platform observable to all market participants. The measure is also likely to reduce risks of hoarding and creating large supply disruptions and large price spikes at a time when prices are already high due to lower harvests and regional supply constraints.

Prior Action 1: In accordance with the Borrower's agricultural modernization strategy to increase climate resilience and eliminate state-controlled agricultural production, the Borrower has abrogated restrictions requiring wheat farmers to sell a fixed quota of production to the State at a price regulated by the State to allow farmers to determine their buyers and to set farmgate prices based on market conditions.

47. Expected results and next steps: The measures supported by this operation are expected to increase farmer incomes and support efforts to mitigate the impact of climate change on food security. Unlike cotton production, which until 2020 was entirely subject to state procurement at fixed prices, varying shares of wheat production have been permitted to be sold at market rates for more than a decade. By using mandatory sale requirements at consistently lower prices compared to the market price, the government was able to achieve its strategic wheat procurement needs, and put downward pressure on bread prices, but at a high cost to farmer incomes. Though the gap between the state and market prices had begun to fall in recent years, the difference was never fully bridged.[31] The adopted measures are expected to equalize the prices paid by government for its strategic wheat procurement and the trading prices of wheat in the commercial commodity exchange (Result Indicator 1). Over time, this is expected to significantly improve farmer incomes and encourage investments in long-term agricultural productivity increases. The reform is also expected to help Uzbekistan's wheat sector adapt to water and food security vulnerabilities, caused by climate change, by enabling farmers to increase investments in water-saving technologies and land improvements, and the use of more climate-resilient crop varieties.

48. Next steps: The next phase of agricultural modernization reforms centers on land. Though impressive progress has been made since 2017 to liberalize agriculture, the tenure, security, and flexibility of land use rights remains a major constraint to agricultural reform. The absence of land markets and the mandatory cotton and wheat crop placement system constrain agricultural productivity and investments in land and irrigation system improvements. New agricultural land legislation is expected to be finalized in 2022 that will begin addressing these issues. Alongside these reforms, the government, with significant technical and investment support from the World Bank and other development partners, will continue to advance the implementation of its agricultural modernization strategy—which spans reforms to transform agricultural financing, improve logistics and transportation infrastructure, and strengthen research, knowledge, and information systems.

[30] Farmers will be required to sell, on average, a little less than half of their production through the commodity exchange, which is a government-owned mercantile exchange that is used widely to trade most primary commodities in Uzbekistan. There are limited restrictions on buyer and seller entry to the exchange, and the exchange provides daily trade volume and price data to inform market participants.

[31] In 2016-2018, wheat farmers were estimated to annually lose 0.5 percent of GDP. In 2019 the loss dropped to 0.1 percent of GDP, increasing to 0.3 percent of GDP in 2020. (World Bank Second Agriculture Public Expenditure Review 2021)

State-Owned Enterprise Reform: Corporate Governance and Financial Accountability

49. <u>Background:</u> About 3,000 tier-1 SOEs account for about 18 percent of employment and 20 percent of exports; together with wider public sector operations, the state produces about half of Uzbekistan's GDP.[32] SOEs in Uzbekistan operate in many economic sectors that could be better served by the private sector and impose a significant cost through quasi-fiscal deficits. In some of these sectors (e.g., airlines, telecommunications, and public transport), they enjoy near monopoly power and thwart private sector entry. SOEs operate alongside the private sector in various subsectors, such as light industry, fruits and vegetables, hospitality services, chemical industry, banking, and insurance. However, they often have preferential access to land, finance, and public contracts at the expense of a level playing field for the private sector. Although explicit on-budget subsidies to SOEs are small (at about 1 percent of GDP), at least an additional 6 percent of GDP in quasi-fiscal support due to below-cost-recovery price controls, inefficient collections, and technical losses, have helped underpin the SOE operating model.[33] Even this support has been insufficient to ensure adequate levels of investment in several sectors. This is particularly the case in public utilities, where technical losses due to poor maintenance, are significant.[34]

50. Though nearly all the largest taxpayers are SOEs, their financial performance is mixed. Nearly all of the top 20 taxpayers in Uzbekistan are SOEs. In 2020, the net financial performance of the largest SOEs in the economy was modestly positive despite the impact of COVID-19. Profits of about 1.5 percent of GDP offset losses of about 1 percent of GDP, with most losses arising from natural gas and hot water distribution companies (about two thirds of total financial losses generated by the largest SOEs in 2020). In 2020, four of the largest SOEs were among the ten most profitable state enterprises: JSC Uzbekneftegaz, JSC Almalyk Mining and Metallurgical Company, JSC Uzmetkombinat ("Uzbek Steel"), and JSC Uzavtosanoat. Three of the largest SOEs were also among the top ten loss-making state enterprises in 2020: JSC UzTransGaz, JSC Uzbekistan Airways, and JSC Uzbekkumir.

51. Financial transparency and corporate governance of SOEs remain weak, although previous reforms have begun demonstrating early gains. SOEs have historically operated as vertically integrated entities combining sector policymaking, regulation, and technical operations. The separation of these functions, and the state's ability to monitor SOEs and discharge shareholder responsibilities have only begun to emerge in recent years (supported by the second DPO). Underdeveloped accounting standards and weak financial reporting standards have compounded financial transparency challenges in SOEs. Since 2017, the government has begun to impose basic corporate governance requirements on SOEs, starting with the introduction of modern accounting standards, comprehensive asset inventories, and the separation of nearly all policy and regulatory functions from operational responsibilities. However, the limited performance management and disclosure requirements for SOEs are still well below the OECD's corporate governance standards.

52. Since the start of the reforms in 2017, and with the support of the first three DPOs, the government has taken important steps to strengthen the financial transparency of SOEs and address institutional weaknesses. With support from the first DPO, the government adopted measures requiring its two biggest (and costliest in terms of explicit and quasi fiscal deficits) SOEs—*Uzbekenergo* and *Uzbekneftegaz*—to adopt international financial reporting standards (IFRS) and produce updated audited financial statements compliant with the new standards. Progress has been strong: both utilities have adopted IFRS and are up to date with their audited statements. Through the support of the second DPO, the government unbundled the vertically integrated state-owned airline, which was responsible

[32] Most state-owned assets are concentrated in the 15 largest SOEs that dominate the most important economic sectors. These SOEs employ 4 percent of the workforce and one third of the industrial workforce. Only one of them (UzbekNefteGaz) generated substantial profits.

[33] World Bank Public Expenditure Review (2019)

[34] For example, losses in natural gas supply are estimated at 1.2 percent of GDP.

for aviation policy, sector operations, and regulation. Similar unbundling exercises have since been carried out in parts of the energy and (non-air) transportation sectors. Under the third DPO, the government began a small SOE privatization program and established revised corporate governance requirements for 32 large SOEs—requiring them to adopt IFRS (from 2021), appoint independent board members, and obtain international credit ratings.

53. __Objective of the prior action:__ **A new law will consolidate the fragmented SOE regulatory framework, modernize corporate governance standards, and introduce legal requirements for the justification of continued state ownership in enterprises.** In November 2021, the government submitted to Parliament (Cabinet of Ministers Letter 02/49365/1-2357) a new asset management law which will create a unified legal framework for the management of state enterprises and property. Following four years of reforms to strengthen SOE corporate governance on a case-by-case basis, the new law establishes good practice corporate governance requirements, based largely on OECD principles, that will now apply to *all* SOEs. This includes requirements to adopt IFRS, develop and implement business transformation plans, enhance the independence of supervisory boards, and separate state ownership and regulatory responsibilities. The law also contains criteria for continued state ownership of enterprises and requires the government to justify its continued ownership of enterprises against these criteria to Parliament as part of regular parliamentary reviews of SOE performance. If such criteria are not met, the draft law requires the government to divest its ownership of state enterprises that do not meet legislated criteria for retained ownership. Finally, to align SOEs' business models with the government's climate and environmental policy goals, the law enshrines environmental and natural resource protection as a core legal principle and requires that the government's management of SOEs and other state assets complies with this principle.

Prior Action 2: To improve the management of state-owned enterprises, the Borrower has submitted a new state asset management law for parliamentary approval that establishes corporate governance and financial transparency requirements for all state enterprises and legislates principles for reducing the number of state-owned enterprises.

54. __Expected results and next steps:__ **The measures in this operation are expected to improve the corporate governance, performance, and financial transparency of SOEs—and help the government develop a better understanding of the continued need for state ownership.** In the short-term, the most important changes under the law are comprehensive changes to the composition and structure of SOE boards--most notably requirements for the appointment of independent board members (Result Indicator 2)—and requirements for the adoption of IFRS standards. Over time, these requirements, and other provisions in the law, such as requirements for strengthened performance reporting, both on an individual SOE basis and through consolidated SOE performance reporting by SAMA, are expected to improve the financial and technical performance of SOEs. More, and more reliable, information on SOE performance is also likely to help accelerate processes to evaluate the need for continued government ownership of SOEs.

55. **A complementary privatization law, currently in an advanced stage of development, is expected to be finalized in 2022 to provide a unified legal framework for privatization.** As in the case of corporate governance, the legal and regulatory framework for privatization is outdated and heavily fragmented. The new privatization law is intended to complement the new asset management law, and provide a unified legislative framework for privatization, setting out the objectives and principles of the government's privatization program, assigning clear roles, responsibilities, and powers for various aspects of the decision-making process, and setting out transparency

and competition criteria for the sale of public sector assets. The law is in advanced stages of development and is likely to finalized by mid-2022.

56. The passage of this new law also establishes an important foundation for stronger climate and environmental governance of SOE operations. SOEs either operate as monopolies or enjoy dominant market shares in sectors of the economy that are responsible for most of Uzbekistan's carbon emissions (e.g., energy, chemicals, and other industrial manufacturing, which represent over 85 percent of Uzbekistan's estimated carbon emissions). Measures in the law require, for the first time, that the government's overall corporate governance framework for SOE management is consistent with the government's environmental policy objectives, which include the need to address climate change risks.[35] It represents an important institutional step towards the implementation of ambitious plans to green the state's presence in the economy.[36] To enhance compliance with this new requirement, and as part of the results supported under this proposed operation, the government is developing a roadmap of measures to improve climate change (Result Indicator 3), environment, and social governance of SOEs. The new legislative requirement and the proposed implementation measures under development by the government are expected to, over time, contribute to Uzbekistan's carbon emission reduction goals.

Pillar 2: Improved fiscal transparency and accountability

Budget Consolidation

57. Background: In 2018, more than half of total public spending took place outside the formal budget process,[37] undermining effective public resource allocations, and increasing fiscal risks. Public resources to fund central government operations were (and, to an extent, still are) collected, allocated, spent, and accounted for in a complex manner that involved multiple legal frameworks, accounting systems, reporting lines, and transparency requirements. Adding to the complexity were various transactions and directed lending operations involving government agencies, government extra-budgetary funds and off-budget accounts (including the UFRD and Agriculture Fund), state owned banks, and SOEs. The considerable fragmentation of public spending has created significant constraints for the government to align its public spending with its core policy priorities, including the improvement of health and education services, the empowerment of women and disabled persons, the stronger emphasis on reducing poverty and supporting low-income households, and the increased level of ambition to tackle climate change and other environmental risks.

58. Since 2018, and with considerable support from the World Bank and the IMF, Uzbekistan has made strong progress in improving budget transparency. Prior to 2018, there were no requirements to publish or seek formal parliamentary approval of the state budget. In mid-2018, the government required annual budget publication and public disclosure of the budget, including citizen budgets (supported by DPO 2). In December 2019, further reforms were enacted to completely overhaul the public financial accountability process, vesting Parliament with the responsibility of reviewing and approving budget legislation. Following the approval of the annual budget law, the government is now required to provide quarterly budget execution progress reports to Parliament and appear before the Budget Committee to answer questions. The law also devolves responsibility for the consideration and approval

[35] Presidential Resolution 5863, which sets out the government's core environmental policy objectives to 2030, identifies climate change risks as a critical area of attention. Climate change risks are also identified as principal areas of focus in other strategic government policy documents, such as in the areas of water management and agricultural development.
[36] Presidential Resolution 4477 outlines measures to accelerate Uzbekistan's transition to a greener economic model in response to climate change risks, and explicitly identifies both SOEs and sectors dominated by SOE operations as areas of reform focus.
[37] Public Expenditure Review (2019)

of local budgets to the newly established local deliberative bodies,[38] whose membership is appointed by means of direct citizen election, introduced by the government as part of the political reform process. The 2019 reforms integrated UFRD spending—the largest source of off-budget activity—into the consolidated budget. The reforms also introduced a formal procedure for supplementary spending: supplementary expenditure (including of the UFRD) exceeding 3 percent of the approved parliamentary ceiling must be re-approved by Parliament.

59. Objective of the prior action: The 2022 government budget will be the first in Uzbekistan's history to contain a fully consolidated budget—representing the entirety of public revenues and spending. Amendments to the Budget Code were approved by Parliament at the end of December 2020 which require the inclusion of all previously excluded sources of public expenditure into all future consolidated budgets presented for parliamentary approval.[39] The 2022 Budget Law, the first prepared since these amendments, contains a fully consolidated fiscal position, comprising the (core) Republican Budget; the revenues and expenses of UFRD; all extrabudgetary (special purpose) funds; and two spending sources that were fully unreported previously: the revenues and expenses of close to 27,000 off-budget accounts, and all externally financed expenditures—which amounted to about 3 percent of GDP of expenditure in 2020.

Prior Action 3: To increase the transparency of public spending and parliamentary oversight of the budget, and to improve the alignment of spending to government priorities, the Borrower has enacted amendments to Articles 45 and 46 of the Budget Code of the Republic of Uzbekistan to expand the composition of the consolidated budget of the Republic of Uzbekistan to include off-budget funds of all budgetary organizations and extra-budgetary funds of budgetary organizations.

60. Expected results and next steps: The measures supported under this operation will improve fiscal reporting, increase accountability and, over time, improve expenditure quality and better alignment to the government's strategic development priorities. The full compliance of subsequent Budget Laws against the approved measures supported in this action will help establish a strong foundation for future reforms to the budget process. For the first time, all public revenues and expenditures will be subject to the stronger parliamentary oversight mechanism established in recent years. A clearer picture of total spending is likely to help improve fiscal consolidation and the alignment of public finances to government spending priorities. This has already begun to happen in the case of the UFRD's consolidation, with windfall revenues from gold mining—that ordinarily accrue to UFRD—being used to fund COVID-19 anti-crisis priorities in the budget. The inclusion of sizable extrabudgetary and off-budget spending (e.g., agriculture, public law enforcement) is also increasing information available to the government about the full cost of its fiscal and quasi-fiscal subsidies—and serving as an important starting point for the government's review of spending to achieve fiscal consolidation priorities. the reforms will also improve information available to Parliament as it assesses budget performance and value for money from public spending.

