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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT
FOR
A PROPOSED LOAN IN THE AMOUNT OF US$350 MILLION AND
A PROPOSED IDA CREDIT IN THE AMOUNT OF US$250 MILLION AND
A PROPOSED IDA SHORTER-MATURITY LOAN IN THE AMOUNT OF US$220 MILLION AND
A PROPOSED IDA SCALE-UP WINDOW CREDIT IN THE AMOUNT OF US$130 MILLION

TO THE

REPUBLIC OF UZBEKISTAN

FOR THE

Advancing Uzbekistan's Economic and Social Transformation
Development Policy Operation

November 14, 2022

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, 2022

UZS 11,180 = US$1.00

ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
AIIB	Asian Infrastructure Investment Bank
ALMP	Active labor market program
AM	Accountability Mechanism
CBU	Central Bank of Uzbekistan
CPF	Country Partnership Framework
CPI	Consumer Price Index
DP	Development Partner
DPO	Development Policy Operation
DSA	Debt Sustainability Analysis
EIA	Environmental Impact Assessment
EU	European Union
FDI	Foreign direct investment
FMIS	Financial management information system
GDP	Gross domestic product
GFS	Government Finance Statistics
GRID	Green, Resilient, and Inclusive Development
GoU	Government of Uzbekistan
GSMA	Global System for Mobile Communications Association
IDA	International Development Association
IFC	International Finance Corporation
IFI	International Financial Institution
ILO	International Labor Organization
IMF	International Monetary Fund
INDC	Intended Nationally Determined Contributions
IPO	Initial Public Offering
JICA	Japan International Cooperation Agency
L2CU	Listening to the Citizens of Uzbekistan
LDP	Letter of Development Policy
LMIS	Labor market information system
MCO	Microcredit Organizations
MNO	Mobile network operator
NBCO	Non-bank credit organizations
NDS	National Development Strategy
NPL	Non-performing loan
OECD	Organization for Economic Cooperation and Development
PDO	Program Development Objective
PEFA	Public Expenditure and Financial Accountability
PFM	Public financial management
PPG	Public and publicly guaranteed
PPP	Public private partnership
SAMA	State Asset Management Agency
SCD	Systematic country diagnostic
SDR	Special Drawing Rights
SOE	State-owned enterprise
SML	Shorter-Maturity Loan
SP	Social protection
SR	Social registry
TA	Technical assistance
TSA	Treasury Single Account
UFRD	Uzbekistan Fund for Reconstruction and Development
UMIC	Upper-Middle Income Country
UMS	Universal Mobile Systems
UN	United Nations
USAID	United States Agency for International Development
WB	World Bank
WBG	World Bank Group
WTO	World Trade Organization

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REPUBLIC OF UZBEKISTAN

ADVANCING UZBEKISTAN'S ECONOMIC AND SOCIAL TRANSFORMATION DEVELOPMENT POLICY OPERATION

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SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Programmatic
P179007	No

Proposed Development Objective(s)

To support Uzbekistan's transition to an inclusive and private-sector led market economy through (a) strengthening market institutions and the environment for private sector growth; (b) improving state-owned enterprise management; and (c) increasing social inclusion and resilience.

Organizations

Borrower:	REPUBLIC OF UZBEKISTAN
Implementing Agency:	Ministry of Finance

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Financing	**950.00**

DETAILS

International Bank for Reconstruction and Development (IBRD)	350.00
International Development Association (IDA)	600.00
IDA Credit	380.00
IDA Shorter Maturity Loan (SML)	220.00

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

Results

Indicator Name	Baseline	Target
Result Indicator 1: Number of annual privatization progress reports prepared and published in accordance with requirements of Article 22 of the new privatization legislation.	0 (August 2022)	At least 1 (end-June 2024)
Result Indicator 2: Number of licensed mobile (telecommunications) network operators (MNOs) that are fully privately owned.	2 (August 2022)	At least 3 (end-June 2024)
Result Indicator 3: Assets of registered Non-Bank Credit Organizations, as a percentage of total banking sector assets.	0.3 (2020)	At least 5 (end-June 2024)
Result Indicator 4: Percentage of filings for restructuring cases over total cases	0.1 (2021)	At least 5 (end-June 2024)
Result Indicator 5: Number of anticompetitive practices sanctioned under the new competition law.	0 (August 2022)	At least 20 (end-June 2024)
Result Indicator 6: Submission of quarterly financial reports by SOEs to the Ministry of Finance.	0 (August 2022)	100% of large SOEs under the ownership management of the Ministry of Finance have submitted at least 4 quarterly reports (end-June 2024)
Result Indicator 7: Share of social assistance beneficiaries among the poorest 40 percent of people.	58% (2021)	65% (2023)
Result Indicator 8: Percentage of women employed in the formal private sector for more than 6 months who are eligible to receive maternity leave benefits paid through social insurance.	0 (August 2022)	100 (end-June 2024)

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

1. INTRODUCTION AND COUNTRY CONTEXT

1. **This proposed standalone Development Policy Operation (DPO) of US$950 million supports the Government of Uzbekistan in advancing the country's transition to an inclusive market economy.** It comprises an IBRD Loan of US$350 million and three IDA Credits: a concessional IDA Credit of US$250 million; a concessional IDA Shorter-Maturity Loan of US$220 million (US$88 million of which is made available through the IDA Scale-Up Window);[1] and a non-concessional IDA Credit of US$130 million through the IDA Scale-Up Window. Despite the prolonged impact of the COVID-19 pandemic and the significant policy challenges created by the spillovers from the war in Ukraine, Uzbekistan has continued to implement an ambitious reform agenda, while strengthening economic management and improving public financial transparency. Reforms supported in this operation focus on (i) strengthening market institutions and the environment for private sector growth; (ii) improving state-owned enterprise management; and (iii) increasing social inclusion and resilience. The proposed operation is central to the World Bank Group's (WBG) overall engagement with Uzbekistan, as outlined in the Country Partnership Framework (CPF) for FY22-FY26,[2] and is also closely aligned with the World Bank's Green, Resilient, and Inclusive Development (GRID) approach and the WBG Global Crisis Response Framework (GCRF). This operation will be supported by parallel financing of US$530 million from the Asian Infrastructure Investment Bank (AIIB), and US$250 million from the Government of Japan.[3]

2. **Uzbekistan has made good progress in its market transition.** Since late 2016, Uzbekistan has implemented wide-reaching economic and social reforms. Most prices have been liberalized. Foreign exchange is now fully convertible for current account needs, and efforts are under way to ease capital account restrictions. An overhaul of the tax and regulatory system has substantially lowered barriers that favored state-owned enterprises (SOEs) and suppressed private sector development. State-directed lending at interest rates below the official monetary policy rate has largely ended, and credit to the economy has slowed to more sustainable levels. Reforms to liberalize horticultural exports and improve cotton and wheat policies have continued to propel strong agricultural output and productivity improvements. These reforms, supported through successive DPOs, have contributed to the maintenance of economic growth despite multiple shocks, and 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 continue to expand.

3. **Despite the uncertainties Uzbekistan faces due to the spillovers from the war in Ukraine, the government remains firm in its resolve to tackle deeper structural constraints to facilitate a more effective and inclusive market transition.** The National Development Strategy (NDS) is ambitious in its goals of halving the poverty rate by 2026 and supporting Uzbekistan's transition to upper-middle-income country (UMIC) status by 2030. To make meaningful progress toward these goals, state controls over factor markets and thousands of SOEs need to be loosened to improve the efficiency of resource allocation and increase private sector growth and investment, including in sectors where considerable private sector interest exists such as energy, telecommunications, chemicals, and aviation. Public investments need better alignment to development and policy priorities. Greater outward economic orientation, on the back of stronger trade and foreign direct investment (FDI) linkages, are critical for higher GDP growth. Further policies to increase the economic participation of women, youth, and the disabled will be important to enhance

[1] The remaining US$132 million is made available as a Shorter-Maturity Loan from the IDA Performance-Based Allocation
[2] Report No. 170931-UZ; discussed at the Board of Executive Directors on May 24, 2022.
[3] Financing from the Government of Japan is expected to be disbursed in 2023 and will contribute to financing for the next budget year.

inclusion. Energy sector reforms, which advanced quickly at the start of the reforms, have slowed down as the impact of COVID-19 and global price shocks have eroded household incomes, constraining policy space to enact difficult reforms, such as tariff increases towards cost recovery, more quickly. Though Uzbekistan is now in its seventh year of reforms, its economic transition is still at an early stage, and success is not guaranteed. Factor markets remain inefficient and dominated by state control, and SOEs remain a pervasive constraint to private sector expansion. Addressing these challenges requires strong legal and institutional frameworks, such as those supported under this operation, but also further reforms to demonopolize SOE controlled sectors and reduce private sector entry barriers. As the reform agenda shifts to addressing these more complex issues, lessons from other transitions highlight the need to monitor and manage risks—such as the influence of vested interests, the need for more transparency and public accountability, and the need to strengthen citizen engagement to sustain the high level of public support for reforms that has persisted since 2017. The government remains focused on sustaining a strong reform agenda and in mitigating reform risks despite facing greater policy uncertainties and maintains the view that Uzbekistan's longer-term prosperity continues to depend on the effectiveness of the ongoing market transition.

4. **The proposed operation advances important reforms that strengthen market institutions and the environment for private sector growth, improve the management and performance of state-owned enterprises, and increase social inclusion.** New privatization legislation will help accelerate the reduction of the state's economic footprint—a key goal under the NDS. The new legislation will also help mitigate social risks arising from the privatization process through greater transparency requirements and provisions for negotiated additional compensation for displaced workers. The privatization of a mobile telecommunications operator is expected to bring much-needed private investment into a high-potential enabling sector, increase competition, and expand digital services for consumers. It is also expected to serve as a test case for further privatization in the telecommunications sector. New competition legislation is expected to help establish strong legal foundations and a level playing field for competitive private sector led growth. New insolvency legislation will help address a major bottleneck impeding private sector restructuring and reorganization, and to facilitate the resolution of non-performing loans (NPLs) in the banking system. Measures to improve SOE governance will help improve the performance, management, and financial sustainability of SOEs. A new social protection policy will help streamline and strengthen the social safety net system—a critical instrument to reduce social risks arising from the reform process. Measures to transfer maternity pay obligations from the private sector to the state will help address a major source of gender-based employment discrimination.

5. **The proposed operation is well-aligned to the WBG Global Crisis Response Framework.** Uzbekistan is highly exposed to the challenges and uncertainty of multiple overlapping global crises. Shocks linked to the COVID-19 pandemic sharply reduced economic activity and employment. Though economic growth rebounded in 2021, risks from additional waves of the pandemic remain. Households in Uzbekistan have also struggled with global increases in food prices, with food prices rising 43 percent between January 2020 and September 2022 (compared to overall CPI increases of 32 percent). The spillovers from the war in Ukraine and the imposition of sanctions on Russia have also significantly increased uncertainties and risks for Uzbekistan. Although the worst of these risks have not yet materialized, further shocks to Russia's economy and indirect risks to Uzbekistan from international sanctions on Russia remain a significant source of uncertainty for Uzbekistan's economic outlook. Remittances and food prices, which disproportionately affect the wellbeing of the poor and vulnerable, are particularly at risk. The proposed operation responds to these challenges by providing financial support and helping Uzbekistan sustain its reform momentum amidst these economic headwinds. In the face of unanticipated higher external market financing costs, and increased budget deficit for 2022 relative to original projections, the Government requested scaled-up support from development partners—including from the World Bank through this proposed operation - to help to fill the fiscal financing gap for 2022.

6. **Uzbekistan's economy and society are highly vulnerable to climate change, and a number of policies in this proposed operation contribute to Uzbekistan's efforts to mitigate and adapt to 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 the annual number of hot days). Water resource management is expected to become more challenging given associated impacts of climate change. In addition to the impact on physical resources, Uzbekistan's people are at risk of being forced into poverty by climate change, as evidenced by the displacements already seen in areas such as the Republic of Karakalpakstan—the most climate-vulnerable region of Uzbekistan. Improving the reach of social safety nets to cover these people will be critical to mitigating this risk. Addressing climate vulnerabilities has received increasing attention and focus from the authorities as part of the overall economic transformation strategy. Several prior actions in this proposed operation are expected to support the government's climate policy objectives in adaptation and mitigation.[4] These include measures to establish explicit provisions for climate action in framework privatization legislation; improve management and performance of SOEs (which are energy-intensive and account for almost 70 percent of Uzbekistan's carbon emissions); and further improve social safety nets (which are already being used to support climate-affected households in Uzbekistan).

7. **A strong and programmatic policy dialogue continues to anchor this proposed standalone DPO.** Uzbekistan has continued to implement a broad reform agenda that spans nearly all aspects of its public sector and economy. The reforms have also continued amidst heightened uncertainties in the external economic environment. A dynamic reform agenda and external environment have required continued agility from the World Bank in providing support for the reforms, warranting the continued use of standalone DPOs. The DPO engagement, however, remains embedded in a well-anchored and programmatic policy dialogue, with each successive standalone operation building on reform sequences supported by previous operations (see Annex 5 for an overview). As external conditions abate, and as the reform agenda matures, the use of programmatic DPOs could be considered to support the implementation of deeper reform sequences and more complex reforms in specific areas.

8. **The main risks to this operation arise from institutional constraints and high administrative centralization.** Uzbekistan's broad and sweeping reform agenda relies on highly centralized government systems, administrative capacity, and expertise that is thinly stretched. This risk is being mitigated through strong technical support from development partners and the government's own efforts to procure international technical expertise and advisory services. Social support for the reforms has been maintained, thanks in part to reforms that have increased incomes and mitigated the most adverse price and economic shocks to vulnerable households. Social risks remain ever-present, especially related to reforms that involve price and employment adjustments. With utility tariffs still below cost recovery levels and with the SOE privatization process still at an early stage, the social risks associated with these reforms will continue to require careful monitoring, strong consultative and public engagement processes, and effective mitigation strategies.

2. MACROECONOMIC POLICY FRAMEWORK

[4] Republic of Uzbekistan: Updated Nationally Determined Contribution (NDC); 2021 (https://unfccc.int/sites/default/files/NDC/2022-06/Uzbekistan_Updated%20NDC_2021_EN.pdf)

2.1. RECENT ECONOMIC DEVELOPMENTS

9. **Uzbekistan's economy rebounded strongly in 2021 from the effects of the COVID-19 pandemic. After a pandemic-induced slowdown to 1.9 percent in 2020 real GDP growth was 7.4 percent in 2021.** A strong recovery in industrial and services output helped offset lower agricultural growth from a weaker wheat harvest and early frosts. The realization of deferred household demand following the pandemic lockdowns, a public sector wage increase, strong remittance inflows, and the continued expansion of social safety net assistance contributed to a 10.1 percent rise in private consumption. A partial recovery in public investments following a COVID-induced slowdown in 2020, and strong demand by trading partners, further supported the rebound in growth in 2021.

10. **Spillovers from the war in Ukraine have tempered economic activity in 2022, though performance has been better than initially expected.** Despite concerns that growth could be significantly impacted by the war, real annual GDP growth for the first half of 2022 was 5.4 percent–only slightly below expectations before the war started. Strong growth in domestic services and in the construction sector, and higher exports are offsetting slower growth in sectors affected by the conflict, such as manufacturing and transportation services. Growth has also been supported by robust remittance inflows for the first six months of 2022—twice those in the first half of 2021. This is likely due to three factors: (a) the continued availability of work in Russia for migrant workers (as Russian labor markets remain relatively robust); (b) the appreciation of the Ruble over the period; and (c) the precautionary repatriation of savings by migrant workers amidst an appreciating Ruble and the continued availability of legitimate financial transfer channels between Russia and Uzbekistan.

11. **The pandemic and the war in Ukraine have brought significant changes in the external accounts. Between 2017 and 2020, and following the liberalization of the current account, Uzbekistan's current account balance reversed to deficits after more than a decade of consistent surpluses.** This change is consistent with other reform experiences and was driven by the end of import suppression and a large increase in capital imports financed by higher public and private investment. Due to pandemic-related impacts, imports (especially capital imports) and exports simultaneously shrank in 2020 and the current account deficit narrowed to 5 percent of GDP. Despite still-subdued capital imports, higher remittances, and a rebound in non-gold exports in 2021, the current account deficit widened to 7 percent in 2021 because of an increase in food, fuel, and consumer imports (on the back of a rebounding economy, higher global prices, and deferred consumption) and lower gold exports. The deficit was financed largely by an increase in borrowing from development partners and from global financial markets. FDI remained below pre-pandemic levels as global investment conditions and the slow pace of Uzbekistan's privatization program limited investment inflows to Uzbekistan. Preliminary estimates for the first half of 2022 show a sharp improvement of the current account deficit, which shrank to 0.7 percent of GDP—an 8.8 percent-of-GDP trade deficit was offset by a net income surplus of 8.1 percent of GDP from higher remittances (and other financial inflows from Russia).