61. The government's resolve to address climate change and environmental risks will benefit from efforts to consolidate public finances. Since 2019, the government has been accelerating its efforts to improve the public financial system's ability to support the achievement of climate change and environmental policy objectives. With support and technical assistance from the World Bank and other development partners, work is under way to strengthen planning, budgeting, taxation, social protection, and procurement systems. Measures supported under

[38] The *Jokargy Kenes* of Karakalpakstan, established in 1992, and the *kengashlar* of regions and the City of Tashkent that were recently established as a centerpiece of the Government's political reforms under the 2017-2021 Development Strategy. The new deliberative bodies increase voice and accountability at the regional level and increase the accountability of regional governors (appointed by the President) to local citizens. It is a step toward directly elected regional governors, which the President has identified as a key medium-term reform.
[39] Law ZRU 660 Dated December 30, 2020

this operation will contribute to greater effectiveness in climate and environmental planning and budgeting in two ways. First, reforms underway to augment and strengthen economic forecasting and modeling processes to factor climate change and environmental risks more explicitly will benefit from more comprehensive revenue and expenditure information—especially given the state's dominant role in the economy and its dominance in sectors of the economy that contribute most to carbon emissions and other environmental risks.[40] Second, improved fiscal consolidation is a necessary prerequisite for the government to improve its budget planning and reporting systems, as part of efforts to strengthen the performance of the budget and enhance the impact of public spending on key government policy objectives—most notably the achievement of Uzbekistan's Sustainable Development Goals. With support from the United Nations Development Program and the French Development Agency (AFD), work is under way to enhance budget information systems to more effectively tag and measure budget allocations and execution to Uzbekistan's SDGs. As part of this work, and as a result supported under this operation, the government is enhancing its methodology and processes to classify and score public expenditures against climate change and environmental policy objectives (Result Indicator 4). As emerging experiences from other countries show, green budgeting serves as an important tool of budget policy to support governments in achieving their climate and environmental goals by improving the quality of evaluations and impact assessments of budget impact, and to ensure coherence in the achievement of national and international policy commitments.

62. With budget consolidation now largely completed, the focus of fiscal transparency reforms is shifting to address other gaps. With nearly all public spending now being reported, authorized, and reviewed by Parliament, the focus of budget transparency reforms will focus on using consolidated fiscal information across sectors and spending agencies to provide more comprehensive information to Parliament and the public about the value for money of overall spending in these areas. In the next twelve months, and beyond the budget, broader fiscal transparency reforms are also expected to focus on improving fiscal risk management and reporting—especially of contingent liabilities which are increasing in size from both SOEs and from the growing number of Public Private Partnerships that the government is entering. Reform implementation strategies to strengthen public investment management following a Public Investment Management Assessment (PIMA) are also being developed.

Public Debt

63. <u>Background:</u> Uzbekistan's legal framework for government debt management is dated and fragmented. It comprises primary legislation (laws enacted with approval of the Parliament) and secondary legislation (executive orders, decrees, ordinances etc.) determined by the President, the Cabinet of Ministers, or individual Ministries. Though this framework establishes a framework for debt management policies that helps to ensure sustainable management of borrowed funds and public debt, the fragmentation creates gaps in definitions and coverage, and in the clarity about institutional roles and responsibilities. In addition, much of this legislation, such as the Law on External Borrowing from 1996, is outdated and does not reflect improvements in international good practices that have been made in recent years. Definitions and coverage of public debt fall short of international standards, as do debt management policies which focus on annual debt management rather than a medium-term strategy. There are also no standard reporting and public transparency requirements.

64. Uzbekistan has implemented several reforms to strengthen debt management that now need consolidation under a unified legal framework. As is the case with other legal and regulatory frameworks, missing provisions for debt management operations are often filled through subsidiary presidential resolutions and regulations. Several of

[40] Estimates from 2016 suggest that the state is responsible for over half of output produced in the economy (World Bank SCD (2016))

these have been issued since the start of the reforms to strengthen debt management and public debt accountability, and to enable Uzbekistan's Eurobond issuances. At least five major regulations have been issued since 2018 that relate to public debt management. In addition to the challenge that the high level of fragmentation poses to ongoing debt management, it also creates constraints in the use of innovative market financing instruments—such as climate and SDG bonds that help crowd in financing to areas where market investment interests and government policy priorities are in strong alignment.

65. **Objective of the prior action: A new debt law will help address these shortcomings and consolidate recent debt management improvements.** In November 2021, the government submitted a new State Debt law for parliamentary approval (Cabinet of Ministers Letter 02/25858/1-609). The new law, developed with support from the IMF, the World Bank, and the US Treasury, expands the definition and scope of public debt coverage, and clarifies institutional roles and responsibilities—including that of Parliament, the Chamber of Accounts (as the supreme audit institution), and the newly established Debt Management Office as the authorized body for public debt management. The legislation also codifies measures taken in recent years to increase debt transparency and reporting, and debt discipline. Parliament will review public debt information quarterly, and a new ceiling prohibits debt from increasing beyond 60 percent of GDP.[41] Budget reforms to introduce annual borrowing limits are also now enshrined as legal requirements in the new debt law. Importantly, the government will now be legally required to produce, and annually update, a medium-term debt strategy.

Prior Action 4: To strengthen the management of public debt and increase debt transparency, the Borrower has submitted a new State Debt law for parliamentary approval that (i) establishes the objectives for debt management and assigns specific purposes, roles, and responsibilities for debt management; and (ii) establishes legally binding requirements for debt reporting.

66. **Expected results and next reform steps: The measures supported under this operation are expected to enhance the effectiveness and transparency of debt management and further align Uzbekistan's debt management practices with international standards.** The first medium-term debt strategy will be prepared for government approval following parliamentary approval of the new law (Result Indicator 5). The strategy will be updated annually, as per the requirements of the new law. Stronger accountability provisions in the law, which impose administrative fines and penalties when information is not provided on a timely basis, are expected to significantly improve debt information and reporting—especially of SOEs where information has been harder to compile. These accountability provisions are also expected to help the government as it looks ahead to a new phase of fiscal transparency reforms that are focused on improving its management and disclosure of fiscal risks—particularly contingent liabilities.

67. **The measures supported under this operation will also strengthen the effectiveness of the government's use of debt financing to address climate and other key government priorities.** Greater clarity on institutional roles and responsibilities and a clearer unified legislative framework will create a more certain regulatory environment that supports innovation in how debt finance is used to support government policy objectives. Clearer legal obligations requiring comprehensive debt reporting and information dissemination will also ensure that investors purchasing purpose-specific impact financing, such as climate-linked or SDG bonds, are better informed about how debt financing has been used to achieve its intended objectives. In addition to supporting greater debt transparency, regular and comprehensive reporting on how purpose-specific impact finance has been used to generate outcomes can play an important role in maintaining Uzbekistan's credibility in international financial markets and help sustain

[41] When public and publicly guaranteed debt reaches 50 percent of GDP, the law also includes a requirement for the government to submit a plan to contain debt so that it doesn't breach the legislated 60 percent ceiling.

its ability to attract further debt financing at competitive prices. Requirements to produce this information for investors and the public are also likely to increase the level of discipline in how debt is used to generate high economic and social returns. To advance this objective, and as a result supported under this operation, the government is developing secondary regulations that will require the regular publication of allocation impact reports for purpose-specific impact bonds. An allocation impact report for the SDG bond issued in 2021, which was explicitly linked to Goal 13 (among others) on climate change, is expected to be the first report published following the adoption of these regulations (Result Indicator 6).[42]

68. Over the medium-term, further debt and capital market management reforms will remain an important area of focus. The recent integration of domestic capital market development responsibilities to the Ministry of Finance will enable a systemwide approach to strengthening debt and capital markets institutional arrangements. Reforms over the next few years are likely to focus on institutional strengthening—particularly on the capital markets side—to accelerate domestic debt market development. Simultaneously, the government is also expected to continue implementing reforms to strengthen debt record management and public transparency of debt information. Reforms envisaged include the establishment of a single public debt portal of information that provides consolidated debt data across all sources (e.g., government and central bank). Reforms are also being implemented to strengthen debt-financed expenditure tagging to specific government objectives, such as the achievement of specific Sustainable Development Goals or domestic policy objectives.

Pillar 3: Increased economic and social inclusion, especially of women and persons with disabilities

Labor Market Regulations

69. Background: Unemployment is high, wages are abnormally low, most work is informal, and a high share of working-age people are out of the labor force. According to ILO estimates, one percent employment growth required 5 percent GDP growth in Uzbekistan between 2010 and 2018, more than twice the average among other developing economies.[43] Those jobs have not proven especially remunerative either. In total, the labor share amounted to only 41 percent of national income in 2017, far below the regional ECA average of 55 percent.[44] The State Statistics Committee estimates that the unemployment rate reached 10.5 percent of the active labor force in 2020, up from about 9 percent in 2019 before the pandemic. Another 34 percent of working age people were inactive (i.e., not working or looking for work).

70. Female labor force participation is low. Female labor force participation is 28 percentage points below that of men – nearly twice the average gap in high-income countries (15 pp) and much higher than in comparator countries such as Russia (10 pp) and neighboring Kazakhstan (12 pp).[45] Women and (and particularly young women) are especially likely to be unemployed or out of the labor force entirely. But despite low levels of labor force participation among women, L2CU respondents say that a lack of jobs for women is just as pressing a challenge as the lack of jobs for men, on average. The disconnect may be due in part to gender discrimination in hiring decisions, which is prevalent and economically significant. A World Bank study in 2020 found that women were 185 percent more likely to get a callback in response to an application than men in female-dominated professions, and men

[42] The SDG bond issued in 2021 was linked to nine SDGs, seven of which either directly or indirectly support the adaptation or mitigation of climate risks.
[43] Towards Full and Productive Employment in Uzbekistan: Achievements and Challenges,' ILO May 2020
[44] ILO Modeled estimate
[45] Source: ILO; Similar estimates are derived from both official HBS and World Bank L2CU data.

were 79 percent more likely to get a callback than women in male dominated professions. Such strong gender preferences contribute to segmentation of the labor market with respect to gender.[46]

71. Though limited job availability is a major contributor to these challenges, they are also the result of complex labor regulations. Forced labor was pervasive in the agriculture sector until recently. Relocating within Uzbekistan to where jobs were more abundant was restricted under the *propiska* registration regime, and until reforms were adopted in 2019 (supported by the third DPO), it was illegal for a person to apply for a job outside of their region, with harsh criminal and administrative penalties for both employer and employee. Minimum wages are set and revised in an ad-hoc way and are considerably lower than mean wages—the result of the national minimum wage not serving just as a wage floor but also as a unit of account for public sector service costs and administrative and criminal fine thresholds. Labor regulations continue to retain onerous Soviet-era burdens and obligations on employers that incentivize non-compliance and illegal hiring practices. The 1995 Labor Code that is currently in force, with a few minor amendments over the last two decades, retained most of the provisions of the original labor code adopted in 1971 by the Supreme Soviet of the Uzbekistan Soviet Socialist Republic.[47] Combined with high taxation of labor income, such heavy-handed regulation contributed to slow employment growth and high rates of informality – in 2019, about 59 percent of total employment was informal, and of all people employed in 2019, only about 35 percent held a "labor book" recording their years of work and pension rights.[48]

72. Objective of the prior action: A new labor code is expected to overhaul labor regulations and improve their alignment to International Labor Organization conventions and good practice guidelines. Since 2019, the government has been developing a new labor code to address weaknesses in labor regulations. An initial version of this code was submitted by the government to Parliament for a first reading in 2019. Following parliamentary Committee and plenary discussions, Parliament asked the government to work with stakeholders to further strengthen the code to improve its compliance with ILO conventions, and to find opportunities to strengthen the rights of women and persons with disabilities in the law. Since then, the World Bank and ILO have been providing extensive support to the government to revise the draft code. The revised version of the code significantly strengthens provisions for contracting and job separation. Importantly, contracting provisions include requirements for equal remuneration for men and women workers for work of equal value. The new code also expands regular annual leave days for workers and establishes a legal definition for the minimum wage that addresses weaknesses in the existing national minimum wage definition. A revised version of the Labor Code was submitted by the government to Parliament in early-October 2021.[49] Following second and third readings, the draft code was approved by the Lower House of Parliament (Oliy Majlis) in mid-October. The Upper House of Parliament (Senat) is expected to review and approve the new code as law in the next month.

Prior Action 5: To modernize labor relations and reduce gender and other discrimination in the labor market, the Borrower has submitted to Parliament for approval a new labor code that (i) introduces equal pay for men and women for equal work; (ii) prohibits discrimination in hiring and labor contract termination; and (iii) establishes and regulates the concept of 'minimum wage'.

73. <u>Expected results and next steps:</u> The measures supported by this operation address several important constraints facing workers (especially women) and employers. The new code overhauls burdensome and largely

[46] Seitz W, Muradova S - Gender Discrimination in Hiring, World Bank Policy Research Working Paper (2021)
[47] Evolution of Employment Protection Legislation in the USSR, CIS, and Baltic States – 1985-2009, A. Murayev, IZA Discussion Paper 5365, December 2010
[48] These data are from Uzbekistan's Ministry of Employment and Labor Relations.
[49] Confirmed via Ministry of Employment and Labor Relations letter 01/00-02/13-12578 dated 12 November, 2021.

Soviet-era regulations and are an important first step in improving labor relations. Employers benefit from clearer rules governing temporary and full-time employment contracts, a regular minimum wage review process, expanded regular and parental leave provisions, and strong measures to reduce discrimination and ensure equal pay for equal work—especially for women and persons with disabilities. Employers are also expected to benefit from a less fragmented and more concise regulatory document that defines their obligations to workers. Importantly, the new code establishes more stringent labor code enforcement standards and establishes a framework for labor code inspections to audit businesses for their compliance with key anti-discrimination provisions of the code, particularly in the areas of hiring, firing, and equal pay for men and women (with the level of inclusion of such checks in compliance audits measured by Result Indicator 7).

74. Over the medium term, other reforms to improve labor market regulations, such as the reform of unemployment insurance and further measures to streamline occupational licensing requirements, are expected to further improve the labor regulatory environment. The lack of a well-functioning unemployment insurance system, which currently covers only about one percent of people employed, contributes to higher worker uncertainties and is an important next area of reform for the government. Other areas include streamlining the still-complex occupational licensing and permit regime and accelerating the implementation of active labor market program reforms.

Poverty measurement and social assistance

75. <u>Background:</u> Uzbekistan's social transfer programs are constrained by a legal framework that is atypical. Article 39 of Uzbekistan's Constitution states that *"Pensions, [social] allowances, and other kinds of welfare [payments] may not be lower than the **officially fixed [through subsidiary legislation] minimum subsistence wage**."*[50] As stated, this provision requires that *all* social transfer programs providing financial benefits to citizens must pay anyone eligible for a social program, regardless of their distance to this threshold, a financial benefit that was unofficially estimated to be near the level of per capita GDP. For social assistance programs, this created a logical incoherence in that the threshold was also the minimum, i.e., a person living below the threshold would be eligible for a transfer valued at 100 percent of the threshold or more. The near impossibility of implementing this set of policies or of redistributing such large shares of economic activity meant that no such measure was ever defined through subsidiary legislation. Instead, such payments were linked to a separate measure known as the *national minimum wage* which was set through a discretionary process.[51] These legal challenges complicated the process of setting minimum consumption baskets (or a poverty line) in Uzbekistan for its first 30 years of independence.

76. The limited recognition of poverty was also a significant constraint in establishing measures of minimum consumption. Prior to 2020, legacy policies allowed little room for formal recognition and measurement of poverty, and officially, there was no poverty in Uzbekistan. A national definition of the "low-income" population was established in 2001, based on the costs of minimum calorie (2,100 calories) intake. However, domestic policy was not formally linked to the measure, the share of people living below the threshold was infrequently published until 2017, and the precise monetary value of the threshold was never published. To implement social assistance programs deprivation was referenced in indirect ways, such as "individuals in need of financial support". Measurement of need in these programs in practice also heavily relied on qualitative judgments from community-level officials, rather than more rigorous quantitative measures that reduce the risk of bias and the role of discretion

[50] Square brackets and emphasis are to clarify context and are not in the official wording of Article 39.
[51] Though this measure began as a conventional minimum wage floor, its use across multiple purposes—such as social assistance payments, fees for public services (e.g., registrations, passports), and administrative and civil fines—eventually led to the measure becoming more of a unit of account with little link to the wage level in the economy.

in the process. As a result, social transfer programs were implemented through a series of discretionary and ad-hoc processes, and without reference to the actual expenditures of the poor to meet their needs.

77. Since 2019, several reforms have transformed the landscape for the assessment of poverty and the relationship between social assistance payment levels and the actual minimum consumption expenditure needs of the poor. In 2019, the government began piloting, with support from the World Bank, a significantly updated Household Budget Survey (HBS) that shifted from antiquated consumption measurement practices to a modern list-based approach of recorded consumption and expenditure. Following the pilot's success, and a major policy shift in early 2020 that (for the first time) acknowledged the existence of poverty in Uzbekistan and the need to combat it, the new HBS was fully rolled out nationwide. The new HBS was a critical pre-requisite for the development of a modern poverty line based on consumption and expenditure—the method preferred in countries, such as Uzbekistan, where large shares of household welfare are derived from own production.[52] Over the last two years, the government has also been developing a comprehensive poverty strategy, comprising improvements to measurement, social transfer policies, strengthening the labor market, and a greater emphasis on inclusive policies as part of the broader market transformation under way. These reforms have also been accompanied by simultaneous measures to strengthen social safety net systems, coverage, and levels of assistance (supported through all three prior DPOs and substantial World Bank and UN engagements).

78. <u>Objective of the prior action</u>: A new poverty line introduced in 2021 represents an important next step towards the systematic measurement and reduction of poverty in Uzbekistan. In April 2021, a new poverty line, the *minimum consumption basket,* was announced by the government.[53] The new line is based on the cost of basic needs—the most common approach to measuring poverty in the world, and is set at UZS440,000 per person per month (about US$41 at market exchange rates). The new poverty line represents a significant shift from current practices in two ways. First, it will result in a substantial increase in the number of people categorized as poor in Uzbekistan. Second, it will change the way that social assistance amounts are set (calculated based on the number of individuals in need). Over time, these adjustments to social assistance amounts are expected to make social safety nets significantly more accessible and poverty reducing than past practice.

Prior Action 6: To better link the social safety net system with the needs of the poor, the Borrower has (i) adopted a new poverty line methodology consistent with international good practice, and (ii) required the new poverty line to be used in the determination of need and the level of social benefit payments made to individuals.

79. <u>Expected results and next steps:</u> The measures supported under this operation are likely to accelerate efforts to reduce poverty and improve the targeting and coverage of the social safety net system. The adoption of the new poverty line method is a critical pre-requisite for the improvement in poverty measurement and social policy reforms. Over the next year, the new poverty line is expected to become the basis for the setting of eligibility criteria and the amount of financial support payable for all major social protection programs (Result Indicator 8). This result is critical in ensuring that social safety nets are adequate and cover the poorest and most vulnerable individuals. The revised method will also play a critical role in strengthening employment and social assistance policies that are being considered under a new social protection strategy. As the government adjusts payment amounts for various types of social assistance payments, however, it will be critical to accelerate accompanying reforms to define clear eligibility criteria and approaches to phasing out benefits alongside rising incomes—which

[52] The alternative is income-based measurement.
[53] Cabinet of Ministers Resolution 544 Dated 27 August 2021

are currently being considered alongside the unified social registry. This will help reduce inefficiencies and perverse incentives already present in the system that encourage informality.

80. **The medium-term focus of poverty reduction and social protection reforms is shifting towards redefining the social contract in Uzbekistan.** Following a first phase of methodological, measurement, and systems reforms, the forthcoming adoption of new poverty reduction and social protection strategies are priorities for the government as it seeks to strengthen and redefine the social contract in Uzbekistan. Both are expected to be approved and adopted for implementation in the next six months and will serve as foundational roadmaps for the next phase of reforms to support Uzbekistan's poorest and most vulnerable citizens.

81. **The measures in this operation will improve the adequacy of social assistance to communities already impacted by climate change and help ensure that those vulnerable to climate change receive adequate levels of support to keep them out of poverty.** In 2020, reforms supported under the third DPO significantly expanded safety net coverage, helping expand the reach of the government's social assistance to communities that were being impacted by the effects of climate change. This includes communities in Karkalpakstan, where some of the poorest citizens in the country live, whose food and nutritional security is adversely being impacted by more frequent droughts, lower soil fertility, and a reduction in the quality of water supply. The reforms enacted in 2020 strengthened the effectiveness of the safety net system, helping to improve its preparedness and agility to respond to the materialization of climate change risks, through more rapid deployments of support to those affected by climate-exacerbated disasters such as increased droughts, floods, mudflows, and avalanches. The reforms supported under this operation build on measures supported under the third DPO by increasing the adequacy of support for poor citizens, including those in climate-affected communities, and by establishing a clear framework for the continued adjustment of the poverty line to ensure support remains adequate.

Equal opportunities for persons with disabilities

82. **Background: Significant institutional and structural barriers stand in the way of persons with disabilities being counted and empowered to meet their basic needs.** Officially, the reported number of persons with disabilities amounts to about 2.1 percent of the population. This is likely heavily underestimated given weaknesses in disability reporting systems and based on recent survey data using internationally developed tools to identify people with functional limitations.[54] Data from UN situational surveys paint a stark picture of constraints in access to public services and opportunities: 25 percent of persons with disabilities do not receive required healthcare services (relative to 10 percent of those without disabilities) and face inordinate physical and bureaucratic obstacles to obtain legally entitled benefits and privileges. 85 percent of buildings and social infrastructure in Tashkent are not adapted for use by persons with disabilities.[55] Children with disabilities have nearly 20 percent less access to pre-school education.[56] Only 46 percent of children and working-age adults with severe forms of impairment are able to access disability benefits.

83. **The challenges are even greater for persons with disabilities to obtain employment.** Persons with disabilities are about four times less likely to find a job than those without disabilities. In 2019, only 8.9 percent of men and

[54] For example, an estimated 15 percent of people around the world have some form of impairment, and about 80 percent of them live in developing countries.[54] These low official figures may be explained by a dated self-reported determination and assessment system. The 2018 baseline survey for the World Bank's *Listening to Citizens of Uzbekistan* found that 13.5 percent of the population aged 3 or over had some form of disability, and 3.5 percent had severe forms of disability.
[55] Findings from the Public Council under the khokimiyat of Tashkent city. ND. "'City for All' project." https://gorod.uz/projects/5.htm.
[56] UN Situational Analysis (2019)

4.4 percent women with disabilities aged 16–59 and 16–54, respectively, were officially employed (7.1 percent overall). The percentage was even lower in rural areas (only 5.8 percent). More than 25 percent of all registered persons with disabilities (162,200 individuals) are recognized as "capable of performing certain types of work." Of these, roughly 6 percent (21,100) are officially employed, though this may be as low as 2 percent.[57]

84. **The absence of a cohesive strategy for the social and economic inclusion of persons with disabilities limits the effectiveness of recent reforms.** Since 2017, several reforms have begun to address some of the constraints that persons with disabilities face. In 2017, a Presidential Decree specified proposals to improve the quality and standard of living of persons with disabilities; to provide them with medical and social assistance; to assist in their realization of rights, freedoms, and legitimate interests; and to play an active role in society. New disability rights legislation went into effect in January 2021 that introduced the principle of non-discrimination on the basis of disability. But the implementation of these reforms is constrained by the lack of a systematic framework for implementation and monitoring. It is also constrained by legal limitations, such as the inaccessibility of courts as a vehicle to pursue disability discrimination cases, and the still-narrow medically based definition of disability.[58]

85. **<u>Objective of the prior action:</u> Uzbekistan's ratification of the United Nations Convention on the Rights of Persons with disabilities (CRPD) represents a significant policy commitment and disciplinary mechanism to accelerate disability inclusion reforms.** Though Uzbekistan had acceded to the CRPD in 2009, it was one of less than 10 countries that had not ratified its accession due to concerns about the legal and budgetary implications of implementing commitments under the CRPD. In May 2021, however, Parliament finally approved a law ratifying Uzbekistan's accession to the CRPD, as one of the first major follow-up measures to its approval of the new disability equal opportunities legislation.[59] Whereas the obligations arising from ratification were previously seen as a financial and legal risk, the same obligations are now seen as an important commitment mechanism to ensure effective implementation of recent reforms, and as a way of aligning and improving the domestic policy environment supporting persons with disabilities with international best practices. Uzbekistan's ratification will also bring with it a disciplinary mechanism in the form of enhanced UN and international monitoring of compliance.

Prior Action 7: To increase the economic inclusion of persons with disabilities, and better align Uzbekistan's legal regime for disability rights with international good practice, the Borrower has enacted a law ratifying Uzbekistan's accession to the Convention on the Rights with Persons with Disabilities.

86. **<u>Expected results and next steps:</u> The measures supported by this operation are likely to accelerate further reforms to improve the economic and social inclusion of persons with disabilities.** Since ratification, several follow-up measures have already been implemented as part of a plan to fully align Uzbekistan's domestic legal and regulatory framework for supporting persons with disabilities with the provisions of the CRPD. Measures enacted between June and October 2021 include expansions of healthcare coverage and entitlements, increases in social allowance payments, and the establishment of a new interdepartmental advisory council on improving disability policies. The first formal national consultation as part of the post-CRPD ratification process has already been held by the UN and Organization for Security and Cooperation to support the government in finalizing a National Action

[57] https://lex.uz/docs/3290919

[58] The United Nations CRPD defines disability as "an evolving concept…[that]… results from the interaction between persons with impairments and attitudinal and environmental barriers that hinders their full and effective participation in society on an equal basis with others."

[59] Law ZRU-695 dated June 07, 2021. The ratification contained one reservation that Uzbekistan did not interpret its commitments under Article 12 (Equality Before the Law) as requiring to fully eliminate substitute decision-making arrangements. This reservation is nearly identical to ones made by several other countries, including Australia, Canada, Ireland, Egypt, and the Netherlands.

Plan. To further strengthen implementation of the law, a broader and more systematic roadmap of reforms to integrate disability inclusion into the broader reform agenda, and to fully align with CRPD commitments, including those in Article 11 relating to climate change, is under development with technical assistance from the World Bank, and is the result supported under this operation. The approval of this roadmap will be an important first step in supporting Uzbekistan's ambitions of fully realizing its obligations under the CRPD.

87. This is an early-stage reform that will require much deeper systems changes to be gradually implemented. Uzbekistan's ratification of the CRPD—and the acceptance of the obligations and monitoring commitments that come with ratification—sends a strong signal of reform intent. It is also a well-sequenced reform, coming after the approval of historic legislation in 2020 to guarantee equal opportunities. The equal opportunities legislation and the CRPD ratification are strong initial policy actions that the government is now committed to following up through consistent measures to include persons with disabilities into Uzbekistan's economy, society, and polity—through improved measurement and counting, wider access to core public services and social assistance, and through broader reforms that reduce physical barriers (e.g., construction codes and standards) sand incentivize inclusion (e.g., wage subsidies or other active labor market measures). These deeper reforms will require more time and a clear implementation strategy. The government is already working with the UN, the World Bank, and other agencies to do this. This policy area also holds strong promise for continued citizen and non-governmental partnerships with government to advance important policy issues. Most of the critical reforms enacted since 2017 have been developed as collaborative projects between government institutions and local non-governmental and citizen groups advocating for greater disability inclusion and better rights.

88. Uzbekistan's ratification of the CRPD will, over time, help increase protections for persons with disabilities, who are disproportionately affected by the effects of climate change. Global evidence suggests that climate change and other natural risks severely and disproportionately affect persons with disabilities, requiring specific and tailored support mechanisms to ensure that they are well protected against such risks.[60] Article 11 of the CRPD obliges governments to ensure that persons with disabilities are included in all protection and safety mechanisms. Together with Uzbekistan's commitments under the SDGs (especially Goal 13 relating to climate change), its ratification of the CRPD requires its government to ensure that all climate-related planning and management is inclusive of, and accessible to, persons with disabilities. A strategy to implement further measures to support Uzbekistan's commitments under Article 11 of the Convention is being developed with technical assistance from the World Bank (Result Indicator 9). Given the government's resolve to achieve its commitments under the CRPD and the SDGs, this measure is likely to help, over time, improve the quality of social services available to persons with disabilities affected by climate change. Regular external assessments of Uzbekistan's progress in implementing its commitments under the CRPD will also create a monitoring and disciplinary mechanism to advance further implementation measures.