12. **Currency exchange rates fluctuated substantially following Russia's invasion of Ukraine, with the Russian ruble depreciating by as much as 42 percent against the Uzbek som in February and March 2022, before appreciating as much as 45 percent above pre-invasion levels.** To limit exchange rate volatility, the Central Bank of Uzbekistan (CBU) increased its interventions in the domestic foreign exchange market in mid-March 2022. Since then, the som has largely stabilized against major currencies.

Table 1: Uzbekistan: Key Macroeconomic and Fiscal Indicators

	2019	2020	2021	2022	2023	2024	2025
					(Projected)		
National Income and Prices							
Real GDP growth (annual percent change)	5.7	1.9	7.4	5.3	4.9	5.1	5.3
Consumer price inflation (end of period)	15.2	11.2	10.0	11.6	11.5	7.6	11.6
External Accounts (% of GDP, unless indicated)							
Exports of goods, of which	23.2	21.4	20.4	24.0	24.3	23.5	23.2
Gold	8.2	9.7	5.9	5.7	6.5	5.4	4.7
Imports of goods	35.4	31.8	33.3	37.1	36.5	36.0	36.0
Services Balance	-3.8	-3.0	-3.6	-4.0	-4.0	-3.9	-3.9
Primary and Secondary Income (Net)	10.3	8.4	9.5	13.8	11.6	11.5	11.6
Current account balance (percent of GDP)	**-5.6**	-5.0	-7.0	-3.3	-4.6	-4.9	-5.0
Foreign direct investment, net	3.9	2.9	3.0	1.3	1.8	2.6	3.0
Gross international reserves (US$ billion)	29.2	34.9	35.1	37.7	38.0	37.2	36.1
Gross international reserves (months of import cover)	15.5	15.1	14.6	11.1	9.7	9.3	7.1
Gross external debt (percent of GDP)	42.5	57.5	57.8	61.2	59.0	54.7	52.4
Fiscal Accounts (GFS reporting; % of GDP)							
Revenues*	27.0	25.6	26.0	29.7	26.9	27.0	28.2
Expenditures*	27.3	28.9	30.6	33.6	29.8	29.8	31.0
Budget Fiscal Balance	**-0.3**	**-3.3**	**-4.7**	**-4.0**	**-2.9**	**-2.8**	**-2.7**
Policy-lending by the UFRD and Ministry of Finance	3.5	1.1	1.5	0.4	0.5	0.3	0.3
Overall fiscal balance (Including policy lending)	**-3.8**	**-4.4**	**-6.2**	**-4.3**	**-3.5**	**-3.0**	**-3.0**
Total public debt	28.4	37.6	35.8	38.2	37.2	35.0	33.6
Monetary Accounts (Annual percent change)							
Broad money growth	17.2	17.9	19.1	18.7	18.3	18.1	20.8
Credit to the economy	48.1	34.4	18.4	18.3	16.4	13.7	14.2
Memorandum Items							
Nominal GDP (US$ billion)	59.9	59.9	69.2	-	-	-	-
Remittances (US$ billion)	8.7	7.1	9.3	13.8	14.9	16.8	18.6

** Fiscal accounts from 2022 include the revenues and expenses of nearly 30,000 off-budget accounts of ministries and agencies are now included in the budget as part of budget transparency and consolidation reforms. In 2021, these accounts were estimated at about 1.6 percent of GDP (World Bank Uzbekistan Country Economic Memorandum 2021)*

13. **Rising food costs have pushed inflation back into double-digit inflation.** From a peak of 20 percent in January 2018, inflation has trended downwards as reforms to liberalize the economy and increase domestic trading activity—especially wholesale trade—have eased supply constraints. The pace of inflation reduction was also aided by tighter monetary policy, a fall in credit growth, and the suspension of utility price increases (a major driver of inflation in prior years). Annual average inflation fell to 9.7 percent in February 2021—the lowest level since the start of the reforms. Since then, however, a sharp rise in global and domestic food prices has led to the return of double-digit inflation, with annual average inflation for September 2022 reaching 12.2 percent. Consumption-weighted food prices were up by 18 percent between September 2021 and September 2022, compared to 12 percent for non-food products and 8 percent for services over the same period.

14. **Monetary policy has remained tight to contain inflationary risks, in line with the central bank's new inflation targeting framework.** The CBU began a phased transition to inflation targeting beginning in January 2020, setting a goal of reducing inflation to 10 percent by end-2021 and 5 percent by end-2023. Having met its target for 2021, the

CBU had initially projected inflation at 8-9 percent by end-2022 but revised these projections upwards to 12-14 percent following the invasion of Ukraine and the resulting spike in global commodity prices. In response to exchange rate pressures in the immediate aftermath of the invasion, the CBU increased its policy rate from 14 to 17 percent. As economic conditions remained better than initially expected, the CBU unwound most of this tightening, reducing the rate back to 15 percent by July 2022.

15. Higher public investment and continued social spending on pandemic-related social assistance has widened the fiscal deficit in the last few years. Public investment spending increased by 1.4 percentage points of GDP in 2021—reaching pre-pandemic levels. Higher spending on policy lending and economic activities (including policy lending for SOE modernization activities; loans for household entrepreneurs; losses on state-financed loans; and funding to the agricultural sector) and the maintenance of safety net spending at levels expanded during the pandemic contributed to an increase in consolidated budget spending as a share of GDP in 2021. Total revenues increased from 25.6 to 26 percent of GDP in 2021, primarily due to increased income and profit tax collections and a modest increase in property tax collections. The net increase in spending and policy lending led to a widening of the overall fiscal deficit from 4.4 percent in 2020 to 6.2 percent in 2021. The deficit was financed mainly through new external debt amounting to 3.8 percent of GDP (against domestic financing of 0.4 percent of GDP) distributed between multilateral, bilateral, and commercial sources. For the first half of 2022, the overall fiscal deficit was 4.2 percent of GDP, with strong revenue growth from large taxpayers (mainly SOEs) and lower public investment spending helping to rein in the overall deficit.

16. Banking sector capital buffers remain above the regulatory minimums, which mitigates concerns related to asset quality risks. The reported total capital adequacy ratio of the banking sector stands at 16.5 percent at end-September 2022 (compared to the minimum requirement of 13 percent). Slowing credit growth (14.9 percent year-on-year in September 2022), coupled with strong deposit growth (51.9 percent year-on-year in September 2022) has led to a marked improvement in the ratio of high-quality liquid assets to total assets over the last twelve months—21.5 percent at end-September 2022 compared with 14.4 percent at end-September 2022. The (pre-provision) net interest margin of the banking system is 5.5 percent at end-September 2022 (compared with 4.2 percent at end-September 2021), providing some buffer to absorb any further deterioration in asset quality. Following a low and stable level of Non-Performing Loans (NPLs) between 2018 and 2020 (at around 1-2 percent), problem loans peaked at 6.2 percent in July 2021 but have since fallen to 4.7 percent by end-September 2022 (4.9 percent for state-owned banks and 4.0 percent for private banks). Loans to individuals (25 percent), industry (26 percent), and trade (16 percent) sectors contributed the most to the current NPL level. Rapid credit growth during 2018-2019 and the COVID-19 pandemic, coupled with NPL data reporting issues by banks, have been the major factors behind the NPL increase. The war in Ukraine and associated repercussions may add an additional credit risk challenge on top of the pandemic-related borrower solvency issues. The CBU 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, and a still significant level of under-provisioning for identified NPLs across several banks (banking sector-wide, around 30 percent of non-standard loans), which needs to be covered in a relatively short period of time. Banks will have to assess the actual asset quality of the loans that have been restructured following the COVID-19 pandemic related deferrals provided by the banks. High share of foreign currency loans and high credit concentration, especially in the largest state-owned banks, are a source of additional credit risk, although the government is contemplating additional measures aimed at reducing the dollarization level in the banking system. To reduce banking dollarization, the CBU has already increased minimum reserves for foreign currency deposits from 14 to 18 percent in August 2021.

17. Borrowing limits are helping to moderate public debt after a rapid increase in the initial years of the reforms. 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 37.6 percent.[5] Prior to 2020, almost all new public debt and guarantees were used to support large capital projects in the energy and public infrastructure sectors. In 2020, a legally binding annual external borrowing limit on the value of newly signed loans—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 in 2020. In 2021, the annual borrowing ceiling was expanded to include domestic debt and set at US$5.5 billion, and the government stayed within the ceiling. PPG debt was about US$26 billion or 35.6 percent of GDP in April 2022, down from its peak of 37.6 percent in 2020.

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

	2019	2020	2021	2022	2023	2024	2025
				(est.)	(projected)		
Total Revenues, of which:	**27.0**	**25.6**	**26.0**	**29.7**	**26.9**	**27.0**	**28.3**
Tax revenues, of which*	18.5	18.7	18.8	19.4	18.0	18.1	18.2
Income and profit taxes	6.0	7.5	8.0	7.8	7.8	8.1	7.8
Value-added taxes	6.4	5.2	5.2	6.3	5.3	5.5	6.0
Excise taxes	1.9	1.9	1.8	1.7	1.5	1.4	1.4
Mining Taxes	2.8	2.7	2.2	1.8	1.9	1.5	1.1
Taxes on international trade	0.4	0.4	0.6	0.7	0.6	0.6	0.7
Other revenues (tax and non-tax)**	**3.9**	**3.1**	**3.3**	**6.5**	**5.3**	**5.2**	**6.4**
Funds	**4.6**	**3.8**	**3.9**	**3.8**	**3.6**	**3.7**	**3.7**
Pension fund	4.6	3.4	3.6	3.5	3.4	3.4	3.4
Other	0.0	0.4	0.3	0.3	0.2	0.2	0.3
Total expenditures, of which:	**27.3**	**28.9**	**30.6**	**33.6**	**29.8**	**29.8**	**31.0**
Social safety nets	5.9	6.7	6.6	7.6	6.5	6.5	7.3
Social and cultural expenditure	9.6	9.2	9.4	9.5	9.0	9.0	9.8
Public investment	2.5	2.3	3.7	3.1	2.0	1.6	2.4
Public administration	1.1	1.4	1.4	1.4	1.2	1.1	1.2
Economy	1.5	1.9	1.4	1.3	1.2	1.1	1.1
Interest expenditure	0.2	0.3	0.3	0.4	0.4	0.4	0.3
Externally Financed Projects	1.2	1.5	1.0	0.8	1.3	1.3	1.4
Other expenditure**	5.3	4.7	6.8	9.5	8.2	8.8	7.5
Budget Balance	**-0.3**	**-3.3**	**-4.7**	**-4.0**	**-2.9**	**-2.8**	**-2.7**
Policy lending***	**3.5**	**1.1**	**1.5**	**0.4**	**0.5**	**0.3**	**0.3**
Overall fiscal balance	**-3.8**	**-4.4**	**-6.2**	**-4.3**	**-3.5**	**-3.0**	**-3.0**
Statistical discrepancy	**0.4**	**-1.8**	**-1.5**	**0.0**	**0.0**	**0.0**	**0.0**
Financing, of which	**4.5**	**2.6**	**4.7**	**4.3**	**3.5**	**3.0**	**3.0**
Domestic	-1.9	-4.2	1.4	1.1	-0.5	0.5	0.5

[5] 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.

External	6.2	6.9	3.3	3.2	4.0	2.5	2.5

** Tax projections account for a reduction in the general VAT rate from 15 to 12 percent from January 2023.*
*** From 2022, the revenues and expenses of nearly 30,000 off-budget accounts of ministries and agencies are now included in the budget as part of budget transparency and consolidation reforms.*
**** Mainly lending to finance SOE investments by the Uzbekistan Fund for Reconstruction and Development, and other smaller on-lending activities of the Ministry of Finance (e.g., mortgage market financing).*
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.

18. **Households' budgets are fragile and leading labor market indicators show signs of a slowing recovery.** Between 2000-2019, real per capita GDP growth averaged almost 5 percent, and rising income contributed to both the near elimination of extreme poverty and a sustained reduction in the national poverty rate. The pandemic brought a sharp reversal, with the unemployment rate climbing to 10.6 percent in 2020 from 9 percent in 2019. The rebound in economic activity reduced the unemployment rate to 9.6 percent in 2021. In July 2022, only about half of respondents to the L2CU survey agreed it was a good time to find a job where they live, down from 63 percent a year before. Respondents also reported low levels of financial resilience in the first quarter of 2022, with more than half saying they did not have any liquid savings, and 54 percent that they could not pay an emergency expense of 100,000 soms (about US$9) in July if needed.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

19. **Growth is expected to be better than initially expected in 2022, and to return to pre-pandemic levels over the medium-term, though downside risks to this outlook remain high due to the war in Ukraine and its possible economic repercussions for Uzbekistan.** Uzbekistan's growth forecast for 2022 has been revised up relative to forecasts prepared in March 2022 as remittances from, and exports to, Russia have fared better than expected. However, risks of an adverse shock remain high should sanctions or events in Russia leave to a sharp disruption of activity. A rebound in agricultural output and tourism arrivals, and increased government spending, are also expected to continue to support growth in 2022. Continued uncertainties about the external economic environment are expected to lower growth slightly in 2023. Growth is expected to return to trend levels of above 5 percent over the medium term as external conditions improve and as domestic reforms continue. Reforms in the agricultural sector are expected to support a steady expansion of 3-4 percent per year, while improvements in energy sector infrastructure and the performance of chemicals and non-gold extractive production should support industrial growth of about 6 percent per year. Construction growth is projected to remain strong amidst a substantial shortfall in urban real estate (particularly in Tashkent), and the liberalization of service sector activity is also likely to underpin medium-term growth prospects. Public and private investment growth is projected to remain strong on the back of efforts to modernize ageing infrastructure. Consumption will be supported by ongoing reforms to expand social protection coverage and levels to address adequacy gaps, and rising labor incomes. Recent efforts to tap new manufacturing export markets, and the revival of Uzbekistan's tourism sector are expected to contribute to strong gains in export earnings. Faster progress with reforms offers an upside to these projections—particularly if reforms to privatize state enterprises, further deregulate the services sector, and address factor market constraints, are accelerated.

20. **The war in Ukraine has introduced significant uncertainty in the medium-term outlook.** Growth projections are subject to uncertainty as the duration and depth of the economic downturn unfolding in the region—especially Russia—is still unclear. Prior to the start of the war, Russia was Uzbekistan's largest trading partner (17.8 percent of trade in 2021) and foreign investor (about 40 percent of the stock of FDI in past years), and Uzbekistan was heavily reliant on supply chain dependencies in retail, services, and manufacturing. Nearly half of Uzbekistan's sea-borne trade relied on Russian rail and road networks. Following Russia's invasion of Ukraine, Uzbekistan's trade, investment, and supply chain relationships saw significant upheaval, and initial expectations were for Uzbekistan's economy to be sharply affected by the spillovers of the war. With Uzbekistan's households heavily reliant on the Russian economy—one in eight have remittance income, most of which comes from Russia (about 80 percent in 2021)—initial expectations were also for a substantial impact on household poverty through a large fall in remittances and the return of labor migrants from Russia. Although these risks did not materialize in 2022—remittances rose sharply and exports to Russia increased—prospects remain high that they could materialize in 2023 or over the medium-term. In addition, higher global inflation—especially food and energy—is weakening household demand, and tighter global financial market conditions and weaker investment conditions could also contribute to Uzbekistan's economic challenges over the medium-term.

21. **Fiscal consolidation is beginning to return the deficit to a more sustainable medium-term level.** The government is moving forward with its fiscal consolidation plans, albeit at a slower pace than initially intended at the time of budget approval. The overall fiscal deficit in 2022 is projected to be 4.3 percent of GDP (against 3 percent at budget approval), with better-than-expected tax collections and expenditure reprioritization helping partially offsetting support measures for food importers affected by transport and supply chain disruptions and higher social safety net spending to mitigate the negative impact of inflation on poor households. Fiscal consolidation is expected to pick up from 2023, despite a reduction in the VAT rate from 1 January 2023, and is premised on further reductions in public investments, economic spending, and policy lending by the UFRD to SOEs (about 1.6 percentage points of GDP over 2023-2024), the withdrawal of remaining pandemic-related stimulus and social protection expansions (about 1.1 percentage points of GDP over 2023-2024), and the streamlining of recurrent spending (about 1 percentage point over 2023-2024 of GDP largely from off-budget accounts while protecting core social protection, health, and education spending). The reductions in spending are expected to more than offset anticipated revenue decreases from the VAT reform and will help support a moderation of the overall deficit to around 3 percent of GDP over the medium term.