[60] An analytical overview of evidence is available at https://bit.ly/30kaIdY

Table 5: DPF Prior Actions and Analytical Underpinnings

Prior Actions	**Analytical Underpinnings** (be specific about the ***key findings*** informing the prior action)
Operation Pillar 1: Stronger market institutions and better management of state-owned enterprises	
Prior Action 1: In accordance with the Borrower's agricultural modernization strategy to increase climate resilience and eliminate state-controlled agricultural production, the Borrower has abrogated restrictions requiring wheat farmers to sell a fixed quota of production to the State at a price regulated by the State to allow farmers to determine their buyers and to set farmgate prices based on market conditions.	Agriculture PER (2021), *forthcoming* Country Economic Memorandum (2021), *forthcoming* SCD (2022) World Bank analytical support on the development of an agricultural modernization strategy (2019), agri-food diagnostic study (2020), growth diagnostic study (2018), agricultural growth assessment (2020), cotton-textile clusters' assessments (2019 and 2020), and cotton pricing reforms (2020). Reports highlight the significant inefficiencies of the state agricultural production system and land tenure and distribution practices, and the many binding constraints it poses on agricultural productivity, individual economic freedoms and welfare, and the long-term climate resilience of the agricultural sector in Uzbekistan. The IFC 2019 Country Private Sector Diagnostic and the World Bank's report Central Asia's Horticulture Sector: Capitalizing on New Export Opportunities in Chinese and Russian Markets (2020) provide an in-depth assessment of the potential for horticulture.
Prior Action 2: To improve the management of state-owned enterprises, the Borrower has submitted a new state asset management law for parliamentary approval that establishes corporate governance and financial transparency requirements for all state enterprises and legislates principles for reducing the number of state-owned enterprises.	*Forthcoming* Country Economic Memorandum (2021), *forthcoming* SCD (2022) Analytical work done under this and previous DPOs, along with support via the Institutional Building Loan (P168180); and analytical support to the government from the EBRD and ADB. Key findings: need for full identification of all SOEs, clear and transparent criteria for ownership and divestiture, stronger financial and operational transparency and independence from state direction, improved cost-recovery of SOEs providing regulated public services, legal and regulatory changes for transparent and competitive privatization, and stronger social safety net and labor market policies to buffer potential displacement costs on those most vulnerable.
Operation Pillar 2: Improved fiscal transparency and accountability	
Prior Action 3: To increase the transparency of public spending and parliamentary oversight of the budget, and to improve the alignment of spending to government priorities, the Borrower has enacted amendments to Articles 45 and 46 of the Budget Code of the Republic of Uzbekistan to expand the composition of the Consolidated Budget of the Republic of Uzbekistan to include off-budget funds of all budgetary organizations and extra-budgetary funds of budgetary organizations.	World Bank Public Expenditure Review (2019), *forthcoming* County Economic Memorandum (2021), IMF Fiscal Transparency Assessment (2018/19), PEFA (2019). The general government's full economic footprint is underreported, with significant off-budget activity, largely from the UFRD and other large off-budget funds. Budget non-transparency, the centralization of the authorizing environment, and limited accountability mechanisms are also identified as potential drivers of inefficient spending. WB TA on national citizen engagement highlight the absence of sufficient local government and citizen ownership in the budgeting process.
Prior Action 4: To strengthen the management of public debt and increase debt transparency, the Borrower has submitted a new debt law for parliamentary approval that (i) establishes objectives for debt management and assigns specific purposes, roles, and responsibilities for debt management; and (ii) establishes legally binding requirements	World Bank/IMF Debt Technical Assistance Mission (2019); Uzbekistan's compliance with World Bank Debt Heatmap recommendations; IMF Technical Assistance on Fiscal Rules (2021).

for debt reporting and the development of an annually updated medium-term debt strategy.	
Operation Pillar 3: Increased economic and social inclusion, especially of women and persons with disabilities.	
Prior Action 5: To modernize labor relations and reduce gender and other discrimination in the labor market, the Borrower has submitted to Parliament for approval a new labor code that (i) introduces equal pay for men and women for equal work; (ii) prohibits discrimination in hiring and labor contract termination; and (iii) establishes and regulates the concept of 'minimum wage'.	*Forthcoming* Systematic Country Diagnostic (2022), World Bank Technical Assistance as part of the UK EGED Trust Funded Project to support the development of the labor code (2021), *Discrimination in Hiring* World Bank Policy Research Paper 9784 (2021) which looks at gender discrimination in Uzbekistan, World Bank Public Expenditure Review and *forthcoming* Country Economic Memorandum (2021)
Prior Action 6: To better link the social safety net system with the needs of the poor, the Borrower has (i) adopted a new poverty line methodology consistent with international good practice, and (ii) required the new poverty line to be used in the determination of need and the level of social benefit payments made to individuals.	*Forthcoming* Systematic Country Diagnostic (2022), World Bank technical assistance support to modernize the Household Budget Survey, revise poverty methodology, and develop a poverty strategy (2019-2021), *Setting a Poverty Line in Uzbekistan* World Bank Technical Note (2021), World Bank Poverty Assessment (2021).
Prior Action 7: To increase the economic inclusion of persons with disabilities, and better align Uzbekistan's legal regime for disability rights with international good practice, the Borrower has enacted a law ratifying Uzbekistan's accession to the Convention on the Rights with Persons with Disabilities.	World Bank Disabilities Inclusion Report (2021), Listening to the Citizens of Uzbekistan Baseline Survey (2018) which included Washington Group questions to estimate number of households with persons with disabilities. UN Common Country Assessment (2020).

4.3. LINK TO OTHER BANK OPERATIONS AND THE WBG STRATEGY

89. This proposed operation is fully consistent with the new focus areas of the 2016-2020 CPF and the 2018 PLR.[61] Adjustments to the CPF were made following a clear signal from the government regarding its intentions to undertake a deeper and broader program of economic and social reform. The first pillar of the PDO is consistent with the first and second focus areas in the revised CPF (supporting a Sustainable Transformation toward a Market Economy and Reforming State Institutions and Citizen Engagement). The second and third pillars of the PDO support the third CPF focus areas of investing in people. Both the revised focus areas under the PLR, and the pillars of the PDO, are consistent with the findings of the first Systematic Country Diagnostic (SCD), and the findings of the nearly-complete second SCD under preparation.[62]

90. Actions supported under this operation align closely with the World Bank Group's strategy to eradicate extreme poverty and promote shared prosperity, and the pillars of the World Bank's COVID-19 Response

[61] The CPF (Report No. 105771-UZ) was discussed by the Board on June 14, 2016; the PLR (Report No. 126078-UZ) was discussed on June 26, 2018.
[62] A second Systematic Country Diagnostic is under preparation for Board delivery in the third quarter of FY22, ahead of a new

Approach. The program pillars are designed to support a systematic and sustainable transformation to a competitive market economy, and that the transformation is underpinned by wide participation, long-term economic stability, and social cohesion. These are key preconditions for sustained poverty reduction. The reforms supported under this pillar are also consistent with the pillars of the approved COVID-19 Response Approach Paper. Actions in the first and second PDO pillars support the third and fourth pillars linked to ensuring sustainable business growth and job creation, and on strengthening policies, institutions, and investments for rebuilding better. The third PDO pillar is consistent with the second pillar of the Approach Paper linked to protecting poor and vulnerable people.

91. The full span of the World Bank Group's operational, analytical, and policy engagements has contributed to this operation. These include: (i) a recent Country Economic Memorandum and two public expenditure reviews; (ii) analytical projects in the energy sectors supporting institutional and regulatory reforms of the electricity and gas sectors; (iii) implementation support for the Agricultural Modernization Project to further deepen the agricultural reform program; (iv) implementation support for the Institutional Building Loan Project to improve fiscal transparency and risk management, and support the SOE reform process; (v) analytical work on citizen engagement, including the *Listening to the Citizens of Uzbekistan* (L2CU) survey which provide support to improve citizen engagement platforms; (vii) several IFC advisory support programs in the financial sector and to support effective PPP management; and (viii) the IFC Country Private Sector Diagnostic for Uzbekistan, which has underpinned the World Bank's engagement and support for private-sector focused reforms that maximize financing for development. Further details are provided in the table of analytical underpinnings (Table 5).

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

92. Public consultation and accountability mechanisms continue to have an impact on the quality of reform implementation. Public feedback has been central to the reform agenda since 2017. One of the earliest social reforms adopted by the government was the establishment of a public regulatory consultation portal and requirements for all major reforms to be publicly consulted, and for public feedback to be considered and responded to, prior to finalization. This portal has supported public consultations on all measures supported under this DPO. Several measures supported under this operation, such as SOE governance reforms, the adoption of a new labor code, and improvements to poverty measurement, were significantly influenced by these public consultations processes. Substantial input from local disability rights groups helped significantly strengthen equal opportunities legislation for persons with disabilities enacted in 2020—the precursor for Uzbekistan's ratification of the CRPD. CRPD ratification was also one of the highest priority actions recommended by non-governmental organizations and other stakeholders working with persons with disabilities.

93. Since 2017, public accountability has continued to evolve from one-way feedback mechanisms into a more dynamic engagement between government and the public. Recent examples of this shift include the development of a new tax code and the passage of new disabilities legislation, where the government opted to co-produce these regulations, from the beginning of the process, through joint taskforces comprising government officials and representative associations such as taxpayer, audit, and disabilities NGOs. Increasing scrutiny from the public and the media have also helped strengthen social accountability. Media investigations have led to strengthened property rights in the event of mandatory land acquisitions, the prosecution and dismissal of public officials for various breaches and offenses (most notably during cotton harvests), higher wages for teachers and medical workers, and expansions in social safety net assistance. Local deliberative bodies are taking a more active role in monitoring the still heavily centralized government service delivery model, and in holding regional officials appointed by the center to account. In addition, virtual "receptions" for public engagement and face-to-face office hours enable the public to

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Country Partnership Framework that will be submitted to the Board in FY22.

meet with senior government officials and members of the Cabinet. While these initiatives are under government control, it is a regulatory requirement for all such officials to hold weekly open office sessions, and to publish information about these sessions online.

94. **The development of reforms to increase the economic and social inclusion of persons with disabilities offer an exemplar of stakeholder engagement.** NGOs of people with disabilities are actively involved in the development and monitoring of legislation. For example, under guidance of the Association of Persons with Disabilities of Uzbekistan uniting 28 organizations of persons with disabilities, contributed to the development of the laws "On social partnership", "On environmental control", and "On the rights of persons with disabilities." These reforms were developed following a highly consultative and collaborative process. A similar process used to develop the new Tax Code also received praise from private sector stakeholders. The replication of such reform development processes—that enable the government to work collaboratively and consultatively with the most relevant stakeholders that benefit from (or are affected by) the reform—across key areas of reforms could help support significant improvements in the quality of reform design and implementation.

95. **The World Bank continues to work closely with other development partners to support the government's reform agenda.** The IMF and the World Bank continue to work closely and collaboratively to assess the adequacy of the macroeconomic framework that anchors their respective operations and engagements. Both agencies remain committed to ensuring that technical assistance is well-coordinated and effective. Several United Nations (UN) agencies have provided considerable analytical and legal support to the government and to the World Bank on measures to strengthen the rights and inclusion of persons with disabilities. The Bank is also working closely with the Asian Development Bank (ADB), the European Union (EU), the Government of Japan, and the Government of France—which are also providing budget support to the authorities—to ensure that the reform agendas supported under respective budget support operations are well coordinated. The Bank is also working closely with European Bank for Reconstruction and Development (EBRD) and the ADB on energy, SOE, Public-Private Partnership (PPP), and financial sector reforms, and with the EU on agriculture and rural development. There is close collaboration with the Governments of Switzerland and France on water sector development, and with the United States Agency for International Development (USAID) on trade and WTO reforms. Finally, the Bank and the ILO continue to share a strong and common interest in eradicating forced labor and improving labor market outcomes.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

96. **The proposed operation is expected to improve the efficient deployment of resources and increase the progressivity of the fiscal and regulatory system.** Of the eight proposed prior actions, five have clear, significant, and direct poverty and/or distributional implications. Three of these four actions are expected to have positive poverty and or distributional implications. These include the new labor code, the adoption of the new poverty line, and Uzbekistan's ratification of the UN CRPD. Two actions could potentially increase the short-term incidence of poverty and/or entail short-term negative social impacts, while at the same time generating progressive distributional outcomes. These are policy actions to reform the agriculture and energy sector. The remaining actions, relating to corporate governance, debt, and fiscal transparency, are expected to have a broadly neutral poverty impact, while generating a potentially positive distributional impact from greater public financial resource efficiency increasing the amount of fiscal space available. Where negative effects are present, they are not unprecedented or

irreversible, and mitigation measures through the social protection system would moderate the expected poverty impacts relating to these actions.

Wheat liberalization

97. **Reforms to the wheat market could increase short-term poverty but could have positive poverty and distributional outcomes over the longer-term.** Increased incomes for about 40,000 farmers, and an estimated one hundred and fifty thousand agricultural workers, are expected to reduce both poverty and inequality. The risk of short-term poverty increasing impacts from the reform stems from a potential increase in consumer prices for bread, flour, and other wheat-based products. In 2020, the state farm-gate price was more than 26 percent below market reference prices, resulting in lost farm income conservatively estimated at about $165 million, which instead was a welfare surplus appropriating to the state. It is likely that a significant portion of this surplus accrued by the state was used to lower consumer prices for flour, bread, and other wheat-based products through subsidized wheat sales to state flour mills. Artificially low prices for bread and flour are socially significant, as bread and wheat products account for a much greater share of food consumption (and total consumption) among the poor than higher income.[63] A reversal of these practices, though not anticipated because of the prior action, could thus increase poverty in the short term by raising consumer prices on goods disproportionately consumed by poor and vulnerable households.

98. **The government is using three mechanisms to mitigate the potential impact of higher wheat prices on poverty.** The first is the potential continuation of one-off support measures through social transfers, like previous measures used to mitigate liberalization of consumer prices between 2017 and 2020. Second, beginning in 2022, the Ministry of Finance will begin the practice of using sales of strategic wheat reserves (about 2.5 million tons between 2022 and 2024) to soften the impact of large short-term price spikes. The final potential mechanism is the continuation of temporary budget support to flour mills to maintain lower flour prices. These direct mechanisms could also be supported by regional wheat market developments that could improve the affordability of wheat for consumers in Uzbekistan. Exports from Kazakhstan are especially uncertain, as falling purchasing power of consumers in Afghanistan (the largest buyer of Kazakh flour) may put downward pressure on regional wheat prices.