22. **Shallow domestic financial markets and tightening global financial market conditions have compelled the government to seek higher levels of fiscal support from development partners.** Low levels of financial inclusion and intermediation limit the extent to which the government can raise money in domestic debt markets. In addition, the use of UFRD funds for budget stabilization purposes is legally prohibited—a deliberate government policy stance since the Fund's inception to ensure that resources are only used for long-term transformational projects. As a result, 76 percent of the projected 2022 gross fiscal financing needs will need to be financed from external sources—including through this proposed operation which will contribute directly to 22 percent of gross fiscal financing needs and an additional 17 percent through parallel financing by the AIIB—with the remainder from a combination of domestic treasury bill issuances, deposit withdrawals, and privatization receipts (Table 3). Amidst high levels of uncertainty and tightening global financial market conditions, the government postponed plans to issue about US$1 billion in Eurobonds this year to finance the 2022 deficit. Instead, it has requested additional support from development partners (DPs), including the World Bank, to cover this amount and help finance the increased budget deficit in 2022 relative to original budget projections. If additional development partner financing is insufficient to fill the financing gap, the government's alternative strategy will be to draw down its International Monetary Fund (IMF) SDR holdings (currently about SDR 794.4 million), and—if needed—a Eurobond issuance despite the high potential costs.

Table 3: Budget Financing Needs in 2022 (US$ millions) (Estimates – November 2022)		
	Needs	**4,362**
1.	**2022 Budget Deficit**	**3,164**
2.	**Amortization due on public debt**	**1,198**
	Sources	**4,362**
1.	**Debt disbursements**	**3,865**
	GOU Eurobonds (external and domestic)	**0**
	Domestic T-bills	**548**
	Development partner project disbursements	**835**
	Development partner budget support financing, of which:	**2,482**
	World Bank DPO (this operation)	*950*
	Asian Development Bank	*650*
	AIIB (via parallel financing against **this operation**)	*530*
	Government of France	*152*
	Islamic Trade Financing Corporation	*100*
	OPEC Fund (via parallel financing against the preceding World Bank DPO)	*100*
2.	**Privatization proceeds**	**110**
3.	**Deposit withdrawals***	**387**

** Includes government deposits in the banking system and held by SOEs*

23. **Inflation is projected to remain high through 2023, before gradually falling over the medium-term.** High food prices—which contributed to higher-than-expected domestic inflation in the first half of 2022—are expected to persist for the remainder of the year and into 2023. This is likely to keep inflation well above the government's inflation target. Further one-off inflationary pressures are also likely should the government resume efforts to increase utility prices to full cost-recovery levels. In the medium-term, and as global commodity prices ease, positive real interest rates, further slowdown in credit growth, and the government's fiscal consolidation efforts are likely to support a more sustainable return to single-digit inflation and to the government's inflation target of 5 percent by 2026.

24. **The current account deficit is expected to moderate over the medium term.** Higher import growth and an abatement of the unusually high remittances recorded during the first half of 2022 are expected to worsen the current account deficit for the remainder of the year to about 3.3 percent of GDP. The deficit is expected to stabilize at about 5 percent of GDP over the medium term as capital imports to support Uzbekistan's economic modernization continue to outpace improvements in export performance and as remittances and financial transfers further moderate. Reforms to accelerate SOE privatization, increase competition, and reduce investment barriers in sectors previously dominated by the state are expected to increase FDI and portfolio inflows and eventually substitute lending from DPs as the primary source of balance of payments financing (Table 4).

25. **Reforms continue to improve the banking and financial sector.** While the war in Ukraine has not triggered major repercussions for the banking system of Uzbekistan (despite linkages to the Russian economy and financial system), increases in credit risk and unanticipated indirect spillovers will require more careful monitoring. Despite challenges in the external economic environment, the government has maintained an ambitious timeline for the privatization of state-owned banks. Other parts of the financial sector, such as corporate equity, debt, insurance, and non-bank credit markets are underdeveloped but are expected to grow as the government develops facilitating legislative frameworks and institutional reforms in the sector. A new non-bank credit organizations law (supported by

this operation) will help expand access to finance for smaller businesses. Recent legal changes enacted in March 2022 will permit resident and non-resident individuals to purchase government bonds, helping to deepen capital markets. In July 2022, the government issued its first-ever inflation-linked bonds worth more than UZS100 billion (about US$10 million, with 2-year maturity). The government is currently working on new capital markets legislation with the support from the World Bank and other international financial institutions (IFIs). The government has also increased its ambition for insurance market reform, including through the development of catastrophe insurance markets and efforts to digitize the insurance market.

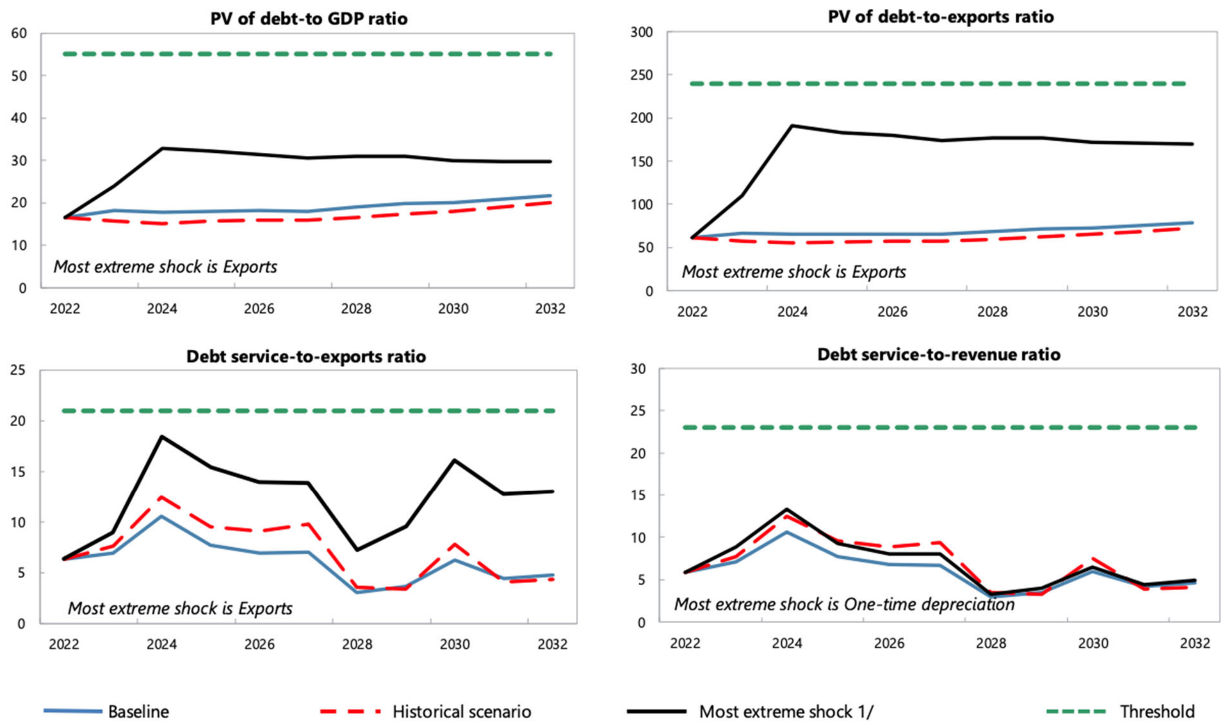
Table 4: External Financing Requirements and Sources (percent of GDP)

	2020	2021	2022	2023	2024	2025
		Est.		Projected		
Gross External Financing Needs, *of which*	**9.5**	**14.1**	**9.8**	**10.5**	**11.2**	**10.4**
Current Account Deficit	5.0	7.0	3.3	4.6	4.9	5.0
Amortization payments	4.5	7.2	6.5	5.9	6.3	5.4
Financing Sources, *of which*	**9.5**	**14.1**	**9.8**	**10.5**	**11.2**	**10.4**
Net FDI and Portfolio flows	3.0	3.0	1.6	2.3	3.3	3.5
Public debt	9.0	5.5	4.5	4.9	4.2	3.7
Other flows	1.5	7.2	5.1	3.8	2.2	2.1
Use of reserves (- increase)	-2.1	0.6	-1.4	-.05	1.5	1.1
Errors and omissions	-1.9	-2.2	0.0	0.0	0.0	0.0

26. **Stronger fiscal discipline is supporting the faster stabilization of public and publicly guaranteed debt.** PPG debt, as a share of GDP, is expected to increase by about 2.4 percentage points of GDP in 2022 before falling steadily to below 34 percent of GDP by 2025. Most new public debt will continue to be raised externally as domestic capital markets remain underdeveloped. A significant part of external borrowing will continue to be at concessional rates from international financial institutions (IFIs) and other DPs. Uzbekistan maintains access to external financial markets, as evidenced by an improving sovereign credit rating outlook and good outcomes for Uzbekistan's external debt issuances—including those issued in local currency. Since 2017, a steady series of reforms has strengthened debt discipline, including a Parliament-approved annual borrowing limit on new PPG external and domestic debt, and reforms to strengthen debt management, transparency, and reporting. A new debt law, supported under the last DPO, recently entered into force, further strengthening debt management practices by introducing a long-term limit for PPG debt at 60 percent of GDP. The Law 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.

27. **Risks to debt sustainability are low.** A joint World Bank–IMF Debt Sustainability Analysis (DSA) conducted in May 2022, noted the most significant risks as worse-than-expected external inflows, mainly remittances and lower exports. PPG debt is expected to stabilize at about 35 percent of GDP over the medium-term, and total external debt is expected to stabilize at about 54 percent of GDP (Figure 1). The public debt-to-GDP ratio is expected to increase moderately over the medium-term, while total external debt-to-GDP is expected to decline modestly. Mitigating these risks are high debt carrying capacity, low rollover risks (due to the relatively low volume of outstanding commercial debt), and high foreign exchange reserves.

Figure 1: Uzbekistan PPG DSA Charts



28. **Uzbekistan's macroeconomic policy framework is adequate for the proposed operation.** Uzbekistan has weathered multiple shocks while maintaining strong fiscal and external buffers. In the baseline, growth is expected to stay at around 5 percent over the medium term. Effective fiscal management is beginning to rein in the deficit after a pandemic-induced increase. Improved fiscal transparency and risk management and stronger debt discipline are expected to help sustain consolidation efforts. Public debt is modest at just under 36 percent of GDP, and Uzbekistan continues to maintain access to financial markets. Although Uzbekistan's more flexible exchange rate policy leaves the economy more vulnerable to depreciation risks—especially given the current external environment—ample foreign exchange reserves provide the authorities space to help smooth excess exchange rate volatility and manage large shocks. Reserves stand at about 11 months of imports and have continued to be helped by high global commodity prices for Uzbekistan's gold and copper exports. Increased fiscal space will also be critical to accommodate any additional social spending in response to further shocks. Inflation is expected to decline over the medium-term as the central bank continues to maintain a tight monetary stance.

29. **The World Bank and IMF continue sharing a close and collaborative relationship in support of Uzbekistan's reforms.** The IMF has continued to provide extensive technical assistance to the government and has increased staff monitoring. An extensive technical assistance program continues to be delivered 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

30. **Consistent with lessons learned from other countries' successful economic transitions, Uzbekistan's first phase of economic reforms under its 2017-2021 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.

31. **Under the economic pillar of the government's new NDS 2022-2026, the focus of reforms has now shifted to reducing the state's role in economic production, where reforms have moved less rapidly (Box 1).** 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 benefit from monopoly rights and special privileges in priority economic sectors (such as energy, mining, telecommunications, and transportation). Ambitious reforms to improve urban and agricultural land markets are under development and are expected to be adopted in 2023. The government is also preparing to partially privatize most of its large SOEs via share sales as a way of increasing SOE oversight and market discipline and deepening local capital markets. The process to privatize state banks is also gaining momentum.

Box 1: Uzbekistan National Development Strategy for 2022–2026

Overarching goals:

1. Attain upper-middle-income status (US$4,000 per capita) by 2030
2. Reduce poverty by half by 2026

Approach:

(a) **Building a "people's state" through the enhancement of human dignity and further development of a free civil society**, including actions to (i) strengthen public accountability, community-led development, and public oversight of state functions; (ii) make public administration more digital, efficient, and citizen centric; and (iii) strengthen parliamentary oversight of government operations.

(b) **Making justice and the rule of law the most foundational and necessary conditions for development**, including actions to protect property rights, ensure the rule of law and constitutional legitimacy, establish strong judicial controls, increase access to impartial justice, and establish a more effective and citizen-centric system of law enforcement to maintain public order.

(c) **Developing the national economy and ensuring high-growth rates**, including actions to improve the investment climate and business environment, reduce the footprint of the state in the economy, improve agricultural and livestock productivity, attract greater private investment, strengthen outward and export orientation in the economy, increase the sustainability of energy and water resource use, and provide effective enabling infrastructure to support economic development in all regions.

(d) **Developing inclusive social policy and human capital development**, including actions to increase vocational education coverage; increase access to high-quality preschool coverage; increase the quality and remuneration of teachers; increase higher education enrollment rapidly to 50 percent, including through an expansion of high-quality higher educational institutions; strengthen links between industrial enterprises and scientific institutions; expand social safety nets among the population; improve the quality of health services (including high-technology services); improve the value for money of public health spending and strengthen partnerships with private health service providers; improve pharmaceutical regulations; and promote healthier lifestyles.

(e) **Supporting cultural and spiritual development**, including actions to transform and popularize reading and libraries, strengthen interethnic and religious tolerance, expand public investments in supporting cultural and artistic talent activities, and improve infrastructure in major cultural sites.

(f) **Addressing global issues at the national level, including actions to mitigate existing ecological issues**, such as protecting the environment and improving the environmental sustainability of urban areas; establishing effective mechanisms to counteract extremism and terrorism; introducing integrity standards for public servants; increasing the efficiency of corruption prevention factors; ensuring safe, organized, and legal labor migration; and strengthening people-to-people links with Uzbekistan's diaspora.

(g) **Strengthening security and defense and conducting an open, pragmatic, and active foreign policy**, including actions to strengthen the defense capability and improve the preparedness and responsiveness of civil defense systems; improve regional cooperation on security, trade, water, energy, transport and connectivity, and cultural and humanitarian issues; further develop relations with traditional partners; accede to the WTO and deepen integration with the Eurasian Economic Community; increase international awareness of Uzbekistan; enhance foreign policy and trade legislation; and improve the performance of Uzbekistan's representational offices abroad.

32. An ambitious social and political reform process complements 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 2021 noted that Uzbekistan cotton "is free from systemic child labor and forced labor". The report also notes that Uzbekistan is making significant progress to strengthen the fundamental labor rights of harvest workers, including through improvements in the wage-setting framework. 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 increasing regional and international people-to-people and trade links, expanding press and media freedoms, and establishing elected regional and local governance. Collectively, these reforms have helped underpin substantial social support for the reforms, which continues to be strong.[6]

33. Uzbekistan's development strategy also includes the government's strong commitments to improve energy efficiency and reduce the intensity of fossil fuel use. Uzbekistan's voluntary commitments on climate change mitigation and adaptation under its updated Nationally Determined Contribution (NDC) from 2021, entail a decrease in specific emissions of greenhouse gases per unit of GDP by 35 percent by 2030 (relative to 2010 levels). Uzbekistan has also committed to continue its efforts toward climate change adaptation, to reduce the risk of 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 retail petroleum subsidies

[6] Recent data from the Listening to Citizens of Uzbekistan survey—a nationally representative survey conducted by the World Bank to monitor the views and well-being of a representative sample of people as reforms are introduced—shows that in August 2022 over 85 percent of those surveyed said that they believed the government was engaging in open dialogue with citizens on reform.

(supported under the third DPO),[7] the energy sector reforms to reduce technical losses and increase the cost-recovery of tariffs, and the approval of a long-term electricity strategy that commits to increase the non-hydro renewable energy from zero to 30 percent of the total electricity generation mix by 2030. Although some energy sector reforms—such as achievement of full cost-recovery tariffs and establishment of a new energy regulator—were delayed by the onset of the COVID-19 pandemic and subsequent uncertainties created by the war in Ukraine, these reforms remain a high priority for the government in 2023.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

34. Consistent with the government's reform priorities, the Program Development Objectives (PDO) of the proposed operation is to support Uzbekistan's transition to an inclusive and private sector-led market economy through (a) strengthening market institutions for private sector growth; (b) improving state-owned enterprise management; and (c) increasing social inclusion and resilience. Under the first pillar, the operation supports measures to establish robust legal frameworks for privatization, competition, and insolvency; increase private sector participation in Uzbekistan's high-potential telecommunications sector; and deepen non-bank financial markets. Under the second pillar, the operation supports measures to restrict SOEs from non-core business activity expansions, reduce fiscal risks arising from SOEs through a new risk management framework, and improve the governance of SOEs. Under the third pillar, the operation supports measures to improve the efficiency, effectiveness, and transparency of social safety nets through a new social protection policy, and the reform of the maternity benefits system for private sector employees. The operation will also contribute to the government's climate action agenda through more explicit requirements for environmental issues to be considered as part of the privatization process, through further measures to streamline the performance and environmental transformation of SOEs, and through reforms that increase the resilience and flexibility of the social safety net system to respond to climate risks.

35. The long-term structural reforms supported by the World Bank's DPOs will take time to show results. Uzbekistan's early reforms have begun to show some promising results in the form of a growing private sector, improved rural incomes, increases in international portfolio and investment inflows, and robust demand for tourism. Many of these outcomes were the result of significant measures to deregulate and liberalize markets—measures that took instant effect from promulgation. However, as Uzbekistan's reform agenda shifts towards deeper and more complex structural reforms that require more time to implement and have effect on the economy, the results of these reforms will take more time to deliver. This is especially the case in actions supported by this proposed operation—such as measures to improve the environment for competition and private sector development, improve SOE governance and performance, and establish strong foundations for effective privatization of state assets. Annex 5 provides an overview of the longer-term results that are expected from these reforms and from the World Bank's DPOs in Uzbekistan.

36. The World Bank remains agile in its use of standalone DPOs to support 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 Uzbekistan's 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. Supporting this reform agenda has required greater operational

[7] *Supporting a Transparent and Inclusive Market Transition (P171751)*

agility—of the kind provided by standalone DPOs. As the pandemic and the war in Ukraine have shown, Uzbekistan's transition is also vulnerable to external events beyond its control, further warranting operational flexibility. As the reform agenda matures, a shift to programmatic DPO series should become more feasible. Despite the use of standalone DPOs, the Bank's policy engagements continue to be anchored to a consistent program of supporting inclusive market reforms. Each standalone DPO has helped sustain sequenced reforms in sectors critical to an inclusive transition such as agriculture, energy, SOE reforms, fiscal transparency, and social protection reforms. The DPOs have also helped anchor the WBG's broader country engagements under a strong and programmatic policy dialogue centered on key transitional issues. Annex 5 provides an overview of how this approach has helped support an effectively sequenced and prioritized reform agenda.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Pillar 1: Strengthening market institutions and the environment for private sector growth.

Legal framework for privatization

37. Background: The first systematic plan to implement large-scale privatization is now under way in Uzbekistan. Just a few months after its independence from the Soviet Union in 1991, Uzbekistan's Parliament approved a law on denationalization and privatization covering a wide range of state-owned assets. However, the country made little progress over the subsequent decades, instead accumulating additional assets through nationalizations and the creation of new entities, including joint ventures with foreign investors. Then in 2020, the government announced an ambitious full-scale privatization process (supported under the third DPO in FY21),[8] aiming to dispose of nearly 3,000 SOEs and most of its individually held fixed assets (e.g., real estate).[9] This followed the creation of a new State Asset Management Agency (SAMA) in 2019 (supported under the second DPO in FY19),[10] which assumed ownership of nearly all small and medium-sized SOEs.[11] Since 2020, close to 500 enterprises have been sold—largely small SOEs with uncomplicated financial structures and few assets. The privatization of larger SOEs has moved more slowly—the result of fragmented legal, regulatory, and accountability frameworks, an interest in learning from the experiences of smaller privatizations, and deteriorating domestic and global investment conditions due to the COVID-19 pandemic and recent global and regional economic and political uncertainty.[12] Despite the relatively slow start to the privatization process and limited progress to date in privatizing medium and large enterprises, the privatizations to date represent the first systematic divestiture of government asset ownership in Uzbekistan since independence.

38. Uzbekistan's existing legal framework for SOE privatization is outdated, non-transparent, heavily fragmented, and does not provide a robust enough framework for the government to realize its ambitious privatization agenda. There is no single unified legislative framework for privatization in Uzbekistan. Instead, the privatization of each SOE is subject to a plethora of laws, resolutions, and decrees that are dated and have overlapping mandates, and conflicting requirements. Outdated privatization and denationalization laws do not have adequate accountability and transparency provisions and leave significant decisions on individual privatizations to the discretion of individual policymakers. The absence of clear accountability provisions and clarity on privatization processes are compounded by the imposition of harsh penalties on individuals that are complicit in privatizations that lead to suboptimal outcomes

[8] *Supporting a Transparent and Inclusive Market Transition (P171751)*
[9] A small number of SOEs – particularly larger enterprises with systemic importance (e.g., gold mining, defense and security) will be retained by the state, while another small subset of SOEs will be partially privatized or converted into Public-Private Partnerships.
[10] *Sustaining Market Reforms in Uzbekistan Development Policy Operation (P168280)*
[11] Ownership of the largest SOEs and state-owned banks was transferred to a newly created unit in the Ministry of Finance.
[12] A notable exception is the privatization of Coca Cola Ichimligi Uzbekistan Ltd.—which was sold after a transparent competitive sale process managed by a global investment advisory firm (Rothschild & Co.).

(e.g., the eventual closure of the business, asset-stripping, or large-scale layoffs). As a result, there has historically been significant risk aversion and reluctance among officials to assume responsibilities for the privatization of SOEs. Lessons from the experiences of other transition economies suggest that early investments in strong privatization legal frameworks are critical to achieving strong outcomes from the privatization of larger and more valuable state assets. The contrasting experiences of privatization outcomes in Poland and Russia also emphasize the importance of strengthening financial stability, closing gaps in market institutions, and ensuring a stable macroeconomic environment. Big gaps in Russia's legal and regulatory framework created loopholes that allowed capture by vested interests. Although this insider advantage was also a problem in Poland's privatization, early investments in strengthening market institutions, especially reforms to strengthen legal frameworks, were critical in restricting insider influence and capture by vested interests. Uzbekistan has largely followed this process, creating institutions to take stock of its assets, testing smaller privatizations first, modernizing legislation, and learning from these experiences to develop more robust frameworks to oversee larger SOE privatizations.

39. <u>**Objective of the prior action:**</u> **A new framework law on privatization will provide a systematic and unified legislative environment for divestiture of government asset ownership.** In July 2022, the government submitted, for Parliamentary approval, a draft Law, "On Privatization", which, when approved, will replace the 1991 denationalization legislation and 13 other substantive laws, resolutions, and decrees that cover various aspects of state asset privatization. In addition to providing a unified legislative framework, the Law addresses several issues in comparison to the existing legal and regulatory framework. First, it assigns clear roles, powers, and responsibilities and functions to the different entities involved in pre-privatization, privatization, and post-privatization monitoring processes, including the President, Cabinet of Ministers, Parliament, government agencies, and the governing bodies and management of the SOEs. Second, it enshrines transparency and competition as overarching principles throughout the privatization process—from the decision to privatize through to post-privatization monitoring, with requirements for state agencies to submit regular reports to Parliament and make available information related to privatization on their websites. Third, it sets out the methods of sale—through auctions, tenders, public negotiations, liquidation, and direct negotiation—and the processes to be followed in each case. Whereas authorized government agencies would have broad discretion in choosing methods of sale other than direct negotiations, any directly negotiated sales would require additional approvals from the President or the Cabinet of Ministers (depending on the size of the government's share in the entity). Further, all assets sold via direct negotiations would be disclosed to the public and as part of regular reporting to Parliament under transparency provisions (that apply to all privatizations) in the Law. Fourth, the Law applies to all privatizations of state assets—no state assets can be sold in a manner or method outside the purview of the Law. Fifth, the Law establishes some checks and balances to limit insider actions—for example from the moment an SOE is approved for privatization, the SOE management cannot reorganize the corporate structure, liquidate, or alienate any of the SOE's assets, or acquire any new entities or large assets. Finally, the Law also sets out a list of social and investment obligations that potential buyers of state assets could be required to agree as a pre-condition for sale, including requirements to preserve jobs and working conditions for a certain time, ensure environmental safety measures, or commit to certain types of investments such as in renewal of capital, purchase of know-how and intellectual property, or investments in improving the skills and knowledge of workers. The Law was prepared with substantial analytical and advisory support from the World Bank and the European Bank for Reconstruction and Development (EBRD).

Prior Action 1: To modernize the legal framework for state-owned enterprise privatization, increase the transparency of privatization processes, and support increased private sector investments, the Borrower has submitted a law on privatization for parliamentary approval.

40. <u>**Expected results and next steps:**</u> **Once approved, the Law is expected to help the government accelerate its privatization program in a more methodical, transparent, and systematic way.** While the longer-term benefits of the new privatization legislation will take time to materialize (especially in the case of larger assets, which require time to prepare for privatization), the law's reporting requirements include—for the first time—a requirement for information to be regularly and publicly disseminated and discussed by Parliament (Result Indicator 1), helping to strengthen public accountability, as the government implements its privatization program. The preparation and dissemination of this information is a critical reform outcome supported by the Law to strengthen transparency and public accountability when public assets are privatized. Once the law is approved, all ongoing pre-privatization and privatization initiatives are expected to be compliant with its provisions. Implementation of the law will also require further legal and regulatory work to align other relevant legislation to the provisions of the new law (a requirement for the Cabinet of Ministers to complete under Article 56 of the draft law) and enact necessary subsidiary regulations and legislation that is needed for the law to take full effect. The Parliament is expected to play a lead role in monitoring the implementation of the law through both its regular reviews of the law's implementation progress and its ongoing quarterly reviews of government agencies' performance.

41. **The measure is also expected to generate climate co-benefits over time as climate policy obligations under the new law are applied to privatization processes.** Article 32 of the new law establishes an important institutional first step in ensuring that the government's climate policies are explicitly factored as part of the privatization process. It requires the government to ensure that any final sale contract clearly outlines the obligations of the buyer with respect to the government's environmental policies, which include its climate change policy objectives. Article 37 of the Law specifies that these obligations could include explicit investment obligations intended to achieve the government's environmental policy objectives. This lays the foundation for further regulations and institutional reforms to ensure that the privatization of more carbon and energy intensive SOEs—especially in the energy, chemicals, and manufacturing sectors, which are responsible for most of Uzbekistan's greenhouse gas emissions—is conducted in a manner that is consistent with the government's climate change mitigation targets. It also establishes a legal and institutional environment for the government to append investment obligations—such as technology modernization or efficiency requirements—that are explicitly linked to carbon reduction in highly carbon-intensive businesses.

42. **Lessons from other SOE reform programs highlight several large risks that must be carefully monitored.** Alongside the entry-into-force of this law, it will be critical for the government to have a strong risk management framework enveloping the privatization process. As the experiences from other countries show, there are significant institutional, social, and political challenges that emerge from government divestiture programs. Most important among these social risks emerging for employees who are negatively affected by the privatization or future employment decisions of the private sector buyer. The Law requires the government to consider any outstanding social obligations before issuing final sale clearances. The Government is working closely with the World Bank to develop improved approaches to assess and quantify risks to workers, design benefits packages for displaced workers, and improve existing rules and policies. These include workers' compensation requirements in the case of bankruptcy, liquidation, and downsizing, together with the adequacy of budget allocations to the State Employment Fund that manages compensation payments.

Privatization in the telecom sector

43. <u>**Background:**</u> **Uzbekistan is well-positioned to benefit from a vibrant digital economy but lags other Central Asian countries in mobile penetration.** Uzbekistan has the largest market in Central Asia by population, with a young, rapidly growing labor force. Currently, the information and communications technology sector employs about 30,000 people across about 1,400 enterprises. Opening the sector to greater private sector investment and competition could help deliver reliable and affordable internet services to Uzbekistan's citizens and create a more supportive environment for greater employment, entrepreneurship, social inclusion, and exports. Uzbekistan lags other Central Asian countries in both mobile penetration (85 percent) and mobile broadband penetration (69 percent) rates. Uzbekistan's overall

mobile connectivity ranking is 128th, only somewhat better than that of Tajikistan and is considerably behind those of Kazakhstan, Kyrgyzstan, and the South Caucasus.[13] The country also ranks poorly on global measures of mobile internet speeds.[14] Uzbekistan's mobile infrastructure has improved in recent years, but it still lags that of most of its neighbors. The low amount of spectrum allocated to each mobile operator—a determinant of network performance and quality of service—is a key inhibitor of growth.

44. The current market structure for mobile telecommunications and the dominance of state ownership inhibits Uzbekistan's digital transformation. The state continues to fully own two mobile operators, and has a substantial ownership share in a third, in a market of five mobile operators.[15] The three operators with government ownership interests collectively account for about 76 percent of the total market share. The state-owned Uzbektelecom has the highest market share and dominates both fixed and mobile retail and wholesale markets. The restrictive regulatory environment and limited competition has also inhibited the faster pace of technological adoption.

45. <u>Objective of the prior action:</u> In March 2022, the government approved the full privatization of Universal Mobile Systems (UMS), a fully state-owned mobile telecommunications operator. UMS is the smallest state-owned mobile telecommunications operator, but is the fastest growing mobile operator in Uzbekistan, gaining nearly 7 percent of the market in just eight months to reach a market share of about 21 percent by end-June 2022, close to the market share of the largest existing private sector operator. UMS enjoys attractive spectrum assignments and relatively well-developed physical network infrastructure. Initial market testing by the government suggests that the privatization is likely to attract strong interest from the private sector. In March 2022, the government announced that UMS would be sold through a fully competitive and transparent sale process. If successfully executed, the transaction will be the first competitive and transparent divestiture of state ownership in the telecommunications sector. SAMA, which is overseeing the privatization process, is in the process of selecting and appointing a transaction advisory company to advise and manage the sale (following a competitive bidding process).

Prior Action 2: To increase private investment in the mobile telecommunications sector and accelerate the expansion of mobile digital services, the Borrower has approved the privatization, through a transparent process, of a fully state-owned mobile telecommunications services provider.

46. <u>Expected results and next steps:</u> The measure is expected to increase private sector ownership and competition in the telecommunications sector (Result Indicator 2). As the first competitive privatization in the telecommunications sector, the sale of UMS is expected to serve as a test case for further liberalization and public ownership divestiture in the sector (particularly fixed-line services).[16] The privatization of UMS is also expected to boost competition in the sector, establishing two private operators of a similar size. Over time, increased competition—supported by other enabling reforms in the telecommunications sector—is expected to spur more investments in new technologies such as 5G. The government has set a target date of April 2023 for the completion of the privatization.

[13] The Global System for Mobile Communications Association (GSMA) publishes an annual Mobile Connectivity Index that measures the performance of 170 countries according to infrastructure, affordability, consumer, and content dimensions.
[14] *Ookla's monthly Speedtest Global Index (June 2022)* – Uzbekistan ranks 116th out of 140 countries for mobile internet speeds.
[15] Of the two fully private operators, only one (VEON/Beeline) operates a large countrywide network. The other (Perfectum) has just over one percent of the market share and is concentrated in urban areas.
[16] In 2020, the government announced a partial privatization (51 percent of state shares) of the state-owned UCell, via a joint venture arrangement involving Russia's UMS Telecom Group (the owner of the Megafon brand). However, this arrangement was not competitive but instead announced as a directly negotiated deal. In August 2022, the government announced its intentions to partially privatize up to 10 percent of Uzbektelecom via a future initial public offering (IPO); the timeline for this operation is still being developed.

47. Further complementary reforms to improve telecommunications sector policymaking and regulation will be required to create more effective conditions for greater private participation in the sector. The state monopoly in fixed-line, wholesale, and gateway services, as well as an outdated legal and institutional framework, reinforce state controls and curtail much needed investments in the sector (especially in costlier 5G services). Announced commitments to liberalize access to international telecommunication gateways—seen as a critical reform to promote lower costs and greater competition in the sector—have not yet materialized, and private sector market participants are required by law to use Uzbektelecom's international gateway services. The legal and regulatory framework is also in need of an overhaul, with basic laws and regulations dating back to between 1992 and 2000, with little changes since then. An independent regulatory authority for the telecommunication sector was created in 2018 but requires greater powers and more institutional support to operate effectively. The government recognizes these challenges and is beginning to address them as part of an ambitious digital transformation strategy. In recent years, there has been significant progress in reducing considerable bureaucratic delays, complex procedures and approvals, and onerous technical conditions that create major hurdles for the private sector to build new telecommunication infrastructure. Addressing these issues is also the focus of substantial World Bank and IFC engagement, given the criticality of digital reforms to spur greater private sector led growth in Uzbekistan.