99. **Over the medium-term, potential poverty and negative distributional impacts are expected to reduce due to productivity growth, higher farmer incomes, and potential market supply responses to rising wheat prices.** The state procurement practices described above generate large distortions in agricultural markets that limit productivity growth. Since 2010, Uzbekistan's agricultural value-added per worker rose by less than any other country in Central Asia, and by much less than either the average in ECA or lower middle-income countries elsewhere in the world. As these distortions are increasingly addressed, productivity improvements and improved market mechanisms (including clearer price signals that provide efficiency and production incentives) are expected to stabilize the market for wheat and flour at a more efficient and socially beneficial equilibrium.

100. **The fiscal implications of the reform and of available mitigation mechanisms will depend how consumer prices evolve following the 2022 wheat harvest**. Previous mitigation programs to address the impact of social bread reform through the social protection system included top-up transfers of 50,000 soms per beneficiary family per month, equivalent to an annual budget of about $98 million in total. This could be considered an upper bound on direct social protection spending in the upcoming phase of reform, as future wheat price liberalization is not expected to affect consumer prices to the same extent as previous actions (which directly liberalized controls on consumer prices). The limitation of transfer-based approaches in this context is the potential for exclusion error, whereby poor

[63] Based on World Bank estimates from 2018 and 2019 data, bread and flour products constitute up to 20 percent of expenditure of the poorest decile of households in Uzbekistan, but just over ten percent of the top decline.

households are not included in social transfer programs and therefore do not receive social support to offset the impact of rising prices. In contrast, using alternative approaches such as selling wheat reserves and subsidies to flour mills would reduce consumer costs in a broad and untargeted way. But the fiscal cost of implementing these two mitigation approaches is unclear and contingent on the magnitude of potential consumer cost increases. Because they are indirect with respect to consumers and untargeted with respect to need, they are likely to prove more costly than transfers to achieve similar protection for poor and vulnerable populations.

101. Using a variety of media, the government has begun to communicate the motivation for the reforms and will rely on its previous experiences with bread price liberalization reforms to communicate potential negative impacts to the public. The liberalization of bread prices, supported under the second DPO, provided a useful learning opportunity for the government in both the design of additional safety net support to mitigate poverty impact, and in ways to effectively communicate its reform intentions and its social support measures to the public. Between now and the 2022 harvest, the World Bank and the Government of Uzbekistan will work closely together to assess potential impacts and develop an effective communications strategy to ensure that any potential negative impacts and additional support measures are well signaled and communicated to the public. In addition, the World Bank will support the government's monitoring of the impact of this reform on individuals' welfare, following the 2022 harvest, using the monthly L2CU survey, price surveys, and local media. If necessary, the World Bank will make recommendations for additional mitigation measures.

Labor code

102. Implementing a modern labor code is expected to generate net poverty reduction and progressive distributional impacts. A World Bank assessment of the new labor code found that it followed international good practice and is expected to improve labor relations and the inclusiveness of employment in Uzbekistan. As the primary source of household income in Uzbekistan, employment and the fairness of labor market institutions are among the most decisive drivers of poverty reduction.

103. Female underrepresentation in economic opportunities is likely due in part to gender discrimination in wage setting. Wage discrimination between men and women is currently not prohibited in (pre-reform) labor law, contributing to lower incomes for women for work equal to that of men, muted incentives for employment, and as a result, wage inequality and poverty risks. The new labor code prohibits this practice. The gender gaps in income and labor force participation are also likely due in part to gender discrimination in hiring practices, which is prevalent and economically significant in Uzbekistan. An audit study conducted by the World Bank in 2020 found that strong gender preferences among employers contribute to the gender segmentation of the labor market. Reforms in the new Labor Code prohibit such discrimination in hiring (or firing) practices in Uzbekistan for the first time.

104. Based on ILO data for 75 countries, the minimum wage level is most frequently set at around 40 percent of mean wages. However, the current ratio of the nominal legal minimum wage to median wage (so-called Kaitz index) of 0.29 in Uzbekistan is low. Establishing a tri-partite consultation mechanism (including labor representatives) for setting the official minimum wage is expected to increase the income of low-wage workers and consequently decrease poverty. There are no adverse employment effects expected as a result of this process.

New Poverty Line

105. Implementing the reforms covered in Prior Action 6 to establish a minimum consumption basket (poverty line) and focus social programs on the needs of the poor is expected to have direct poverty reducing impacts. According to the Resolution 544 of the Cabinet of Ministers, the explicit objective of setting a poverty line was to improve systems to identify people who have insufficient means to obtain the necessities of life, and to use this information to implement programs that reduce poverty and provide social support to improve the wellbeing of poor people. The decree states that beginning in 2022, the monthly per capita income criterion used to recognize a family as low-income through the information system "Single Register of Social Protection" will be increased to the newly established poverty line, increasing the number of families identified as poor and thus formally eligible for social assistance and other protection programs.

Convention on the Rights of Persons with Disabilities

106. Implementing the Convention on the Rights of Persons with Disabilities is expected to have direct poverty reducing impacts and progressive distributional impacts. These effects are expected primarily via improved employment opportunities for people living with disabilities, with additional impacts in improved access to essential services including healthcare and transportation. In 2017, there were 346 thousand officially registered people with disabilities of working age and only 5 percent were employed at that time. Lower rates of labor market participation are the most important channel through which disability can lead to monetary poverty. Data from the situation analysis on children and adults with disabilities in Uzbekistan in 2019 found barriers to accessing essential services that limit education and training opportunities for people with disabilities, preventing the accumulation human capital. A recent survey of people with disabilities found that only 84 percent of people with disabilities report access to education compared to 99 percent for persons without disability, and about 51 percent of people with disabilities report access to professional secondary education compared to 97 percent of persons without disability. The Convention requires progressive realization of equal social and economic rights including "reasonable accommodation" and "universal design" that would narrow these gaps as provisions are implemented.

107. In addition, the social objectives of this prior action interact with the Labor Code reforms in Prior Action 5. The new labor code implements commitments described in the convention including the prohibition of discrimination against people with disabilities, additional leave provisions, as well as the use of social quotas for employment promotion and to expand equitable opportunities for people with disabilities.

5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

108. The existing Environmental Impact Assessment (EIA) and management system in Uzbekistan is robust and undergoing renewal to ensure it can meet the needs of a transitioning economy. EIAs are required for activities that are regulated under four categories of incrementally higher environmental risk. EIAs are conducted in either one or two stage processes, depending on the level of environmental risks arising from activities. Higher-risk projects require a two-stage process with draft declarations on environmental impact required at an early stage of the decision-making process, before projects are approved and financed, and a declaration of environmental consequences required after project construction and before commissioning. Capacity constraints, however, likely affect how well these standards are enforced in Uzbekistan, but this is likely to improve over time as the government increases its ambition and attention to environmental policy issues. Since 2018, the State Committee for Ecological and Environmental Protection has also been empowered to require a three-stage EIA process for certain very high-risk projects. EIAs are subject to time limits and require public participation. Environmental legislation also allows public ecological expertise—through NGOs or citizens—to conduct public ecological expert reviews of proposed activities. The conclusions of such reviews can constitute additional advisory material by the government before a final decision is made. Although this EIA process is relatively well established and enforced, the government has recognized the need for modernization, transparency, and institutional strengthening.

109. The government is continuing to make progress in addressing gaps in the EIA framework. The new Environmental Code, which is being drafted with support and inputs from the World Bank, is being designed to overhaul and modernize the existing environmental management system. Improvements are expected to include improved environmental standards, extended time limits to allow for more robust EIAs to be conducted, and greater conformity with international conventions relating to EIAs and public participation in environmental matters as well as expanded scope of EIA coverage to include transboundary contextual assessments. The government is also working closely with several development partners, including the United Nations Environment Program and the United Nations Economic Commission for Europe. With the UN support, Uzbekistan is also in the process of introducing Strategic Environmental Assessment requirements for sector-wide reforms, which is relevant for several focus areas of this DPO. In 2019, Uzbekistan became a signatory to the Stockholm Convention on the Persistent Organic Pollutants (POPs), recognizing the impact of the chemical sector in Uzbekistan on the environment. In September 2020, the Cabinet of Ministers approved the digitization of existing EIA processes and introduce strengthened and mandatory stakeholder consultations for high and substantial risk projects.

110. The government has significantly strengthened its focus on environmental issues in recent years. A new National Biodiversity Strategy and Action Plan was adopted in June 2019 to expand protected areas to 12 percent of Uzbekistan's territory by 2028, increase forestation of the Aral Seabed to 1.2 million ha by 2028 and integrate biodiversity conservation issues into all sectors of the economy.[64] In October 2019, the authorities approved a new strategy (Presidential Resolution 4477) and implementation measures to accelerate Uzbekistan's transition to a greener economic model. The main goal of this strategy is to achieve sustainable economic growth and social development in ways that reduce greenhouse emissions, strengthen climate and environmental sustainability, and integrate "green" principles into the ongoing structural reform agenda. The focus areas for implementation measures include (i) energy efficiency; (ii) adaptation and mitigation to climate change; and (iii) improved environmental policy implementation. Expected results by end-2030 include the achievement of the government's greenhouse emissions target under its INDC, a doubling of energy efficiency, a halving in the carbon intensity of GDP, one-third of energy produced by non-hydro renewables, at least a 20 percent increase in industrial energy efficiency and improvements in industrial environmental practices, expanded use of electric vehicles in the country, increased water efficiency through a target of 1 million ha under drip irrigation cultivation and a 20 to 40 percent increase in crop yields, and the achievement of neutral land degradation balance. In addition to these measures, the government is in the process of adopting a revised environmental code to modernize the environmental regulatory framework and is also working with the World Bank and the Global Green Growth Institute to identify opportunities to apply circular economic principles in relevant sectors of the economy.

111. Measures supported by this operation are largely expected to have neutral environmental impacts, and three actions could generate positive environmental impact with careful management of environmental policy issues. Based on the application of the provisions of the World Bank Toolkit,[65] actions pertaining to wheat, energy, and SOE reform will need careful integration of environmental policy issues to avoid longer-term adverse environmental impacts. While these actions have the potential to generate considerable positive effects, such as strengthening environmentally friendly practices, improved natural resource management, and the use of climate change adaptation technologies, there are also risks of land and biodiversity degradation, soil and water pollution, occupational hazards, and poorly managed legacy environmental liabilities.

112. The abolition of wheat quota and state-controlled prices on wheat is a building block of the larger agricultural modernization strategy to transition to climate-smart and climate-resilient agriculture. This transition is crucial to adapt to climate related vulnerabilities affecting Uzbekistan's agriculture. The effect is expected to be positive in that it is expected to lead to crop diversification, increased farmer incomes and as a result in increased

[64] To achieve this goal, an afforestation program has started covering about 700,000 hectares (ha) of dry Aral Seabed with drought-resistant plants, representing a 40 percent increase from the previous year.
[65] "Assessing the Environmental, Forest, and Other Natural Resource Aspects of Development Policy Lending" http://www.wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2010/08/18/000356161_20100818054032/Rendered/PDF/561680WP0Box341IC10WBDPLTooklitCRA1.pdf

incentive towards new land and irrigation system investments that address and are adapted to context specific climate related challenges such as water shortage, extreme climate events and declining soil productivity.

113. Efforts to strengthen SOE corporate governance will need further follow-up measures to ensure that pollution and other environmental legacies are well-managed. The preservation of natural resources and environmental management have been explicitly included as core principles of the new law and the definition of state asset and property management. This helps set the framework for more effective management of pollution and other environmental legacy issues that may be linked to SOE operations. This framework will need further development through follow-up regulatory measures to establish clear guidelines as to how these legacies are identified and defined, how they will be addressed, and what the respective responsibilities of government and any subsequent new owners of SOEs would be. These could include abandoned industrial sites, abandoned agrichemical storage facilities, fully degraded lands, abandoned former collective cattle farms, etc., all of which could continue to be pollution sources.

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

114. The 2018 PEFA assessment highlights the strength of Uzbekistan's upstream public financial management (PFM) system in contrast to relatively weaker downstream systems. Fifteen out of 31 indicators were rated A or B, while 16—mainly downstream indicators—were rated C or D. Public finances have become more transparent through increased budget and debt transparency. There is also some progress in other areas, such as procurement, audit, financial reporting, financial reporting, subnational transfers, and the production of adequate performance information for service delivery. There are also some weaknesses in the management of public assets and liabilities that create fiscal risks. The Public Expenditure and Financial Accountability (PEFA) report on Uzbekistan also highlighted the weak areas related to policy-based fiscal strategy and budgeting, such as macroeconomic and fiscal forecasting, fiscal strategy, medium-term fiscal management, and the budget preparation process.

115. The government has taken credible steps to develop and implement an ambitious PFM reform strategy. This strategy covers a range of measures aimed at strengthening budget preparation and execution, public sector accounting, treasury systems, as well as improving legislative base for PFM reforms. The Treasury Single Account (TSA) has been introduced and made functional. In addition, the government has made progress on implementation GFS-2001 compliant Chart of Accounts, and interim financial management information system (FMIS). Uzbekistan's procurement systems are largely assessed to be robust in their design, with the main gaps linked to the systematic use of more competitive procurement methods.[66] To address these gaps, the government adopted new procurement legislation and a new e-procurement system that strengthens mandates for the use of competitive procurement and significantly strengthens controls over the use of direct procurement methods. Procurement reforms have also supported the establishment of an internal portal established to post information related to tendering processes. There has been significant progress in improving budget preparation and approval processes, including increased transparency and accountability. The general government budget is now publicly available online both prior to approval for public consultation and published following approval in online and printed formats. Since 2018, an annual "Citizens Budget" document has also been published each year that provides budget information to citizens in plain language and in a more accessible information format. Debt management systems have also improved, and

[66] The 2019 PEFA assessment assigned a "B" rating to the overall procurement system—largely the result of a "D" rating assigned to procurement methods. Data provided at the time of assessment showed that 42 percent of procurement in the previous fiscal year was conducted competitively, and 58 percent was awarded directly.

the government is in the final stages of upgrading and adopting a new debt management system, debt legislation, and a medium-term debt strategy.