Non-bank financial sector development

48. <u>Background</u>: The non-bank financial sector—a catalyst of financial deepening in developing countries—is vanishingly small in Uzbekistan. Uzbekistan's financial sector is almost entirely dominated by commercial banking activity—most of it by state-owned commercial banks. Over the last six years, banking sector reforms have focused on strengthening prudential supervision and oversight, modernizing legislation, improving corporate governance, reducing state-directed preferential lending, and preparing state-owned banks for privatization. The reform agenda has been supported extensively by the World Bank and other DPs, including through successive DPOs (see Annex 5). In recent years, the government has also increased its attention to deepening Uzbekistan's credit markets—a key priority under its financial sector development and inclusion strategies, and efforts to extend access to groups currently excluded from financial market participation. Non-bank credit organizations (NBCOs) in Uzbekistan consist of Microcredit Organizations (MCOs), pawnshops and mortgage refinancing companies supervised by the CBU. As of August 2022, NBCOs account for just 0.5 percent of total banking sector assets, of which MCOs account for more than 60 percent in total NBCO assets, and mortgage refinancing about 30 percent. The microloans offered by MCOs typically come with short maturities (3 years) and relatively high interest rates (at approximately 60 percent on average), in part due to high operating costs–typical for small-sized firms–and lack of access to the right types of financing.[17] Reducing these high rates and increasing lending volumes of NCBO is a key area of focus for the government. In addition, around 25 active leasing companies, not regulated by the CBU, provide leasing services to commercial entities, and have a combined portfolio of around 1.4 percent of the banking sector credit portfolio.[18] The underdevelopment of the NBCO sector is largely the result of the fragmented and highly restrictive legal framework. There is no overarching legal framework that defines and regulates non-bank credit organizations in Uzbekistan. Instead, various types of NBCOs are regulated through a multitude of laws, Presidential and Cabinet of Ministers Resolutions, and central bank regulations. Strict limitations on activities of MCOs and their funding sources, and restrictions on new branch openings, have significantly hampered the growth of MCOs. In addition, while MCOs are not allowed to take deposits, they have

[17] The assets of MCOs are financed by their own capital (52 percent) and loans from banks and shareholders (45 percent). Pawnshops fund their assets almost entirely through their own funds (91 percent).
[18] Overview of the leasing services sector in Uzbekistan, 2021, Leasing Association of Uzbekistan

nonetheless been subject to relatively harsh prudential requirements (with 10 percent capital adequacy ratio)– equivalent to those set for banks.[19]

49. <u>Objective of the prior action:</u> **A new law will define and regulate non-bank credit organizations and unify the legal and regulatory regime that applies to them.** In March 2022, a new Law "On Non-Bank Credit Organizations and Microfinance Activities" (NBCO Law) was approved by Parliament. Developed with substantial analytical and advisory support from the World Bank, the Law draws on global good practice to create a unified legal framework that encourages NBCO development, provides regulatory oversight that is proportionate to the size of the sector and nature of the sector's activities, and protects consumers of financial services provided by NBCOs. The Law is comprehensive, spanning the definition and establishment of NBCOs; their regulation and supervision, their financial reporting requirements; their obligations to consumers and the rights that consumers are entitled to; and provisions overseeing the restructuring of NBCOs and dealing with dispute settlement processes. Importantly, the prudential regulatory regime has been overhauled with the intent of being proportionate to the types of activities carried out by the NBCO. NBCOs operating solely with their own capital or bank borrowed funds will not be subject to any prudential norms—such norms will only apply when NBCOs operate with capital that is borrowed publicly, from state or IFIs. The Law also contains strong disclosure provisions to protect consumer rights and expands the possibilities for non-residents to enter the NBCO market and establish NBCOs in Uzbekistan (previously it was limited only to non-resident MCOs and only in the form of co-ownership).

Prior Action 3: To modernize the legal framework that governs the regulation and supervision of non-bank credit organizations and support the expansion of non-bank credit markets, the Borrower has enacted a law on non-bank credit organizations and microfinance activities.

50. <u>Expected results and next steps:</u> **The Law is expected to lead to an increase in the number of NBCOs, their branches, and the volume of their financial intermediation.** Assets intermediated by NCBOs are expected to rise steadily with the near-immediate removal of the most binding constraints limiting the expansion of NBCO activity as a share of total banking sector assets. From nearly zero, the share of NBCO assets to total banking sector assets is expected to rise rapidly to 5 percent by 2024 (Result Indicator 3). Over time, with the removal of structural constraints that contributed to higher costs for microcredit organizations (such as the previously onerous prudential requirements) that were passed on as higher lending rates to consumers, the cost of obtaining microcredit services is also expected to fall.

51. **The passage of the NBCO law is an important step towards greater non-bank financial inclusion and greater diversity in the sources of financial intermediation in the economy.** Long neglected in Uzbekistan in favor of the near-totally dominant commercial banking sector, the passage of a unified legal framework is a first step in supporting the expansion of non-bank credit markets. Further work will now be needed to develop and implement subsidiary regulations and procedures specified in the legislation, including the development of a licensing framework; the establishment of a regulatory sandbox; measures to regulate Islamic financial services and payment agent services; the development of prudential regulations and financial reporting requirements; and detailed consumer protection requirements. While the development of deposit-taking non-bank credit organizations is not an immediate priority given the still-nascent state of the sector and the high levels of risk involved in the sector without strong institutional frameworks, this may be an area for development in the longer-term. In addition to non-bank credit markets, the government is also preparing institutional and legal reforms to strengthen the insurance and capital markets. These reforms are expected to gain momentum over the medium-term.

[19] The leverage ratio (assets to capital) of MCOs stood at below 200 percent as of August 1, 2022, indicating that MCOs have been unable to attract sizable funding (apart from own funds) for their operations so far.

Insolvency and Creditor Rights

52. <u>Background:</u> A sound insolvency regime is critical to more efficient capital allocation and higher firm productivity in Uzbekistan. Effective insolvency regimes play a critical role in a market economy. They encourage the restructuring of distressed but viable firms, thereby protecting the capital allocated to productive businesses and decent jobs. They force distressed and non-viable firms to exit the market, thereby opening space for new firms and reallocating capital to more productive businesses. In transition economies, insolvency regimes are even more important as a lack of experience with market mechanisms and greater information asymmetries put shareholders and creditors of distressed firms at a serious disadvantage in comparison to the managers of these firms. Effective and efficient insolvency frameworks become even more critical during crises, as it is essential for viable firms to be able to restructure and adjust to the new challenges posed by changing economic conditions. Weak insolvency frameworks not only promote a destructive wave of premature bankruptcies but may also lead to the creation of so-called "zombie" firms that remain in existence but cannot close—which disrupts competitiveness, demands unhealthy restructuring of credit, and negatively affects the financial system's efficiency and private sector dynamism. This effect is particularly harmful in the case of SOEs—which are often large and dominant in the markets they operate—especially in Uzbekistan where SOEs account for a significant share of economic activity.

53. The Uzbekistan's 2003 insolvency law is perceived as a key bottleneck for the restructuring of viable firms. External assessments suggest that Uzbekistan's insolvency regime is not in line with good practices for corporate reorganization and leads to the destruction of firm value.[20] Out of nearly 10,000 insolvency cases reported in 2021, 98 percent were either simplified or ordinary liquidations. The insolvency system is expensive, time-consuming, and unproductive—for most companies, neither creditors nor debtors are interested in filing for insolvency. The formal process is creditor-centric and offers little or no incentive for debtors to seek restructuring or for creditors to seek approval of restructuring plans. The 2003 law also excludes SOEs from its scope of application. Provisions applicable to the approval of a restructuring plan are outdated and promote conflict of interests between creditor groups. Additionally, the isolated provisions on avoidance of fraudulent and preferential transfers are extremely limited and contain no supporting provisions. As a result, insolvency is mostly viewed as a last resort. In the absence of timely restructuring options for viable firms, liquidation is often the only option. Only two restructuring procedures were opened in 2021, one judicial management and one external management procedure.

54. Multiple shocks have created substantial vulnerabilities in Uzbekistan's private sector. During 2018-2020, about 45,000 firms were liquidated in total in Uzbekistan. After the COVID-19 shock about the same number of firms was liquidated in 2021 alone.[21] In parallel, the number of inactive firms progressively increased from 14,700 in 2018 to 28,800 in 2021.[22] Likewise, the economic courts experienced a 36 percent increase in insolvency filings, from 7,302 in 2020 to 9,994 in 2021.[23] SOEs—accounting for nearly half of total output of the economy—have become even more unprofitable and, in many cases, likely distressed.[24] Given the size of the SOE sector in the economy, Uzbekistan should also pay close attention to their potential for 'zombification' that could delay transition to market principles because of extraordinary state interventions. Problems in the corporate sector naturally spill over to credit markets: NPLs in the banking sector reached about 17.5 trillion soms by September 1, 2022, a 200 percent increase since end-2020.[25] The

[20] See "Legal Aspects of NPL Resolution", WBG (2021), as well as the EBRD's Insolvency Assessment on Reorganization Procedures (2021).
[21] The State Committee of the Republic of Uzbekistan: Number of liquidated enterprises and organizations by regions
[22] The State Committee of the Republic of Uzbekistan: Number of inactive enterprises and organizations by sectors of the economy.
[23] Statistics of the Supreme Court of Uzbekistan, available at https://stat.sud.uz/iib.html.
[24] See IMF, Art. IV, 2022.
[25] Data from Central Bank of Uzbekistan.

repercussions from Russia's invasion of Ukraine and the sanctions imposed on Russia, a key trading partner, may push more distressed firms to insolvency. For these reasons, protecting productive businesses and release stranded capital to new entrepreneurship activities will become even more important.

Prior Action 4: To modernize the legal framework that governs insolvency and to support a resilient recovery through the restructuring of distressed but viable firms and distressed consumers, the Borrower has enacted a law on insolvency.

55. <u>**Objective of the prior action:**</u> **A new law will modernize the insolvency framework and encourage the restructuring of distressed but viable firms to protect capital allocated to productive business and decent jobs.** In April 2022, a new Law "On Insolvency" entered into force. Developed with substantial engagement and support from the World Bank, the Law draws on some of the best practices for insolvency and creditor rights regimes. Among other features, the Law provides distressed borrowers with a 'menu of options' so they can choose the insolvency procedure that fits their needs best, incentivizing all parties to seek a restructuring either via the external or the judicial reorganization procedures. Among other positive features, the Law follows international good standards and is applicable to SOEs, which until the enactment of the Law remained outside the scope of the insolvency procedure and could not be restructured in court.[26] The Law also addresses one key shortcomings of the 2003 law by providing for a full regime on transaction avoidance that will reduce fraud and abuses in the insolvency context—although some concerns may remain around the lack of defenses available to honest debtors. The Law includes key provisions dealing with the insolvency of consumers, making Uzbekistan the first country in Central Asia to introduce a personal insolvency system. Finally, the Law increases the powers and remuneration of insolvency administrators for them to play a more active role in maximizing the likelihood of successful debtor restructuring. These newly introduced powers include the faculty to borrow funds for the purpose of reestablishing the debtor's solvency, in line with good international practices.[27]

56. <u>**Expected results:**</u> **The new legislation is expected to lead to the increased use of insolvency and restructuring proceedings.** By introducing incentives for debtors to attempt a restructuring and by granting additional powers to insolvency administrators for pursuing restructuring, the enactment of the 2022 Law is expected to increase the number of restructuring cases that are opened by economic courts every year, which if successful, would protect more productive businesses from market exit and job destruction. This medium-term goal assumes that the new framework will encourage both distress business and their creditors to actively use it at scale. This greater use and increased restructurings will be measured relative to the total number of cases opened each year. In 2021, the Economic courts registered 9,994 insolvency cases of which only 0.02 percent were restructurings. It is expected that the 2022 Law, together with ensuing implementation actions envisaged in the coming months, would bring up the share of restructuring cases over total insolvency cases to at least 5 percent by end-2024 (Result Indicator 4).

57. <u>**Next steps:**</u> While the passage of the new Insolvency Law is a significant first step, further opportunities exist to further align the legal and regulatory framework dealing with insolvency with international best practices. The most important of these include measures to encourage the use of restructuring processes by allowing legal-entity debtors to initiate insolvency proceedings with only very limited supervision of an administrator; extending timelines to develop restructuring plans; further strengthening the transaction avoidance regime to involve shorter look-back periods, and be subject to reasonable defenses; clarifying the rules imposing personal liability on directors; strengthening the grounds for greater restructuring plan acceptance by secured creditors; linking the insolvency legal framework with business advisory assistance to SME debtors; and eliminating the subordination of secured claims to administrative and

[26] See UNCITRAL Legislative Guide on Insolvency Law, recommendation 8.
[27] See UNCITRAL Legislative Guide on Insolvency Law, recommendation 63.

personal injury claims. These are areas where further reforms are expected to be advanced by the government over the medium-term.

Competition Legislation

58. <u>**Background:**</u> **The degree of competition in Uzbekistan's markets is still perceived as weak compared with peer countries.** According to the latest Bertelsmann Stiftung's transformation index, perceptions of the state of market competition in Uzbekistan have improved since 2016, likely the result of reforms to improve the business environment.[28] However, as of 2020, Uzbekistan still falls behind its peers in Europe and Central Asia (Figure 2). This is also true of perceptions of the effectiveness of antimonopoly policy (Figure 3).

Figure 2. Perception of Market Competition, Uzbekistan vs. Selected Countries, 2016 and 2020

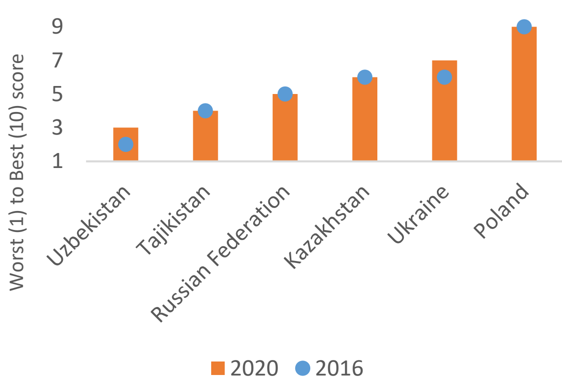
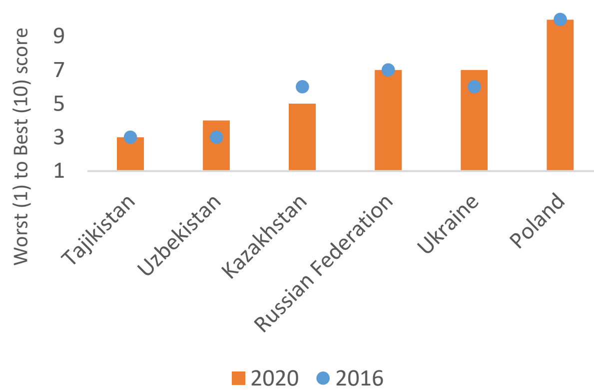


Figure 3. Perception of the Effectiveness of Antimonopoly Policies, Uzbekistan vs. Selected Countries, 2016 and 2020



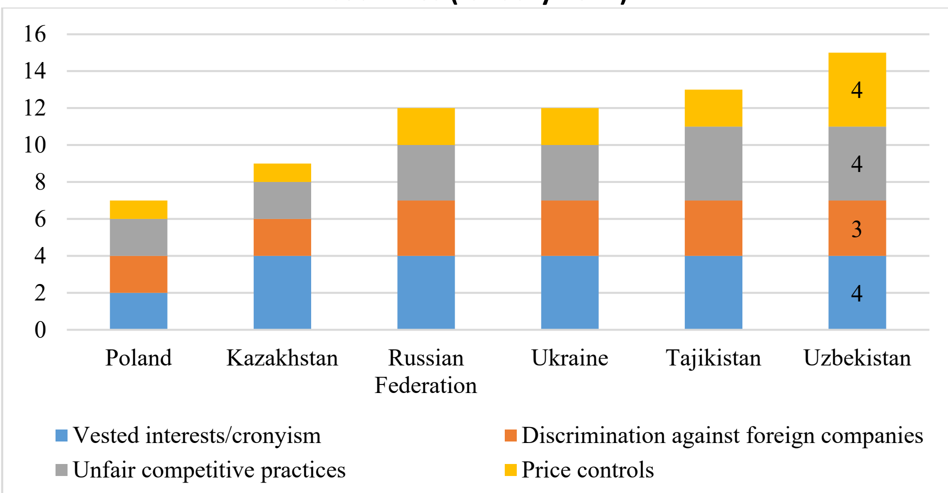
Sources: World Bank calculations; 2020 data of BTI (Transformation Index) (dashboard), Bertelsmann Stiftung, Gütersloh, Germany, *https://bti-project.org/*

59. **Government interventions are still seen as hampering competition, despite the relative improvement over the past few years.** According to the latest data from the Economist Intelligence Unit (EIU, Risk Tracker dataset, January 2021), firms in Uzbekistan perceive that their ability to compete might be impaired by government rules that impede competition on merit. Uzbekistan performs at the bottom of its comparator group, particularly on the perception of vested interests that are distorting economic decisions (Figure 4). The perception of unfair competitive practices, discrimination against foreign companies, and price controls also appear at the highest level among comparator economies. Most competition distortions induced by government interventions in Uzbekistan are related to State presence in the economy, in particular the direct state participation through SOEs and lack of competitive neutral policies among private and public operators, as most SOEs are not covered by the same laws as private firms and benefit

[28] BTI (Transformation Index) (dashboard), Bertelsmann Stiftung, Gütersloh, Germany, https://bti-project.org/

from favorable treatment as compared with the private sector.[29, 30] This situation may hinder competition and hamper the establishment of level playing field in the market.

Figure 4: Competition-related risks for business in Uzbekistan and selected ECA countries (January 2021)



Source: World Bank staff based on the EIU's Risk Tracker data (January 2021).
Note: The graph shows an aggregation of four indicators, each scored on a scale from 0 (very little risk) to 4 (very high risk).

60. Uzbekistan has adopted reforms to support the development of a comprehensive competition policy framework. In the past few years, the Government of Uzbekistan (GoU) adopted important steps towards the development of a comprehensive competition framework through legal and institutional changes. In January 2019, the GoU established the Anti-Monopoly Committee (AMC) as a spin-off from the previous State Committee for Assistance to Privatized Enterprises and Development of Competition.[31] The AMC was empowered to tackle anti-competitive behavior, distortive regulations, state aid control, and ensure non-discriminatory access to goods, works, and services. In July 2020, a Presidential decree introduced a comprehensive strategy to promote competition, establishing basic competition principles, detailed measures to encourage competition, and specific timelines and assigning specific authorities responsible for implementing a comprehensive competition policy strategy for Uzbekistan.

61. However, the policy and legislative framework for competition remains underdeveloped in Uzbekistan. A recent review of Uzbekistan's competition policy and legal environment by the Organization for Economic Cooperation and Development (OECD) identified several shortcomings in the current competition framework, including overlapping

[29] According to a new WBG Global Database on Businesses of the State (BOS), there are almost 4000 firms in Uzbekistan with at least a 10 percent GoU ownership stake, and more than 75 percent of those are found in typically competitive sectors (where it is economically viable for many operators to provide the good/service and inherent market features in these sectors, such as cost structure or demand characteristics, do not typically lead to significant market power and entry barriers are low. See Dall'Olio, A., Goodwin, T., Martinez Licetti, M., Alonso Soria, A.C., Drozd, M., Orlowski, J., Patiño Peña, F., Sanchez Navarro, D. (forthcoming), *A taxonomy of economic activities to assess SOE Presence in the Economy*.
[30] For instance, in subsectors in which SOEs directly compete with the private sector, such as hospitality services, chemicals, banking, and insurance, SOEs enjoy unfair access to inputs and regulatory preferences.
[31] The other two state bodies created as part of this restructuring process were the State Assets Management Agency (SAMA) and the Agency for Development of Capital Markets.

objectives; unclear assignments of roles, responsibilities and legal powers for institutions involved with competition policy; weaknesses in antitrust legislation and regulations; and the need for a stronger institutional focus on competitive neutrality.[32] There is also considerable fragmentation in the legal framework—a now growingly dated 2012 Competition Law has been superseded by a range of new resolutions and decrees, most of them issued after the start of the 2017-2021 Development Strategy, that have drastically altered the legal, regulatory, and institutional environment for competition policy design, implementation, and enforcement.

62. <u>**Objectives of the prior actions:**</u> **A new competition law is expected to help strengthen the legal framework for the implementation and enforcement of competition policy.** A new competition law has been under development since 2017 to address weaknesses in the competition legal framework. In particular, the draft legislation touches on all key aspects of competition policy, including mergers, anticompetitive practices, state aid, competitive neutrality, participation of SOEs in markets, public procurement, and advocacy. It also brings greater clarity to procedural issues and the powers of the AMC in investigations. While the AMC does not have any prosecutorial powers, it does have the powers to both levy penalties and fines for violations of the Law, and to refer more serious cases to law enforcement agencies for prosecution decisions. The legislation refines provisions on key definitions and concepts—for example dominance, anticompetitive agreements and concerted practices, and the use of merger thresholds—and aligns them with international best practice. It strengthens procedural steps such as procedural safeguards in investigations, protections for privileged information, methodical and predictable fines, and penalties for violations and non-compliance. The Law introduces a framework for regulating digital markets. Finally, the Law streamlines the powers and mandate of the AMC—including its involvement in SOE oversight and state aid policy—to avoid encroaching on the authority of other state bodies that are involved in market regulation and/or the implementation of competition policy (which could risk institutional conflict). The draft law was prepared with substantial engagement and support from the World Bank, the European Bank for Reconstruction and Development, and the United States Agency for International Development. It is expected to be approved by Parliament early next year.

Prior Action 5: To strengthen the competition legal framework, the Borrower has submitted a law on competition for parliamentary approval that defines: (i) the operative rules applicable to enforcement investigations and merger notifications, including procedural requirements and safeguards; and (ii) the functions of the competition authority as a compliance agency, including its involvement in state-owned enterprises oversight and areas for inter-agency collaboration.

63. <u>**Expected results and next steps:**</u> **The measures supported by this law are expected to strengthen the legal and regulatory environment to promote more competition in the economy.** The new Law to be submitted to Parliament includes clear operative rules for antitrust enforcement and mergers, appropriate procedural frameworks, and predictable, methodical penalties and fines—and it is expected to strengthen the ability of the AMC to enforce competition rules effectively in Uzbekistan. If well implemented, the reform is expected to increase the ability of firms to compete on a level playing field. Achieving this outcome, however, will take time. In the interim, the Law is expected to have some immediate outcomes—most notably an increase in the number of anticompetitive sanctions issued by the AMC following the Law's adoption (Result Indicator 5). The approval of the new Law is also expected to enhance the consistency and predictability of AMC decisions and create an environment where market players and the public have confidence in the AMC and the impartiality of its processes.

64. **While a stronger legal and institutional environment is a necessary ingredient for greater competition, complementary reforms will be needed to further improve the pre-conditions for greater private sector growth and competition in the economy.** Critically, secondary regulations and guidelines should be adopted to detail various

[32] *OECD (2022), An Introduction to Competition Law and Policy in Uzbekistan.*

procedural aspects, particularly the information requirements and notification process for mergers, the leniency policy, the fining guidelines setting out key aspects of the methodology, and the investigative and analytical processes of the competition authority in the context of enforcement investigations, among others. While the legislation espouses the principles of competitive neutrality and establishes rules for state aid, further reforms to demonopolize sectors of the economy controlled by SOEs are also needed in complement to legal reforms to reduce barriers to private sector entry, investment, and competition. A comprehensive capacity building program will also be necessary to ensure staff have the required skills and expertise to conduct the investigations in a proper manner, analyze and handle the information collected, and reach appropriate findings.

Pillar 2: Improving state-owned enterprise management

65. **Background: Nearly 2,500 SOEs account for about 18 percent of employment and 20 percent of exports.**[33] SOEs in Uzbekistan operate in many economic sectors that could be better served by the private sector and impose a significant economic cost through quasi-fiscal deficits generated by administered prices, subsidized lending, and other preferences. 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. In the absence of frameworks enforcing competitive neutrality, SOEs often enjoy preferential access to land, finance, and public contracts that tilts the playing field in the favor. Although explicit on-budget subsidies to SOEs are small (at about 1 percent of GDP), 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.[34] 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.[35] Over time, many larger SOEs (e.g., energy utilities) expanded into business activities well beyond their core sectors of operation and original intended mandate, while relying on government subsidies to finance these expansions.

66. **Financial transparency and corporate governance of SOEs is slowly improving from years of steady reforms, but there are still gaps in the data, regulatory, and risk control environment.** SOEs have historically operated as vertically integrated entities combining sector policymaking, regulation, and 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 in FY19).[36] Underdeveloped accounting standards, weak financial reporting standards, and limited risk monitoring and financial controls by the government have compounded financial challenges arising from SOEs. They have also hindered efforts to improve the quality of SOE financial and risk information, with no consistent systems in place for the Ministry of Finance to obtain key financial data from SOEs that affect fiscal risk management—such as data on non-guaranteed SOE debts. The role of SOE supervisory boards has historically had a relatively narrow focus on monitoring the performance of the chief executive, with most other decisions influencing the operational decisions of SOEs coming from government decrees and resolutions. Since 2017, the government has begun to impose basic corporate governance requirements on SOEs, starting with the introduction of modern accounting standards (supported by the first DPO in 2018), comprehensive asset inventories, and the separation of policy and regulatory functions from operational responsibilities. Since 2019, and as part of a first wave of corporate governance measures taken by the State Asset Management Agency (SAMA) and the Ministry

[33] 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 in 2021.
[34] World Bank Public Expenditure Review (2019)
[35] For example, losses in natural gas supply are estimated at 1.2 percent of GDP.
[36] *Sustaining Market Reforms in Uzbekistan Development Policy Operation (P168280)*

of Finance, medium and large SOEs began divesting their ownership of non-core business activities. Since 2017, several reforms have been enacted to strengthen and expand the role of supervisory boards and draw clearer lines of accountability between the senior management of SOEs and the supervisory board. In 2022, a new corporate governance law was enacted (supported by the fourth DPO in FY22) to create a legal framework for improved performance management and SOE disclosure requirements—bringing Uzbekistan's SOE corporate governance framework in closer alignment to OECD's corporate governance standards.[37] Data quality is also improving gradually with the centralization of shareholding responsibilities under SAMA. This operations build on these reforms to address further gaps in SOE performance, risk control, and governance frameworks to strengthen the quality of SOE management and reduce fiscal risks.

67. **Objectives of the prior actions:** The two prior actions in this pillar advance aspects of the government's SOE ownership strategy (Presidential Resolution 6096; October 2020—supported under the third DPO in FY21) and the new corporate governance law enacted in 2022 that have not yet been addressed by existing legal and regulatory instruments.[38] They are: (a) the government's desire to ensure that SOEs are focused on their main business and are not allowed to expand their commercial activities beyond the scope of the core strategic mandate; (b) the government's intention to improve fiscal risk identification, monitoring and mitigation, and increase financial controls and reporting requirements on SOEs that borrow (with or without a government guarantee); and (c) the government's interest in further improving board and CEO performance.

Prior Action 6: To improve the financial sustainability of state-owned enterprise operations, the Borrower has: (i) restricted state-owned enterprises from engaging in new commercial activities, or owning or acquiring shares in other enterprises, that are not consistent with their core business, in accordance with their respective strategic plans; and (ii) revised the performance assessment criteria for supervisory boards of state-owned enterprises to include the achievement of corporate organizational improvement outcomes and improved financial sustainability.

Prior Action 7: To reduce fiscal risks arising from state-owned enterprises, the Borrower has (i) required the assignment of financial risk ratings to all state-owned enterprises based on transparent business solvency, liquidity, and profitability criteria; (ii) established risk-based ceilings and approval procedures for the issuance of non-guaranteed debt by state-owned enterprises; and (iii) required state-owned enterprises to regularly provide financial data to the Ministry of Finance.

68. **Prior Action 6:** In April 2022, and as part of an omnibus Presidential Resolution to improve the environment for private sector growth (UP-101), the government introduced new legal restrictions that prevent SOEs from engaging (or re-engaging) in non-core business activities outside the core competencies of the enterprise, as defined in the SOE's charter and strategic plan. The adopted Resolution prohibits SOEs from expanding commercial activities, or acquiring shares in other businesses, that are in areas outside the SOE's core business areas, as defined in the SOE's strategic documents. To strengthen financial discipline, it also introduces new requirements for SOE managements to seek supervisory board approval before acquiring or building new real estate; or purchasing shares in other enterprises; that are related to the core business of the SOE. The Resolution also introduces new performance assessment criteria for SOE supervisory boards (which are conducted by SAMA and the Ministry of Finance to determine whether to re-appoint or terminate board members). The objective of these revisions is to require supervisory boards to take more ownership in overseeing the performance of SOEs and ensuring effective organization transformation processes that are under way—especially in medium and large SOEs; and in ensuring the financial

[37] *Accelerating Uzbekistan's Transition Development Policy Operation (P176353)*
[38] *Supporting a Transparent and Inclusive Market Transition (P171751)*

sustainability of SOEs—especially the level of SOE indebtedness and the value for money of procurement systems used by the SOEs.

69. **Measures requiring supervisory boards to enhance oversight of SOE performance are also expected to generate climate co-benefits.** They will help embed reforms to strengthen climate change and environmental governance of SOEs that were supported in the preceding DPO as part of the new SOE corporate governance legislation. These reforms, which enshrined environmental and climate change principles as a core legal principle in the governance of SOEs, have been followed up by further reforms to mainstream climate change and environmental governance into the overall transformation plans of SOEs. The measures supported by this operation will enhance the supervisory board's monitoring, oversight, and accountability framework for how these plans are being implemented.

70. **Prior Action 7:** Historically, the management, supervisory boards, and shareholders of state-owned enterprises have had full independence to make financial decisions—including decisions to raise non-publicly guaranteed external debt—without the need for approval from the Ministry of Finance. In March 2022, through Cabinet of Ministers Resolution 107, the government introduced a new risk-based framework that assigns a low, medium, or a high-risk rating to all SOEs based on their liquidity, solvency, profitability, and existing debt burden. Under the new framework, low-risk SOEs will be able to continue raising non-publicly guaranteed external debt without requiring approval from the Ministry of Finance but will now be required to notify the Ministry of Finance prior to borrowing. Medium-risk SOEs will also be able to do the same, but only if the debt is below a certain threshold (currently US$20 million). For higher amounts, and for high-risk SOEs, any intended borrowing must be first approved by the Ministry of Finance. In addition to these new controls, all SOEs will be assigned an overall debt ceiling based on the total debt servicing costs. SOE cannot raise additional external debt that creates debt servicing costs more than this ceiling without explicit approvals from the Ministry of Finance. Finally, the Resolution also establishes new financial and performance reporting requirements for SOEs: they are required on a quarterly basis to provide financial information to the Ministry of Finance, including information on the status of outstanding guaranteed and non-guaranteed debts, evidence that the outstanding debt has been serviced in a timely manner, and additional implementation data for projects that are debt-financed. The purpose of this final requirement is to address historically poor compliance from SOEs in providing timely information on non-guaranteed SOE debt.

71. **Expected results and next steps:** The measures in this operation are expected, over time, to further improve the financial sustainability of SOEs by strengthening the incentives for better management and supervisory board performance, reducing financial risks from non-core activities, increasing financial and debt discipline, and enhancing SOE financial transparency. While the longer-term outcome of these reforms—a more efficient and financially sustainable SOE sector—will take time to materialize, the measures are expected to have some immediate benefits. The most important of these is improvement of the availability and transparency of information relating to the financial health of SOEs—currently a critical data gap that limits effective SOE governance and financial oversight by SOE boards, the Ministry of Finance, and Parliament (which authorizes and oversees all budget spending). Uzbekistan's assessment under the World Bank's debt transparency heatmap identifies the lack of SOE financial information as a major gap.[39] New quarterly financial reporting requirements are expected to address this gap and provide supervisory boards with a more periodic snapshot of the organization's financial health (Result Indicator 6). The requirements are also expected to help improve the boards' ability to take corrective actions to strengthen organizational performance and financial sustainability (Result Indicator 6). The reports, which must be shared with the Ministry of Finance on a timely basis after each quarter, are also expected to address a major gap in the government's fiscal risk management and improve external assessments of Uzbekistan's fiscal and public debt transparency. Consistent with previous

[39] https://www.worldbank.org/en/topic/debt/brief/debt-transparency-report

government SOE reform objectives (including those supported under the fourth DPO),[40] these reforms are also expected to improve the operational efficiency of SOEs in the energy, chemicals, and manufacturing sectors—which are responsible for most of Uzbekistan's greenhouse gas emissions.