116. Progress to strengthen the Chamber of Accounts (CoA), the country's Supreme Audit Institution, is still in the initial phases of its development. A new law to strengthen the CoA was approved by Parliament in July 2019, which clarifies and expands the institutional mandate of the CoA to go beyond financial and compliance audits to include regular efficiency and performance audits of government agencies. Staffing levels have increased, and the CoA is routinely conducting compliance and financial audits. Limited progress has been made on efficiency and performance audits, but the more urgent priority is the need for alignment of Uzbekistan's public audit practices with international standards of supreme audit institutions. The government continues to implement comprehensive reforms to strengthen capacity of CoA staff to enable them to transition from basic financial information validation audits to compliance and performance audits. The government is also investing in the introduction of the IT-based tools and solutions for strategic and annual audit planning, fieldwork, reporting, monitoring of recommendations, and audit quality control.

117. The foreign exchange control environment at the Central Bank of Uzbekistan (CBU) is assessed to maintain overall adequate operational control over its exchange reserve management. The CBU has been audited regularly by internationally recognized audit firms and received satisfactory audit reports. In particular, the 2020 audit of the CBU's consolidated financial statements was conducted by an international audit firm, which issued an unmodified opinion on the financial statements.[67] However, financial statements are not prepared in accordance with IFRS, but rather in accordance with internal accounting and reporting procedures issued by the CBU. The audit was conducted in accordance with International Standards on Auditing (ISA). The audited financial statements of the CBU are not made publicly available and the Audit Report is for restricted official use. The accompanied Management Letter issued by the auditor did not report any internal control issues.

118. An IMF safeguards assessment for the CBU has not yet been conducted, and the World Bank will therefore apply additional mitigation measures to mitigate fiduciary risks. Although fiduciary risks are moderate, the absence of an IMF safeguards assessment for the CBU has served as a basis for the application of additional fiduciary safeguards. For this operation, this will involve the opening of a Foreign Currency Dedicated Account for the operation. The Bank will also require that the Foreign Currency Dedicated Account be audited by an auditor acceptable to the World Bank, on terms of reference acceptable to the World Bank. The Audit Report will be submitted to the World Bank within five months after fiscal year ending on December 31. The government has requested the IMF to conduct a safeguards assessment, and an assessment is likely to be conducted in the next 12 months. Upon completion of this assessment, these mitigation measures could be considered for removal in future operations.

119. Funding under this operation would be made available to the government upon the effectiveness of the Loan and Credit Agreements and the submission of withdrawal application for the loan and credits and provided the Borrower has carried out the Program in a satisfactory manner and its macroeconomic policy framework is adequate. The proceeds of the loan and credits will be disbursed into a Foreign Currency Dedicated Account that will form part of the country's official foreign exchange reserves held by the CBU and will be opened in the name of the Ministry of Finance. All withdrawals from the loan and credits in this operation will be deposited by the Bank into this dedicated account. Within 5 business days following the deposit of the amount of the loan and credits into this account, the Borrower will transfer the amount from the loan and credits into the TSA (US dollars and/or Uzbekistan soms). The Borrower, within 30 days after the withdrawal of the loan and credits from the dedicated account, will report to the Bank: (i) the exact sum received into the dedicated account; (ii) the details of the account to which the

[67] 2019 Audit reviewed on October 19, 2020.

equivalent of the proceeds of the loan and credits in this operation will be credited; (iii) the record that an equivalent amount has been accounted for in the Borrower's budget management systems; and (iv) the statement of receipts and disbursement of the dedicated account.

120. The Ministry of Finance is responsible for the proposed operation's administration and for the preparation of the withdrawal application, maintaining the dedicated account, as well as the TSA. The Ministry of Finance, with the assistance of the CBU, will maintain records of all transactions under this operation in accordance with sound accounting practices, and the proceeds of this operation will be promptly accounted for in the country's budget management system using the country's regular procedures for such accounting. Following reforms in 2019, the government budget is also now publicly available for consultations prior to approval and published in full following parliamentary approval.

121. If, after funds are deposited in the dedicated account, proceeds from the loan and credits in this operation are used for ineligible purposes, those proceeds will be refunded to the World Bank. Amounts refunded to the Bank in respect of excluded expenditures (as defined in the General Conditions) will be cancelled from the loan and credits.

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

122. The Ministry of Finance is responsible for the implementation of the program supported by the proposed operation. As the main implementing agency, the Ministry of Finance will coordinate with other government agencies involved in the implementation of the operation, including the Presidential Administration, the Office of the Cabinet of Ministers of Uzbekistan, the Central Bank of Uzbekistan, the Ministry of Economy, the Ministry of Agriculture, the State Asset Management Agency, the Ministry of Mahalla and Family Support, the Oliy Majlis, the Ministry of Employment and Labor Relations, the Development Strategy Centre, the Center for Economic Research under the Presidential Administration, and the State Committee on Statistics. The Ministry of Finance will work with these institutions to collect the necessary data of assess implementation progress and evaluate results. The technical capacity of these institutions is adequate to perform regular monitoring of the indicators and outcome measures shown in the monitoring and results framework of the policy matrix (Annex 1).

123. Grievance redress. Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche-release conditions under a World Bank's Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the World Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed to address pertinent concerns. Affected communities and individuals may submit their complaint to the World Bank's independent Inspection Panel, which determines whether harm occurred, or could occur, due to World Bank non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

6. SUMMARY OF RISKS AND MITIGATION

124. The overall risk to the operation is moderate as Uzbekistan nears five years of a strong, sustained, and systematic reform program. Political and governance risks have moderated significantly since 2017 as reforms continue to enjoy strong political and public backing. Although the complexity of reforms has increased, for example in areas such as factor market and SOE reforms, the government has established a track record of ameliorating negative social impacts, creating new economic opportunities, maintaining strong economic management, and strengthening citizen and media engagement processes. Although the COVID-19 crisis increased implementation challenges for the government, it has also provided momentum to accelerate change processes in health and social safety net systems and created opportunities to build a more resilient economy. These changes are likely to further moderate the risk environment in Uzbekistan over the longer-term. Nevertheless, the complexity of the next phase of reforms envisioned by the government, and the continued management of the COVID-19 crisis, requires careful management of economic and social risks, increased focus on greater transparency and accountability of government actions, and a firm commitment to maintaining macroeconomic discipline to rebuild buffers over the medium term. The most significant risk to this operation is institutional capacity. Other risks are assessed to be moderate or low (Table 6).

125. Institutional risks remain substantial due to the impact of the COVID-19 pandemic, the fast pace of reforms, and still-new institutional frameworks. The impact of COVID-19 on administrative capacity has been hard, in both the expanded breadth of challenges that the authorities are confronting, as well as infection risks to public officials. Institutions continue to remain under substantial pressure to maintain a strong pace of reforms. These challenges are compounded by the high level of centralization which creates significant pressures on administrative capacity. The situation is improving, albeit slowly, with an increased number of sector line ministries being tasked with responsibilities to reduce pressures on core central agencies. These measures also allow sector ownership of reforms. But many of these institutions are new, and it will take time to identify and recruit expert talent in sectors that have long been managed through vertically integrated SOEs. It will also take time for these new institutions, such as those in the energy and transportations sectors, to develop clear sector strategies and policies, and to enforce strong governance over the sector. The government is well-aware of these risks and is working closely with the World Bank and other institutions to receive expert assistance and policy advice.

126. The government's strong partnerships with development partners, institutional reforms, and continued efforts to attract high quality talent to the public sector are helping to moderate institutional risks. Uzbekistan's reform agenda is supported by a wide range of bilateral and multilateral development partners that are providing high quality technical assistance. Institutional reforms to strengthen public data transparency and public accountability have also helped mitigate institutional risks, although there is room to further strengthen public accountability through strengthened citizen engagement processes. Reforms to reduce bureaucracy and strengthen public sector management are also gathering pace following the presidential approval, earlier in 2021, of a public sector administration reform roadmap to strengthen public sector performance and accountability. Simultaneously, the government is actively making efforts to attract global experts and diaspora talent that are willing to build and supplement administrative capacity. Although progress is being made to decentralize government functions and fiscal responsibilities, further reforms are needed to reduce the high level of administrative centralization.

127. The government has taken several positive measures to mitigate social risks to the reform process. To minimize social risks, almost all reforms go through a process of public consultation,[63] and reforms with large poverty and social impact are accompanied by analysis-based mitigation measures, such as additional increases in social assistance payments. This approach was used successfully in previous reforms to liberalize bread prices and increase energy tariffs and will be used to mitigate potential social risks in this operation, such as those arising from Prior Action 2 (Energy reform). The government has also increased its efforts to communicate and disseminate information about progress with reforms more frequently and has become more open to citizen and media engagement and feedback. Greater media scrutiny of government policies and the conduct of public servants has led to several instances where significant policies have been completely overhauled to address weaknesses. In addition, the government has also prioritized reforms that help deliver quick and visible results to citizens, particularly through reforms in agriculture, improvements in public service delivery and transparency, the removal of *propiska* controls, and the expansion of social safety nets. Prior to the crisis, measures to increase inclusion had already begun to have an effect through higher rural incomes and increased private consumption in the economy, creating strong public support for continued reforms.

128. Macroeconomic risks to the reform agenda remain moderate but require careful monitoring. Strong fiscal and external buffers continue to moderate risks to the reform agenda. Despite significant macroeconomic headwinds in 2020 and the first half of 2021, public debt is projected to stabilize at a modest level of about 40 percent of GDP within the next two years. Slowing credit growth, improving monetary policy transmission and continued exchange rate flexibility are helping to contain inflation risks and reduce risks to the financial system at a critical point in the financial sector and SOE reform and privatization process. Continued attention is needed on strengthening the central bank's independence and capacity to conduct monetary policy and bank sector supervision, managing the fiscal risks from SOE operations and PPP projects, and improving the efficiency and effectiveness of budgetary institutions. The World Bank and other development partners are supporting government efforts in each of these areas.

Table 6: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	Moderate
2. Macroeconomic	Moderate
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Low
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Moderate
7. Environment and Social	Moderate
8. Stakeholders	Moderate
9. Other	Moderate
Overall	Moderate

.

ANNEX 1: POLICY AND RESULTS MATRIX

Prior actions and Triggers	Results		
Prior Actions under this operation	**Indicator Name**	**Baseline**	**Target**
Pillar 1: Stronger market institutions and better management of state-owned enterprises			
Prior Action 1: In accordance with the Borrower's agricultural modernization strategy to increase climate resilience and eliminate state-controlled agricultural production, the Borrower has abrogated restrictions requiring wheat farmers to sell a fixed quota of production to the State at a price regulated by the State to allow farmers to determine their buyers and to set farmgate prices based on market conditions.	**Result Indicator 1:** Convergence of prices paid by government for wheat with domestic market prices.	Price set annually by regulatory decree **(January 2021)**	Price paid per ton of wheat by the government for public grain reserves is within a 5% range of the market price determined in the Commodity Exchange **(end-December 2023)**
Prior Action 2: To improve the management of state-owned enterprises, the Borrower has submitted a new state asset management law for parliamentary approval that establishes corporate governance and financial transparency requirements for all state enterprises and legislates principles for reducing the number of state-owned enterprises.	**Result Indicator 2:** Improved supervisory oversight of SOEs, as measured by the number of top 30 state-owned enterprises, classified by size of balance sheet assets, for which the State Asset Management Agency has selected and appointed independent supervisory board members, in line with OECD corporate governance principles	Zero **(January 2021)**	At least 20 **(end-December 2023)**
	Result Indicator 3: Improvement in the climate change and environmental governance of state-owned enterprises.	No specific legal requirements for SOE corporate governance to account for environmental	Approved implementation roadmap in place for the transition of SOE

Prior actions and Triggers	Results		
		and climate change risks. **(January 2021)**	operations to more sustainable and climate-friendly business practices, consistent with requirements under the new Asset Management Law. **(end-December 2023)**
Pillar 2: Improved fiscal transparency and accountability			
Prior Action 3: To increase the transparency of public spending and parliamentary oversight of the budget, and to improve the alignment of spending to government priorities, the Borrower has enacted amendments to Articles 45 and 46 of the Budget Code of the Republic of Uzbekistan to expand the composition of the Consolidated Budget of the Republic of Uzbekistan to include off-budget funds of all budgetary organizations and extra-budgetary funds of budgetary organizations.	**Result Indicator 4:** Improved alignment of consolidated government spending to government priorities relating to climate change and environment.	No methodology exists for the classification and scoring of public expenditures against government environmental and climate change priorities. **(January 2021)**	Approved methodology in place and being piloted for the classification and scoring of public expenditures against government environmental and climate change priorities. **(end-December 2023)**

Prior actions and Triggers	Results		
Prior Action 4: To strengthen the management of public debt and increase debt transparency, the Borrower has submitted a new State Debt debt law for parliamentary approval that (i) establishes objectives for debt management and assigns specific purposes, roles, and responsibilities for debt management; and (ii) establishes legally binding requirements for debt reporting.	**Result Indicator 5:** Increased parliamentary oversight of the government's medium-term debt strategy.	No Medium-Term Debt Strategy in place. **(January 2021)**	A Medium-Term Debt Strategy has been approved by the government and at least one annual debt report has been submitted to Parliament **(end-December 2023)**
	Result Indicator 6: Improvement in climate and environmental related debt reporting.	No regulatory requirements exist for the government to report on purpose-specific impact bonds. **(January 2021)**	Secondary regulations have been approved to require government to produce allocation impact reports for purpose-specific impact bonds, and at least one allocation impact report which includes climate-specific objectives has been published. **(end-December 2023)**
Pillar 3: Increased economic and social inclusion, especially of women and persons with disabilities.			
Prior Action 5: To modernize labor relations and reduce gender and other discrimination in the labor market, the Borrower has submitted to Parliament for approval a new labor code that (i) introduces equal pay for men and women for equal work; (ii) prohibits discrimination in hiring and labor contract termination; and (iii) establishes and regulates the concept of 'minimum wage'.	**Result Indicator 7:** Increased enterprise compliance with new labor regulations prohibiting gender and other forms of discrimination, and requiring equal pay for men and women.	Regulations did not exist. **(January 2021)**	At least 60 percent of all labor code compliance audits and investigations conducted by the Ministry of Labor and Employment Relations

Prior actions and Triggers	Results		
			include checks of new labor code regulations. **(end-December 2023)**
Prior Action 6: To better link the social safety net system with the needs of the poor, the Borrower has (i) adopted a new poverty line methodology consistent with international good practice, and (ii) required the new poverty line to be used in the determination of need and the level of social benefit payments made to individuals.	**Result Indicator 8:** Increased usage of the new poverty line in social assistance programs, as measured by the share of total public expenditure on regular (non-emergency) social assistance programs that are based on program criteria determined by the new poverty line (eligibility thresholds and/or the setting and indexation of benefit amounts).	Zero. **(January 2021)**	At least 80 percent **(end-December 2023)**
Prior Action 7: To increase the economic inclusion of persons with disabilities, and better align Uzbekistan's legal regime for disability rights with international good practice, the Borrower has enacted a law ratifying Uzbekistan's accession to the Convention on the Rights with Persons with Disabilities.	**Result Indicator 9:** Strengthened institutional frameworks that supported greater inclusion of persons with disabilities, and their protection from future vulnerabilities, as measured by the presence of a national implementation plan to progressively realize Uzbekistan's obligations under the United Nations Convention on the Rights of Persons with Disabilities (CRPD).	Uzbekistan's accession to UN CRPD not ratified. **(January 2021)**	A national implementation plan, which includes strategies to reduce the impact of climate change risks on persons with disabilities, has been approved and is under implementation. **(end-December 2023)**

ANNEX 2: FUND RELATIONS ANNEX

Republic of Uzbekistan—Assessment Letter for the Asian Development Bank and the World Bank
November 8, 2021

Recent Developments and Outlook

1. **Uzbekistan has been significantly impacted by the COVID-19 pandemic, although the country has fared relatively better than many of its peers.** Reported COVID-19 cases peaked in the summer of 2020 and again in the summer of 2021 but have been declining recently. The pandemic struck the economy the hardest in the second quarter of 2020 when activity fell sharply. The authorities responded quickly and decisively with measures to support lives and livelihoods, boosting health and social spending, as well as support for businesses affected by the crisis. As a result, activity started to bounce back in the second half of the year, growing at around 1.7 percent for the year 2020 as a whole.

2. **With the authorities’ strong policy reaction, the economic recovery has continued in 2021, with growth projected to exceed 6 percent this year.** Support measures were extended into 2021, while restrictions on mobility have been largely lifted. Vaccinations accelerated in the last few months and by end-October 2021 some 20 percent of the population had been vaccinated. Output losses due to the pandemic have been recovered, except in some sectors such as tourism, but output and income levels remain below pre-pandemic projections. Inflation remains above 10 percent, mainly due to higher food prices and supply constraints, reflecting global trends. With tight monetary policy, inflation is expected to gradually decline over the medium term toward the Central Bank of Uzbekistan’s (CBU) 5 percent target.

3. **The current account deficit narrowed in 2020 as domestic demand fell but is projected to widen to about 6 percent of GDP in 2021 as imports pick up faster than exports with the recovery in domestic economic activity.** Remittances have held up remarkedly well and have shown an increase so far this year. The current account deficits continue to be financed mostly by official financing and portfolio investment, with the government as well as some state-owned banks successfully tapping international capital markets, while foreign direct investment remains relatively modest. International reserves are projected to remain stable at around US$35 billion by end-2021 (equivalent to 14 months of imports).[68]

4. **Risks to the outlook include the evolution of the pandemic, commodity price fluctuations, and trade developments.** A resurgence of infections and a slower-than-expected rollout of vaccines could slow, or even reverse, the recovery. Uzbekistan would also be adversely affected by slower growth in

[68] At the time of the 2021 Article IV consultation (IMF Country Report No. 2021/085), Uzbekistan’s external position was assessed as broadly consistent with economic fundamentals and desirable policies.

trading partners' economies, and volatility in commodity prices, particularly gold. A tightening of global financial conditions could adversely affect Uzbekistan's borrowing costs and access to capital markets.

Economic Policies

5. **The 2021 budget appropriately maintained an accommodative fiscal stance.** The overall fiscal deficit (including policy lending) is projected to increase by about 1½ percentage points to 6 percent of GDP. The budget continued to provide additional expenditures for healthcare and vaccination, as well as investment, while further expanding social assistance. The budget also included public wage increases, following last year's wage freeze, to catch up with inflation. The deficit will be mainly financed from external sources, including budget support from multilateral (Asian Development Bank and the World Bank) and bilateral partners and the issuance of Eurobonds. A relatively small part of the deficit is financed through domestic treasury bill issuances, reflecting the relatively shallow domestic financial markets, and receipts from privatization.

6. **Uzbekistan remains at a low risk of debt distress and the authorities are committed to ensure fiscal sustainability.** Public and publicly guaranteed (PPG) debt is projected to reach 40 percent of GDP by the end of 2021, in part due to the expansionary fiscal policies necessary to mitigate the impact of the pandemic. The authorities aim to bring the budget deficit back to around 3 percent of GDP in the years ahead—starting with the budget for 2022, as support measures are phased out and with revenues supported by the recovery and continued high gold prices—and to introduce a set of fiscal rules by adopting a new debt law that will set a limit of 60 percent of GDP for PPG debt and incorporating limits for the annual budget deficit and new guarantees in the Budget Code. With the planned gradual fiscal consolidation, PPG debt is projected to peak at 43 percent of GDP in 2022, before gradually declining to around 40 percent of GDP over the medium-term (consistent with the recent Debt Sustainability Analysis (see *IMF Country Report No. 21/085*). High international reserves (at about 50 percent of GDP) and low rollover risks, due to the long maturity of the debt, also significantly reduce the risk of debt distress.

7. **The CBU's relatively tight monetary policy stance remains appropriate to achieve a gradual reduction in inflation.** The CBU has kept its policy rate at 14 percent since September 2020, firmly positive in real terms. In the near term, however, inflation is expected to remain elevated due to food and commodity price pressures, while energy tariff increases could further add to inflation. The CBU remains ready to tighten policy if needed. It continues to allow the exchange rate to adjust to market conditions, with a neutral intervention policy whereby purchases of locally produced gold are offset by sales of foreign exchange. In the first ten months of 2021, the UZS/USD exchange rate depreciated by 2½ percent.

8. **Banks appeared resilient during the pandemic, although non-performing loans (NPLs) have increased.** Banks entered the crisis with relatively strong capital buffers and were instructed to refrain from paying dividends, and the CBU closely monitored banks. NPLs have increased to 6 percent by end-August 2021 but remain relatively modest. Still, the full effects of the pandemic, and the high credit growth in prior years, on the quality of loans may yet emerge. Loan portfolios show high concentration and foreign currency risks, with large exposures to SOEs and with some banks heavily exposed to specific sectors, while accounting standards need to be improved. Reforms are underway, with improvements in

state-owned banks' governance and the start of their privatization, but further efforts are needed as state-owned banks still dominate the sector, while the level of financial intermediation is low and dollarization is high.

9. **The pace of structural reforms slowed somewhat due to the pandemic, but the authorities remain committed to advancing reforms**. They continue to strengthen key economic institutions, supported by sizable technical assistance. Governance is being improved, with increased transparency of public procurement and improved reporting and management of SOEs, and the planned introduction of asset declaration requirements. Efforts to improve tax administration and statistics are also continuing. The authorities plan further energy sector reforms, including tariff reform as tariffs remain below cost recovery, and the restructuring and divestiture of SOEs—including by adopting new privatization and state-ownership laws—to reduce the still large role of the state in the economy, two areas where the pandemic, combined with capacity constraints, had contributed to delays. Recently, the first major SOE and state-owned bank were successfully sold through transparent and competitive processes. Competition will need to be enhanced further by opening up markets and eliminating SOE advantages and privileges.

IMF Relations

10. **Surveillance and financial support.** The IMF Executive Board had approved US$375 million in emergency financing in May 2020 (see *IMF Country Report No. 20/171*) and concluded the 2021 Article IV Consultation on April 22, 2021 (see *IMF Country Report No. 21/085*). In August 2021, the Executive Board approved an allocation of *Special Drawing Rights*, adding about $750 million to Uzbekistan's reserves.

11. **Capacity Development**. The IMF provides significant technical assistance to Uzbekistan. Areas of focus include tax policy, tax administration, public financial management, debt management, monetary and foreign exchange operations, stress testing, and statistics (including external sector and government finance statistics, monetary and financial surveys, and national accounts).

ANNEX 3: LETTER OF DEVELOPMENT POLICY

O'ZBEKISTON RESPUBLIKASI
MOLIYA VAZIRLIGI

MINISTRY OF FINANCE
REPUBLIC OF UZBEKISTAN

"12" November 2021 y. № 01/38-03-05-35/697
"___" ________ 20__ y. № ________

David Malpass
President
World Bank Group

November 12, 2021

Dear Mr. Malpass,

I am writing to update you on Uzbekistan's progress in implementing the historic and ambitious economic and social transformation, as we near the completion of the historic 2017-2021 Development Strategy.

Introduction

Since 2017, the Government of Uzbekistan, under the leadership of President Shavkat Mirziyoyev, has taken bold steps to liberalize Uzbekistan's economy, improve social freedoms and conditions, and open Uzbekistan's doors to the world. Although it is still early in Uzbekistan's market transition, the process of change has begun to show results. Prior to the COVID-19 crisis, records were set in tourist arrivals, horticulture exports, new income taxpayer registrations, and the number of new firms created. Foreign exchange and imports have been liberalized. Foreign direct investment is reaching new sectors of the economy that were historically neglected. Agriculture, once a sector in steady decline, is emerging as a powerful driver of inclusion and shared prosperity that will help distribute the benefits of the transition to a wider share of citizens.

Though the COVID-19 pandemic dealt a blow to the economy in 2020, Uzbekistan committed not to be defeated by the pandemic but to emerge stronger from it. Growth in 2021 is now forecast to exceed 6 percent, compared with 1.7 percent in 2020. Ambitious expansions in social safety nets have reversed the declines in poverty and hardship created by the crisis in 2020. Investments in health and education—which were acutely affected by the pandemic—are now priority areas for public investments as the Government seeks to accelerate improvements in

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the quality of human capital and the nation's resilience to future pandemics. Most importantly, and as I will highlight in the remainder of this letter, the structural transformation of Uzbekistan's economy continues at a strong pace.

Market reforms

The transition to an inclusive, competitive, and private sector-led market economy is critical to the achievement of our development objectives of becoming an upper middle income by 2030 and halving poverty by 2026.

Agriculture

The flagship reform supported under this Development Policy Operation is the further liberalization of agriculture—a sector that has tremendous potential to serve as the engine of growth, inclusion, and accelerated poverty reduction. Building on a strong sequence of reforms as part of the Government's 2030 Agricultural Modernization Strategy approved by President Mirziyoyev in 2019, the removal of mandatory state procurement and state-controlled prices in the wheat sector helps bring an end to the last vestiges of the state agricultural order system. Once this measure takes effect, the harvest and fruit of every seed sown in Uzbekistan will be free of state-controlled procurement and price controls. Farmers, traders, and markets will determine the price of these products. All state procurement of these products will take place in markets and at prices determined by markets. The role of the state will shift to that of supporting and enabling farmers to improve their yields, move products to markets quickly, and ensure that a robust system of financing, logistics, and infrastructure surrounds our fertile and dynamic agriculture sector.

These are important steps, but more remains to be done to unlock the full dynamism of agriculture in Uzbekistan. The government's attention is now shifting towards addressing deeper structural issues—most importantly the system of land ownership and tenure, and the agricultural financing system. Earlier this year, the government announced the development of new legislation and regulations as part of reforms to agricultural and non-agricultural land. This process is well under way, and the first phase of land reforms is expected to be implemented over the coming year. These reforms are aimed at increasing the transparency of land allocation, strengthening land tenure rights and security, and reducing uncertainties for farmers. Simultaneously, the government will continue to reform the agricultural financing system to ensure that farmers have access to adequate pre-harvest financing and to support the gradual transfer of agricultural financing responsibilities from state to the private sector.

State-owned Enterprise Reform

The reform of State-Owned Enterprises (SOEs) has been a priority of the Government since the start of reforms in 2017. It has also been an important and continuous area of focus under each DPO supported by the World Bank.

To date, a steady sequence of reforms has been enacted to improve SOE performance and reduce the number of SOEs in the economy. These reforms have been broad, covering both sector-level SOE reform priorities—such as in the energy and transportation sectors, and strategic issues such as the institutional framework for SOE ownership management and for privatization processes. Having enacted these reforms, the next sequential step of the Government has been to develop broader framework legislation that consolidates these reforms, codifies them into law, and provides a unified framework for SOE reform. The first of these framework laws is supported under this proposed operation and covers the management of SOEs and other state assets such as property. This law represents a significant modernization to Uzbekistan's legal framework for the sound and effective management of SOEs and brings our standards into much closer compliance with international good practice. The effective implementation of this new law will make SOEs more transparent, effective, and efficient in their operations. It will also require the State to be more transparent about its rationale for continued state ownership and will serve as a basis for the Government to continue advancing its commitments to further prioritization and reduction in the number of SOEs.

Early next year, a second important law is expected to be finalized that establishes a framework for privatization. Again, this law brings together many reforms and measures already enacted at a lower level and codifies them into a framework legislation that applies more uniformly. It will enshrine key principles, such as transparency in how pre-privatization and privatization processes are conducted, methods of sale and how they will be decided upon, and clarity about institutional roles, responsibilities, and obligations of all parties that are part of the privatization process. In addition to this law, we continue to make good process in implementing financial sector reforms, such as through the advancement of our current State-Owned Bank privatization program, and through new laws that will strengthen oversight and supervision over non-bank financial institutions and deepen our capital markets.

With the enactment of these laws, the process of SOE reform and privatization, which has already gained momentum this year, is expected to advance at an even faster pace. This remains a critical necessity for both the creation of space for private sector growth, and the reduction of fiscal pressures.

Other market reforms

Beyond the specific areas supported under this operation, the government is continuing to advance important market reforms at the sector level and across the economy. Over the next year, important reforms will be enacted to further strengthen the market orientation of the energy sector, including through measures to improve the quality of regulatory oversight, the resumption—following a temporary suspension due to the COVID-19 pandemic—of tariff adjustments towards their path of full cost recovery, and expand the role of markets to wholesale and longer-term contracts. These reforms will be augmented by measures to further improve institutional settings and clarify the role of the state in the sector as a regulator, principal buyer of energy, and as the owner of key network infrastructure. To ensure that much needed energy sector reforms, particularly tariff recovery, do not push our poorest and most vulnerable citizens into greater hardship, the Government is also working closely with the World Bank to ensure that robust social protection measures accompany the medium-term tariff adjustment process.