Pillar 3: Increasing social inclusion and resilience

Social protection policy

72. **Background:** While Uzbekistan inherited a relatively comprehensive social protection system from the Soviet Union which included many programs, the limited performance of many of these programs has complicated the transition to a more dynamic and inclusive market economy. Before the start of the new national development strategy in 2017, coverage of the country's flagship social assistance programs consistently fell each year, cumulatively by more than 40 percent from 2013 to 2016. In 2019, only 46 percent of children and working-age adults with severe forms of impairment were able to access disability benefits, often due to legal limitations such as the inaccessibility of courts as a vehicle to pursue disability discrimination cases, and the narrow medically based definition of disability. Official non-recognition of poverty was also a significant constraint to comprehensive social protection programs, while strict fiscal limits on social assistance capped the possible number of beneficiaries, regardless of need. In the absence of a formal definition of poverty—and constrained by a fragmented institutional structure—Uzbekistan's policymakers lacked the tools needed to ensure an inclusive transition to a market economy.

73. **Global experience highlights that even economic reform that have a positive net impact on overall welfare generally entail some income redistribution, such that some households can become worse off.** In this context, social protection (SP) plays a critical role in the reform process when society is faced with new risks. SP also is also essential to building long-term resilience, not only to economic shocks but for risks such as the potential effects of climate change as well.[41]

74. **A series of reforms since 2017 has strengthened the administration of the social protection system, while more clearly defining spending priorities and mechanisms.** Reforms of the social protection system in Uzbekistan were anchored in two new administration systems: the Single Registry (SR) managed by the Ministry of Finance, and the Labor Market Information System (LMIS) managed by the Ministry of Employment and Labor Relations. The introduction of these systems established evidence-based processes and criteria for the administration of social protection programs. The former provided a more transparent and efficient management system for social assistance programs (including enrollment, certifications, and payments). The latter provided modern management tools to implement unemployment-related support, training, labor management, and active labor market programs. Overall, the coverage of poverty-targeted benefits (low-income family allowances and others) more than quadrupled since 2017 (including in response to the COVID-19 pandemic shock) to 2.3 million families; new active measures to promote employment and entrepreneurship have been introduced that cover a target population four time greater than those receiving unemployment support in 2018. The adoption of a new, improved national poverty line in 2022 led to the reform of social benefit amounts (pensions and allowances) and eligibility rules adjusted to the new official definition of poverty. But as categories of increased spending were more targeted to needy populations than in previous years, in 2021 social protection related spending represented a similar share of GDP as in 2016 (Table 5).

[40] *Accelerating Uzbekistan's Transition Development Policy Operation (P176353)*

[41] Examples include Simai, Mihaly. "Poverty and inequality in Eastern Europe and the CIS transition economies." (2006).; and Birdsall, Nancy, and John Nellis. "Winners and losers: assessing the distributional impact of privatization." World development 31.10 (2003): 1617-1633.

Table 5: Trends in Spending on Social Protection (as a percent of GDP), 2016-2021

Spending on:	2016	2017	2018	2019	2020	2021
Contributory pensions	5.90	5.40	5.00	5.10	5.30	5.00
Social Safety Nets	0.87	0.83	0.92	0.96	1.30	1.40
Social Care Services	0.02	0.03	0.03	0.04	0.04	0.05
Labor Market Programs	0.00	0.00	0.01	0.01	0.05	0.06
Social Protection, total	6.79	6.26	5.97	6.11	6.70	6.50

Source: World Bank's staff calculations based on the Ministry of Finance, Ministry of Employment and Labor Relations and Extra-budgetary Pension Fund administrative data on SP program expenditures using ASPIRE WB methodology.

75. **<u>Objective of the prior action</u>: A new social protection strategy defines the system of basic social protection for all citizens through 2030.**[42] It establishes the government's policy framework to ensure that (i) social protection is extended to all members of society with links between social insurance, social assistance, social care services, and labor market programs; (ii) social protection priorities are aligned with needs and rights; and (iii) designates the form of coordination among agencies involved in SP design and delivery. With respect to social assistance, the new policy defines the universe of social assistance programs through 2030, and the targeting principles to be used. It also designates the Single Registry as the core administrative mechanism to implement all social assistance programs (requiring consolidation of currently dispersed program administration approaches), ensuring improved transparency of social support. The "Women's book" the "Youth book," and the "Iron book" lists, which were established during the COVID-19 pandemic to quickly identify people in need and provide ad hoc transfers, currently rely on community-based targeting and the views of local officials. The SP Strategy requires the reorganization of these programs so that they are administered through the Single Registry and use the same formal needs-based targeting required of other social assistance programs. With respect to active labor market programs for vulnerable populations, the Strategy defines the operations of paid public works, promotion of entrepreneurial activities, services to support employment search, implementation of the quota system for vulnerable groups (including disabled persons), professional training, legal protection support, financial aid to victims of violence/forced labor/discrimination, and support for labor migrants. The Strategy also sets out a phased transition from the "medical" model to the modern "social" model of determining disability. With respect to social care services, the policy defines the role of khokim's (district-level governor) assistants, and other community-level positions focused on local development priorities. With respect to institutional design and financing, the Strategy provides the parameters for the establishment of a Social Insurance Fund, the framework for identifying the minimum tax burden on an employer and employee to establish financing sources for insurance payments. Finally, the policy introduces a monitoring and evaluation framework to ensure more effective implementation of social protection programs, leveraging newly strengthened information systems.

Prior Action 8: To improve the effectiveness of the social protection system in supporting vulnerable people, including those affected by climate change, the Borrower has approved a National Social Protection Strategy that has: (i) clarified institutional roles and responsibilities for the design and delivery of social protection; (ii) designated the Single Registry of Social Protection as the single window for social assistance delivery; and (iii) introduced a result-oriented budget system to achieve the Borrower's social protection policy goals.

76. **<u>Expected results and next steps:</u>** The measure supported under this operation is expected to improve the integration, performance, and quality of the social protection services. The resulting improvement in targeting is expected to reduce errors of inclusion and exclusion in social assistance programs by 30 and 20 percent, respectively

[42] An approved "Strategy" in Uzbekistan is a policy reform that includes concrete legal/regulatory changes that take effect immediately upon approval.

(Result Indicator 7). This result of increasing the transparency and management of applications for assistance is critical in reducing the fragmentation and inefficiencies of the current approach to safety net administration. It will also help strengthen systems to identify the poorest and most vulnerable individuals for coverage. As the government adjusts social assistance programs it will be critical to strengthen approaches to identify need and establish evidence-based eligibility criteria for implementation of the policy, as the approved Resolution itself attests. The action is expected to lead to the synchronization of social assistance programs with employment promotion programs through integration of SR and LMIS systems. It is also expected to establish the role and scope of social protection programs implemented at the community level. The measures supported by this action are likely to improve the economic and social inclusion of persons with disabilities – not least through a clear definition of disability support programs and a commitment to modernize the determination of disability. As a result, the approved Resolution is a critical step in the implementation of Uzbekistan's commitments of the Convention on the Rights of Persons with Disabilities (supported in the last DPO). It is expected to lead to the creation of the social insurance fund, payment of maternity benefits through the social insurance system, results-based budget systems and obliges continued financing consistent with comprehensive social protection coverage.

77. The approved measures will also help improve the adequacy of social assistance for climate-affected communities and strengthen systems to identify and support those that may be affected in the future by climate change shocks. The approved Resolution is designed to protect all of society against the detrimental impacts of a wide range of shocks, including natural disasters and climate-related impacts. Special provisions are included for the communities at elevated risk of climate-linked impacts, 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 supported under this operation build on measures supported under earlier DPOs by establishing the mechanisms of support for vulnerable citizens, including those in climate-affected communities, and by establishing a clear framework for continued protection.

Maternity benefits at the workplace

78. Background: Uzbekistan's employer-financed maternity leave requirements both created incentives to discriminate against women and provided advantages for public sector employers over the private sector. The new labor code of Uzbekistan (supported in the previous FY22 DPO) prohibits employers from discrimination in hiring decisions based on gender. But preventing discrimination is not limited to legislating against discrimination, but to tackle incentives for discrimination. In the case of Uzbekistan, the cost of maternity benefits to employers was a notable example. In Uzbekistan, traditional practice additionally disadvantaged private sector employers. While maternity leave benefits for SOEs and the public sector were financed by the state, formal private sector employers were required to cover these costs directly, creating strong financial incentives for private sector employees to discriminate against female candidates in hiring decisions, and making it more likely women work in informal roles. The reform is consistent with the recommendations of the ILO Maternity Protection Convention, and with international practice. Due to discrimination concerns, globally, only 26 percent of countries finance maternity leave benefits through mandated contributions from employers rather than through social insurance mechanisms.

79. Incentive distortions have contributed to Uzbekistan's low female labor force participation. 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). 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 is due in part to gender discrimination in hiring decisions, which is prevalent and economically significant.

80. Objective of the prior action: In March 2022, a Presidential Decree was approved to reform the system of maternity benefits (UP-87), transferring all maternity benefit payment obligations from the private sector to the state (budget financed) Social Insurance Fund. By financing maternity leave though the social insurance system, the prior action will reduce financial disincentives for hiring women and equalize the treatment of public and private sector employees who take maternity leave. Women who have continuous work experience over the past 6 months in all legal entities, except for budgetary organizations (employment in which already entitles women to state-financed maternity leave benefits), are paid maternity benefits at the expense of the State budget based on the minimum amount of monthly consumer spending.

Prior Action 9: To reduce hiring discrimination barriers against women in the private sector, the Borrower has abrogated the requirement that private employers pay maternity benefits and has instead required such benefits to be paid from public funds.

81. Expected results and next steps: The action is expected to reduce the imbalanced treatment of women working in the private sector (Result Indicator 8) and bring Uzbekistan closer to alignment with the ILO Maternity Protection Convention, 2000 (No. 183), and its accompanying Recommendation (No. 191). Next steps include the launch of the social insurance fund and inclusion of women who are formally employed in the private sector in the same social insurance program as women currently working in the public sector. The measures supported by this action will address several important constraints facing both women in the private sector and their employers.

Table 6: DPF Prior Actions and Analytical Underpinnings

Prior Actions	**Analytical Underpinnings**
Pillar 1: Strengthening market institutions and the environment for private sector growth.	
Prior action #1: Privatization Law	Country Economic Memorandum (2021), SCD (2022), Analytical work done under previous DPOs, along with analytical support via the Institutional Building Loan (P168180); and analytical support to the Government from the EBRD and ADB. Key findings: need for a clear and unfragmented legal framework; 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.
Prior action #2: Privatization in telecommunications sector	SCD (2022), analytical support via ongoing preparations for a telecommunications sector project; in-depth data from the GSMA connectivity index. Key findings: highly concentrated government ownership in the sector; high level of government ownership and limited investment outcomes as an impediment to new technology adoption; Uzbekistan's lagging relative mobile telecom outcomes against regional and income peers.
Prior action #3: NBCO Law	SCD (2022); National Financial Inclusion Survey (2021); World Bank support for the preparation of a national financial sector strategy (2020) and analytical assistance to develop new non-bank credit organization legislation (2021/22). Key findings: shallowness of non-bank credit activity; legal fragmentation; inconsistencies in

	regulatory requirements that apply to NBCOs.
Prior Action #4: Insolvency Law	Reform Roadmap (2018); SCD (2022); CEM (2021); Analytical support under the Institutional Building Loan (P168180); analytical support to the government from the EBRD, Japan International Cooperation Agency (JICA), and ADB. Key findings: the reports identify significant shortcomings in the insolvency legal framework and ICR regime.
Prior action #5: Competition Law	SCD (2022), Country Economic Memorandum (2021), World Bank TA to Anti-Monopoly Committee (2018-2022), OECD review of Uzbekistan's competition legal and policy environment (2022), and World Bank Enterprise Surveys (2020, 2016). Key findings: The reports find significant weaknesses in the legal and regulatory framework for competition, and considerable room to bring them in line with international good practice.
Pillar 2: Improving state-owned enterprise management	
Prior action #6 SOE governance	Country Economic Memorandum (2021), SCD (2022), OECD SOE corporate governance guidelines (2015); Analytical work done under previous DPOs and 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 SOE financial information, stronger financial and operational transparency and independence from state direction, more stringent budgetary and governance constraints to improve SOE performance and corporate governance.
Prior action #7: SOE fiscal risk management	World Bank Country Economic Memorandum (2021); World Bank Debt Transparency Heatmap (October 2021 vintage); IMF technical assistance on fiscal transparency (2018, 2019) and fiscal risk management (2021/2022). Key findings: The reports identify incomplete SOE financial data as a substantial fiscal risk and threat to SOE financial viability. The weak framework for non-guaranteed SOE debt financing is especially singled out as a high risk.
Pillar 3: Increasing social inclusion and resilience	
Prior action #8: Social protection strategy	WB-UNICEF-ILO Social Protection System Assessment (2020); Social protection chapters in World Bank Public Expenditure Review (2020) and Country Economic Memorandum (2021); Youth Employment in Uzbekistan (2021); Family allowances performance analysis (2022) and analytical work as part of the Strengthening Social Safety Nets project implementation (which includes support for the development and expansion of the Single Registry and LMIS as well as inputs to the preparation of the new social protection strategy). Key findings: these reports describe challenges in the design and delivery of social assistance and the need for systems reforms. 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–these underpinnings helped support a revision of methodologies and improvements to the adequacy of safety nets.
Prior action #9: Maternity benefits	SCD (2022), World Bank Technical Assistance as part of the UK Government 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 drivers of gender discrimination in Uzbekistan and identifies maternity leave inequities between public and private sector as a source of discrimination.

4.3. LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

82. **This proposed operation is fully aligned with the focus areas of the CPF for FY22-FY26.** All three pillars of the PDO are consistent with the first high-level outcome of the CPF on increasing inclusive private sector employment—specifically Objective 1.1 on expanding competitive access to markets, Objective 1.2 on enabling private sector growth and investment, and Objective 1.4 on improving infrastructure for competitiveness and connectivity. Additionally, the third pillar of the PDO is consistent with the second high-level outcome of the CPF on improving human capital—specifically Objective 2.3 which aims to expand social protection coverage and improve inclusive labor market policies.

83. **The use of programmatic DPOs engagement could help support a maturing reform agenda—but heightened uncertainties and the breadth of Uzbekistan's reform agenda warrant continued flexibility.** The use of standalone DPO engagements by the Bank has been effective in supporting a still nascent and broad economic and social transformation in Uzbekistan. Varying levels of administrative capacity to implement reform sequences in different areas of policy focus—and differing levels of institutional and political readiness for reforms—have allowed the Bank to support a broad structural reform engagement that has maintained a strong focus on establishing effective foundations for an inclusive market transition. It has also created room for a more flexibility that allows time for political and social consensus building (and adequate technical advisory support) for more difficult reforms, and that allows the Bank to be flexible in identifying and using windows of opportunity to advance other reforms that help create strong and enduring reform outcomes. Successful examples of the latter include measures to decriminalize (and eventually end) internal labor migration restrictions, consolidate off-budget spending, and increase protections against gender-based violence. As the complexity of the reform agenda increases, and as administrative capacity to implement an effective reform program continues to grow, the use of programmatic DPO engagements could help strengthen the Bank's support for a more sequenced and sustained reform engagement. Any shift towards this approach would require a careful assessment of external uncertainties—which could have a material impact on the reform environment—and the maintenance of continued flexibility within a programmatic DPO engagement to seize windows of reform opportunity in other reform-critical areas as they arise.

84. **A wide range of World Bank operational, analytical, and policy engagements has contributed to this operation.** These include: (i) a recent SCD, Country Economic Memorandum and public expenditure review; (ii) implementation support for the Institutional Building Loan Project to support competition legislation and regulatory improvements, improve fiscal transparency and risk management, and support the SOE reform process; (iii) implementation support for Strengthening the Social Protection System in Uzbekistan project which has been the bedrock of World Bank support and engagement on Uzbekistan's substantial overhaul of the social safety net system; and (iv) the Listening to the Citizens of Uzbekistan survey, which has underpinned the World Bank's engagement and support for private-sector focused reforms that maximize financing for development in the telecommunications sector. Further details are provided in the Table 6.

85. **The prior actions in this proposed operation are well-aligned with the WBG's GCRF**. The prior action relating to social protection is aligned to the second pillar of the Framework (Protecting People and Preserving Jobs). The prior action relating to the legal framework for non-bank credit organizations is aligned to the third pillar of the Framework (Strengthening Resilience). Prior actions relating to privatization, competition, SOE governance, and maternity benefits are aligned to the fourth pillar of the Framework (Rebuilding Better).

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

86. **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 almost all measures supported under this DPO. Several measures supported under this operation, such as SOE governance reforms, the new social protection strategy, and reforms to maternity benefits, were significantly influenced by these public consultations processes.