Other areas of focus over the coming year for further liberalization and market reforms include the chemicals and transportation sectors. These sectors have tremendous growth potential through greater private sector investment and leadership. In these areas, measures are being developed to unbundle regulatory, policymaking, and SOE ownership responsibilities, and to reduce barriers to private sector entry and competition.

Improving fiscal discipline and transparency

Since 2018, substantial measures have been enacted to strengthen fiscal transparency, improve public financial management systems, and strengthen fiscal discipline. In addition, citizens have more information and power over government spending through reforms that have increased the accessibility and simplicity of information about public finances and given local authorities more powers to independently prepare and approve local budgets. Under the new Budget law process, the national budget must be publicly consulted on prior to Parliamentary submission. These reforms have also been complemented by an ambitious restructuring of accountability, with public finances now being subject to Parliamentary authorization and oversight.

This year, two important reforms are supported under this proposed operation. The first of these actions completes a significant effort over the last three years to improve the comprehensiveness of the budget. From the 2022 Budget, all off-budget accounts will be included in the Consolidated budget that is presented to, and approved by, Parliament. This measure represents a significant and important moment in the Government's fiscal transparency reform agenda, as it will enable greater coordination of public spending across different sources and offer more opportunities to align public spending to the priorities of the Government.

Thus, starting from 2022 over 27,000 off-budget accounts will be included in the Consolidated budget. The total expenditures funded through these accounts amount to more than 1.5 percent to GDP.

The second action supported under this operation represents is critical to our commitments in maintaining fiscal discipline and preserving fiscal buffers during the transition. The new Debt Law that has been submitted to Parliament modernizes Uzbekistan's legal framework for debt management and reporting. It also introduces important fiscal disciplinary mechanisms, such as a ceiling on the level of external debt, and requirements for the Government to take corrective fiscal policy actions to reduce debt levels well before the ceiling nears. The Law also strengthens debt transparency requirements and obligates state entities to regularly report on their debt levels, which in turn will be consolidated and presented to Parliament by the Ministry of Finance on a regular basis. These reforms are critical in ensuring that Uzbekistan continues to use its privilege of access to external debt markets and concessional finance in a manner that is sustainable and is effectively contributing to our development objectives.

In the next year, the government will continue to strengthen its management of public finances and debt. Key areas of focus include measures under development to strengthen fiscal risk management, further expand the medium-term fiscal framework, and develop a medium-term debt strategy that will be approved by the government.

Sustaining a strong focus on an inclusive transition

Inclusion remains core to the Government's economic reform agenda. As reforms in each of our Development Policy Operations since 2017 have demonstrated, our ambitious market and institutional reforms are matched in ambition by our strong focus on removing the barriers that limit any of our citizens from accessing opportunities and pathways to greater prosperity. This approach will always be at the heart of the philosophy guiding Uzbekistan's reforms.

This year, three signature reforms supported under this proposed operation continue to pave the path to greater economic and social inclusion of our citizens. The first of these measures is the revision of Uzbekistan's Labor Code. Following reforms supported under the last Development Policy Operation to guarantee equal rights for men and women, the new Labor Code that has been submitted for Parliamentary approval establishes guarantees of equal pay for equal work, and substantially strengthens protections against gender and other forms of discrimination in the labor market. The new Labor Code also establishes a more systematic framework for the determination and implementation of minimum wages and strengthens the requirements for labor contracts to ensure that both employers and employees have greater clarity about their obligations. These improvements to labor relations are critical to the creation of an efficient and inclusive labor market in Uzbekistan. But these reforms also mark only the beginning of our efforts to address labor market constraints. Over the medium-term, we will continue to remove impediments in the labor market such as the lack of information and data and unnecessary occupational licensing and regulatory constraints. This agenda is also backed by our increasing investments in education and skills to accelerate the realignment of skills to the needs of a new economy.

The second reform supported under this proposed operation is the establishment of a new poverty line in Uzbekistan. This is a watershed reform and is the product of a systematic and multi-year engagement between the Government of Uzbekistan and the World Bank to improve household data measurement, revise poverty calculation methodology, and establish appropriate policies which ensure that our poorest and most vulnerable citizens are protected from hardship. This measure represents the start of an ambitious program to strengthen our social contract and safety net system. The new poverty line has already been used to strengthen our pension allowances, and other social assistance programs are now being reformed and revised to be consistent with the new line. We have set ourselves ambitious goals both in the level the Government has chosen as the poverty line, and in our commitments to accelerate reforms that align our social assistance and poverty reduction approaches to this new line. Our focus over the medium-term will be to ensure that we deliver on these ambitious commitments through the implementation of new social protection and poverty reduction strategies that are under development. These measures will be accompanied by continued reforms to strengthen the performance of the new unified social registry that has been supported under previous DPOs.

The third reform supported by this proposed operation represents a historic advance in strengthening our commitment to supporting, empowering, and enabling persons with disabilities. Following new legislation enacted in 2020 to guarantee equal rights and opportunities for persons with disabilities, Uzbekistan has now ratified its acceptance of the United Nations Convention on the Rights of Persons with Disabilities. This is an important measure that demonstrates our international-level commitment to the economic and social inclusion of persons with disabilities. It is also critical to our reform agenda—unlike many other transition economies, we are eager to harness the talents and energy of all our citizens from an early stage. Persons with disabilities have much to contribute to Uzbekistan's transformation, and we are committed to ensuring that those contributions are easier to make. Over the next year, we will be working closely with the World Bank and other partners to develop an implementation roadmap to ensure that Uzbekistan meets its commitments under the Convention. This roadmap will receive the strongest levels of support from the Ministry of Finance and other economic agencies.

Conclusion

The measures I have chosen to highlight in this letter are a smaller subset of the Government's ambitious and broad-reaching economic reform program. It is a program that reaches every corner of our economy and society and remains grounded by our commitment to strong macroeconomic and fiscal management. Our commitment to this reform program and to the structural transformation process remains strong, as does our shared priority of improving the well-being of Uzbekistan's citizens.

The conclusion of both the 2017-2021 Development Strategy and the current Country Partnership Framework provides an important opportunity to further strengthen our partnership and look ahead to emergent challenges that Uzbekistan faces as the transition continues. The most notable of these challenges is the changing environmental landscape, and the new risks that our people and economy face amidst a rapidly changing climate. We are committed to strengthening the sustainability of this transition—not only through more efficient resource use but also through a more deliberate strategy to green our economic model. We see this process not just as a risk management exercise but also as an opportunity to create new markets and strengthen the long-term competitiveness of our economy in a changing global market. We look forward to working closely with the World Bank and other development partners to advance this important priority in the coming years.

In closing, I would like to reiterate the gratitude of the Government of Uzbekistan for the continued support and assistance of the World Bank. This assistance is important because there is no going back on these reforms, but instead there is much to do to harness a bright and prosperous future for Uzbekistan. We do not intend to rest on our laurels of what we have achieved over the last five years, but instead draw hope and courage from our achievements as fuel that powers the next phase of reforms that improve the lives of our people. Our partnership with the World Bank will remain critical to the tasks we face ahead. We look forward to this partnership growing further through this proposed operation and through our continued engagement in the coming years under the next Country Partnership Framework.

Sincerely,

Timur Ishmetov
Minister of Finance of the Republic of Uzbekistan

ANNEX 4: ENVIRONMENT, POVERTY, and SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Operation Pillar 1: Stronger market institutions and better management of state-owned enterprises		
Prior Action 1: In accordance with the Borrower's agricultural modernization strategy to increase climate resilience and eliminate state-controlled agricultural production, the Borrower has abrogated restrictions requiring wheat farmers to sell a fixed quota of production to the State at a price regulated by the State to allow farmers to determine their buyers and to set farmgate prices based on market conditions.	Likely positive (improved yields, land and irrigation investments)	Likely negative poverty / positive distributional benefits, mitigated by social protection measures
Prior Action 2: To improve the management of state-owned enterprises, the Borrower has submitted a new state asset management law for parliamentary approval that establishes corporate governance and financial transparency requirements for all state enterprises and legislates principles for reducing the number of state-owned enterprises.	Potentially positive over longer-term as law has environmental stewardship principles that must be followed in implementation.	Likely neutral (not expected to lead to job losses)
Operation Pillar 2: Improved fiscal transparency and accountability		
Prior Action 3: To increase the transparency of public spending and parliamentary oversight of the budget, and to improve the alignment of spending to government priorities, the Borrower has enacted amendments to Articles 45 and 46 of the Budget Code of the Republic of Uzbekistan to expand the composition of the Consolidated Budget of the Republic of Uzbekistan to include off-budget funds of all budgetary organizations and extra-budgetary funds of budgetary organizations.	Neutral	Likely neutral poverty Likely positive distributional through increased fiscal efficiency.
Prior Action 4: To strengthen the management of public debt and increase debt transparency, the Borrower has submitted a new debt law for parliamentary approval that (i) establishes objectives for debt management and assigns specific purposes, roles, and responsibilities for debt management; and (ii) establishes legally binding requirements for debt reporting.	Neutral	Neutral

Operation Pillar 3: Increased economic and social inclusion, especially of women and persons with disabilities		
Prior Action 5: To modernize labor relations and reduce gender and other discrimination in the labor market, the Borrower has submitted to Parliament for approval a new labor code that (i) introduces equal pay for men and women for equal work; (ii) prohibits discrimination in hiring and labor contract termination; and (iii) establishes and regulates the concept of 'minimum wage'.	Neutral	Positive
Prior Action 6: To better link the social safety net system with the needs of the poor, the Borrower has (i) adopted a new poverty line methodology consistent with international good practice, and (ii) required the new poverty line to be used in the determination of need and the level of social benefit payments made to individuals.	Neutral	Positive
Prior Action 7: To increase the economic inclusion of persons with disabilities, and better align Uzbekistan's legal regime for disability rights with international good practice, the Borrower has enacted a law ratifying Uzbekistan's accession to the Convention on the Rights with Persons with Disabilities.	Neutral	Positive

ANNEX 5: OVERVIEW OF REFORMS SUPPORTED UNDER PREVIOUS DPOS

Sector	Reforms supported in the first two DPOs (2018, 2019)	Reforms completed in the last DPO (2020)	Major results
Areas of support across all DPOs since 2017			
Agriculture	• Large reduction in cotton/wheat growing areas • Increase in wheat and cotton farmgate prices to equalize with international benchmarks • Removal of almost all horticulture export barriers • Liberalization of bread prices	• Ending mandatory cotton production targets for farmers, and all mandatory state cotton production surrender requirements	• A revival of agriculture growth and record horticultural exports • Up to 1.2 percent of GDP increase in rural incomes from higher farmgate prices for cotton and wheat production • End of systematic forced and child labor
Energy	• New renewable energy legal and institutional framework • New energy tariff policy and methodology, and the establishment of a new tariff commission to improve independence of tariff-setting • Electricity and gas tariff reforms to strengthen cost-recovery • IFRS accounts and audits of main energy and gas SOEs	• Ending all retail petroleum price controls (and subsidies) • Removing constraints to increased private sector investments in energy generation PPPs	• Unbundling of vertical gas and electricity SOEs, separation of policy/regulation to new Ministry of Energy • Electricity cost recovery from 70 to 92 percent within 2 years. • First competitive and transparent private investments in power generation in Uzbekistan's history • Petroleum prices are freely determined in the market and have been allowed to adjust to recent spikes in oil prices without intervention.
Financial Sector	• Strengthened prudential requirements to comply with Basel Core Principles, and stress testing requirements • Modernization of banking legislation	• Stopping UFRD on-lending via commercial banks • Ending almost all preferential lending by state banks • Strengthening independent governance of Bank boards	• Substantial improvement in capital and liquidity buffers • Sharp slowdown in preferential lending and credit growth from state-directed lending • Almost all bank lending now is being priced at rates above the reference rate.
SOE Reform	• Creation of SOE reform agencies • Unbundling of vertically integrated national airline SOE • Increased financial transparency of energy SOEs	• SOE reform framework to improve the performance of the largest SOEs • Identification of at least 15 percent of all SOEs to be fully	• Identification and transfer of all SOE shares to new agency and initiation of privatization process. • Forthcoming PPP of domestic airports

		privatized via a competitive process	• Over 200 small SOEs have been privatized or liquidated since the start of the process. Corporate governance reforms for the largest SOEs are on-track.
Fiscal transparency	• Full disclosure of budget information to public • Preparation of citizen budgets to explain public spending. • Fiscal consolidation to close and consolidate off-budget accounts • New community-level budgets where citizens can determine how spending occurs	• Integration of UFRD revenue/expenditure into State budget (4% of GDP of off-budget spending now on-budget) • Transfer of budget approval and accountability from Cabinet/President to Parliament and regional parliaments	• The full 2021 Budget was, first time, publicly consulted before submission to Parliament. • Off-budget spending has fallen from over 6 percent of GDP to an estimated 1.5-2 percent of GDP • The 2022 Budget will be Uzbekistan's first fully consolidated budget.
Social protection and labor	• End of systematic forced and child labor by the state • Expansion in social assistance beneficiaries to support price liberalizations in 2017 (large price control removals), 2018 (bread and energy tariffs), 2019 (energy tariffs), and 2020 (COVID) • Creation of a unified social registry • Improved seasonal contractual conditions and obligations. • Tax reforms to lower high labor taxes discouraging employment formality	• Removal of almost all internal migration controls • 10% increase in low-income allowance beneficiaries for COVID • Countrywide rollout of a new unified social registry to consolidate and improve safety net coverage and amounts • New legal framework to prevent gender-based violence. • Legal guarantees of equal opportunities for women.	• Largest social assistance beneficiary expansions since independence • Complete transformation of safety net system with single registry, with transparent data on applications and decisions • The new system is now operational countrywide. Reforms are now being enacted to streamline types of assistance, expanding coverage, and increase the adequacy of support.
Other Reforms Supported in Previous DPOs.			
Liberalization of business and trading environment	• Unification of exchange rate through an unannounced 50 percent overnight devaluation of the som against the US dollar • The removal of all current account foreign exchange restrictions and export earnings surrender requirements • Removal of onerous domestic trading licensing regulations and firm-to-firm advance prepayment requirements • Price liberalization and removal of trading restrictions to allow market-based formation of prices • Reduction in average import tariffs		• Foreign exchange access, once the biggest firm constraint, is no longer a problem • Average import tariffs fell from 13 to 8 percent • Record increases in 2019 and first three quarters of 2020 in domestic trading business registrations • Average tariffs fell from 13 to 7.9 percent