87. **Since 2017, public accountability has gradually evolved 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 social protection reforms, where the government opted to co-produce the text from the beginning of the process, through joint taskforces comprising government officials, international organizations, and representative associations. 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 the government has introduced a requirement that all senior government officials hold weekly sessions for face-to-face meetings with the public

88. **The World Bank continues to work closely with other development partners to support the government's reform agenda.** The World Bank and the IMF 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. The World Bank and several United Nations (UN) agencies are involved in supporting the government's desire to accelerate social protection, active labor market, and other reforms to increase economic and social inclusion—particularly of vulnerable and disadvantaged groups. The Bank is also working closely with the Asian Development Bank (ADB), the European Union (EU), the Government of Japan, the Government of France, and the Asian Infrastructure Investment Bank (AIIB)—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 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 World Trade Organization (WTO) accession 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

89. **Overall, the operation is expected to improve the efficient deployment of resources and increase the progressivity of the fiscal and regulatory system.** Of the nine proposed prior actions, six have clear, significant, and direct poverty and/or distributional implications. Three of the six are expected to have strong positive distributional impacts, namely measures to increase competition, strengthen the social protection system, and to improve the maternity benefit system. In the absence of mitigation measures, two actions could potentially carry short-term risks of increased poverty and/or entail negative social effects. These relate to two privatization-related reforms. The remaining actions on non-bank financing, insolvency, and SOE reforms are likely to be broadly neutral in their impact, although the insolvency reforms may have positive indirect benefits over the longer-term. Where negative effects have

been identified they are not irreversible, and mitigation measures through the social protection system and the use of other regulatory safeguards would moderate possible adverse poverty and social impacts relating to these actions. These are reinforced by the continued focus of the World Bank's DPO engagements on improving the social safety net system in Uzbekistan, including through measures proposed under this operation.

Privatization

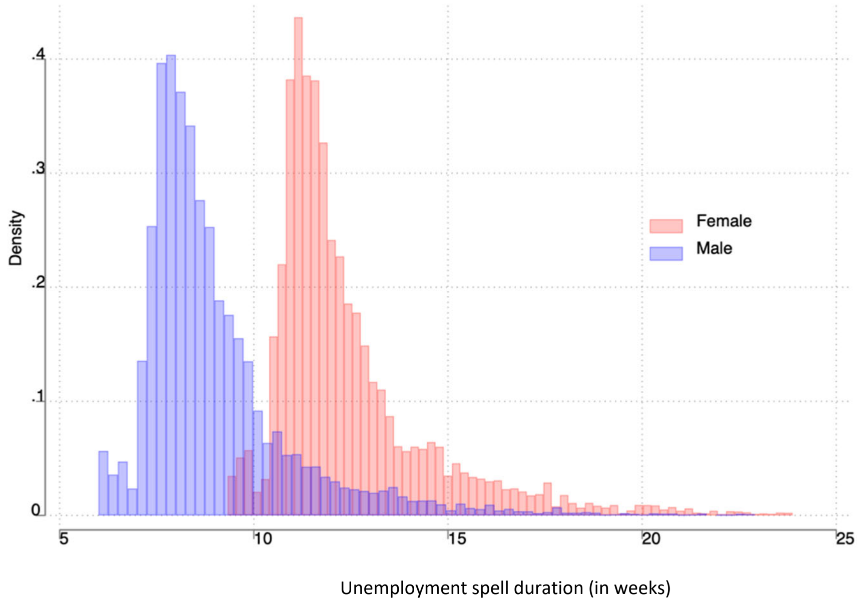
90. Early investments by the Government to manage potential social risks will help strengthen the success of the longer-term privatization agenda. Three primary risks are of concern: (i) risks related to vested interests; (ii) risks to employment in SOEs; and (iii) risks of rising consumer and producer prices. Privatizations of public assets that are not implemented in a manner consistent with the public interest pose a fundamental social risk. Evidence from the failure of past privatization programs to achieve equitable and social sustainable outcomes in the former Soviet Union highlights the dangers of reform if procedures are inappropriately applied and/or the process lacks accountability. If not implemented by knowledgeable, accountable, and financially disinterested actors, programs can result in the loss of public resources on a massive scale and substantial increases in inequality. The new privatization law supported by this operation establishes a much stronger legal and accountability framework and enshrines principles of transparency and competition throughout the privatization process. This will help mitigate the high risk of privatization being compromised by vested interests. It also helps establish stronger institutional frameworks before large privatizations begin—an important lesson from the successes and failures of other post-Soviet privatizations. The new law will also work in tandem with new corporate governance legislation supported under the last DPO to enforce accurate and open valuation of assets, and to minimize risks of creating private monopolies.

91. Stronger social protection systems and budgetary mechanisms will help offset potential labor displacement risks arising from the privatization process. The new privatization law, and other complementary SOE and labor and employment legislation, including the new corporate governance law and labor code (both supported under the last DPO), all explicitly require the government to ensure that social obligations are carefully considered during the privatization process. In the case of UMS which employs fewer than 5000 people, formal contracts currently in force include standard severance provisions of up to three months following termination, and employees are eligible for unemployment assistance in the event a worker is unable to find work during that time. As part of agreements to divest its ownership of assets, including the privatization of UMS, the new privatization law authorizes the government to add non-standard social support provisions beyond basic requirements. However, the determination of any additional protections for UMS employees has not yet been finalized. Former UMS workers would be eligible for targeted social assistance and unemployment programs (including retraining and other ALMPs) in the event of unemployment beyond the statutory severance period.

92. Although the risk of poverty and unemployment from job loss is less among those formerly employed by SOEs than non-SOEs, women and older workers are at higher risk.[43] Among those who leave SOE employment in Uzbekistan, the duration of job search is about 10.6 months, 15 percent less than non-SOE employment according to L2CU and HBS data. SOE employees are five times as likely to have completed tertiary education than non-SOE employees, and typically have both higher incomes during employment as well as stronger employment prospects following job loss. However, the duration of non-employment following the loss of an SOE job is imbalanced, at 12.1 months for women compared to only 8.9 months for men. Older age is also associated with longer unemployment spells. Those aged 25-34 typically find a new job within 9.6 months, while those aged 55-64 take 12 months on average (Figure 5).

[43] These durations may vary depending on whether voluntary or involuntary separation from SOE employment.

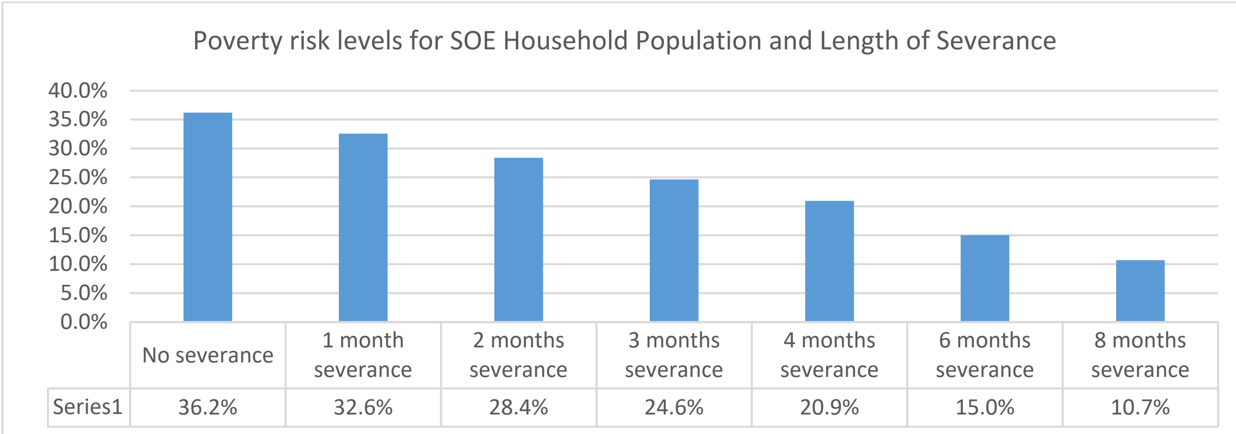
Figure 5: Predicted unemployment spell distribution among males and females formerly employed in SOEs



Source: World Bank staff using HBS and L2CU-derived projections
Sample period: September 2018 – September 2022

93. **The existing severance payments scheme significantly reduces short-term negative effects of job loss but alone does not eliminate poverty risks.** A minority of those formerly employed by SOEs may face short-term poverty risks in the event of delays in finding other work and/or in the absence of financial support. The share of workers for whom total household income may fall below the poverty threshold in the absence of income from SOE employment ranges from 36 percent if no severance payments are made, to 25 percent if the full statutory 3-month severance were paid (see figure 6). An increase to severance payments up to 8-months would limit poverty risk to about 10 percent of SOE workers, although the feasibility of such payments would also depend on fiscal costs and affordability constraints. Unemployed workers in Uzbekistan may also be eligible for targeted social assistance and unemployment benefits that complement severance payments for vulnerable workers. As social assistance is more efficiently targeted, it is a more cost-efficient means of reducing poverty risk than extension of severance payments. Analysis of simulated poverty gaps after losing SOE employment and obtaining three-month severance payments suggests the median annual per capita poverty gap would amount to around 1.9 million som in January 2022 terms, equivalent to 30 percent of the statutory three-months' severance payment.

Figure 6: Simulated short-term poverty risk against scenarios for severance payments

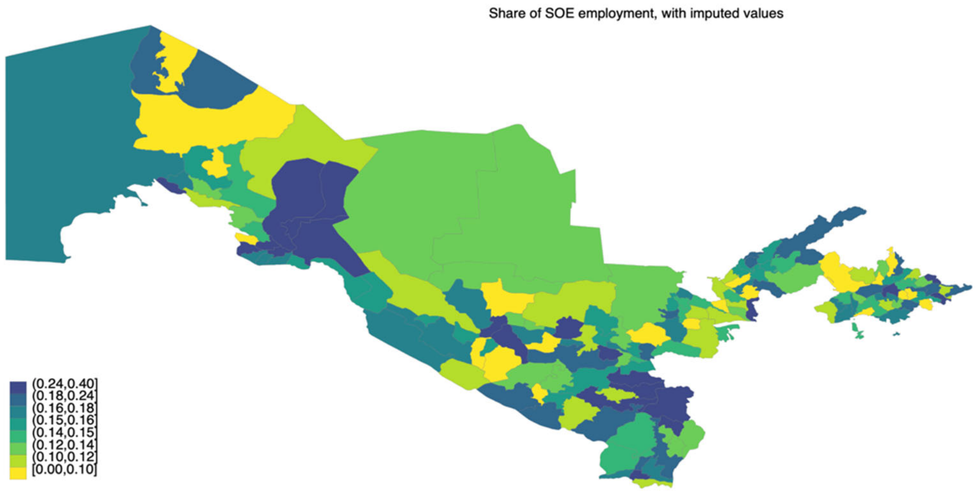


Note: x-axis - length of severance payments
Source: World Bank staff using Household Budget Survey and L2CU-derived projections.

94. **Prioritizing voluntary separation, leveraging retraining programs, and active labor market policies included in the social protection strategy can mitigate risk for vulnerable workers**. As most new jobs are created in the non-SOE sector in Uzbekistan, it is likely some former SOE employees will face skills mismatch with available private sector jobs. Women stand out as a peculiar at-risk category due to longer projected unemployment spells and fewer jobs available in the private sector. SOE employment in Uzbekistan is skewed to older age groups. The retirement age in Uzbekistan is currently 60 years for men and 55 for women. After losing employment, people of pre-retirement age (5 years or less before retirement) face longer unemployment spells and fewer chances to find a job. They are also usually less mobile and less likely to acquire new skills. On average, about 7 percent of SOE employees have five or fewer years before retirement but are as high as 13 percent in the Namangan region, and 11 percent in Fergana and Samarkand regions. Minimizing the need for retrenchment among more vulnerable categories of workers may be accomplished through voluntary separation packages (processes that are permitted but not required in the labor code). State provision of retraining programs as required by the labor code may also mitigate challenges of skills mismatch. The new social protection strategy supported by this DPO elaborates the available retraining programs and other active labor market policies, including but not limited to career counseling, entrepreneurship, or relocation support, will mitigate challenges among those formerly employed by SOEs who have difficulties finding a new job.

95. **With respect to future privatizations, the largest SOEs shape the spatial distribution of SOE employment, and extended unemployment risks**. Spatial spillovers may play a significant role in the passthrough, especially for the ability to find new employment considerations. Community-level SOE employment data from the L2CU survey and administrative characteristics provides estimates of SOE employment share (Figure 7). The zones with the highest shares of SOE employment are concentrated around Tashkent, in the southeast, and in the center of the country, where SOE employment reaches 25-40 percent of employment. The spatial distribution is shaped by the location of the largest SOEs and by the absence or abundance of other employment opportunities. The Navoi Mining and Metallurgy Company mining sites generate higher SOE employment shares in the central parts of the country. Uzbekneftegaz oil fields, Kumir coal extraction and Almalyk mining generate SOE-intensive districts in the East. Finally, many of the infrastructure SOEs concentrate their management in Tashkent.

Figure 7: Estimated SOE Employment Shares Across Uzbekistan



Source: Small area estimates from, L2CU and Mahalla administrative data, aggregated to rayon.
Note: The boundaries, colors, denominations, and other information shown on any map in this work do not imply any judgment on the part of the World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.

96. **The privatization of the UMS telecommunications company is expected to increase competition in the sector in the medium term, with small but positive potential distributional implications through consumer prices and indirectly through increased access to internet and e-services.** Social risks from privatization are moderate, arising primarily from the privatization process itself. Ensuring legal standards requiring transparent and competitive procedures are followed is essential to mitigate risks and provide an important test case for the procedures established in the new privatization law. Although no detailed estimates of potential job losses from privatization are yet available, UMS directly employs fewer than 5,000 people. Were job losses to materialize, as formal employees in an SOE, existing employment contracts include standard severance payment stipulations under the labor code. The World Bank Institutional Building Loan project focuses on strengthening the SOE reform implementation capacity of line ministries and state agencies, including with respect to limiting potential negative employment-related impacts. Finally, any affected workers who face extended unemployment beyond the period covered by statutory severance are eligible for targeted social assistance and ALMPs included in the social protection strategy.

Competition and Insolvency

97. **The introduction of law on competition is expected to generate poverty reducing and progressive distributional effects.** The new law on competition addresses imbalances in market power that advantage concentrated economic interests at the expense of consumers and other groups. In their absence, costs from low competition are typically borne by consumers in the form of higher prices and lower quality goods and services. A World Bank literature review (Begazo & Nyman, 2016) of the impacts of low competition notes the wide consensus that market power plays a pivotal role in inequality in the distribution of household wealth.[44] Policies that reduce monopoly power generally have positive effects on growth and progressive effects on the distribution of income. Rodriguez-Castelan (2020) finds that higher product market concentration will typically increase the poverty rate, as households with lower incomes are often more exposed to the negative effects of low competition. Baker and Salop (2015) show that market power would be expected to increase inequality by raising the return to capital relative to the rate of economic growth, and by

[44] Begazo, Tania; Nyman, Sara (2016), Competition and Poverty. View point, note no. 350, World Bank

discouraging innovation and productivity growth.[45]

98. **While the magnitudes vary, empirical studies on the distributional impacts of competition law enforcement generally find positive and significant effects.** Social welfare can be increased through competition policy primarily in two ways: directly, through actions that require more competition within a market, and indirectly, through deterrence effects. There are no reliable estimates of the returns to anti-competitive actions taken in Uzbekistan, however, examples from elsewhere in the world suggest the social gains are typically large, and efficiency enhancing. With respect to direct effects, the United States Federal Trade Commission estimates that in 2021 total consumer savings was 13 times the amount of FTC resources allocated to consumer protection law enforcement, and 21 times the cost of merger-related actions taken to maintain competition. A recent assessment of the application of competition law in the United Kingdom estimated that the indirect effects were on the order of 3.7 times the direct effects, suggesting even higher returns to the threat of a regulatory authority's enforcement powers.

99. **The immediate distributional implications of Uzbekistan's law on insolvency are neutral, while the long-term expected impacts are positive, but indirect.** The primary channel through which insolvency laws affect social wellbeing is through efficiency and productivity gains, which produce diffuse but positive effects on growth. In contexts where effective insolvency laws are lacking, the ability and rate of reallocation of economic resources is limited. The resulting underutilization of resources limits economic growth below potential.

5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

100. **The existing Environmental Impact Assessment (EIA) and management system in Uzbekistan is robust and undergoing renewal to ensure conformity with international standards and so 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.

101. **The government is continuing to make progress in addressing gaps in the EIA framework.** Uzbekistan's first Environmental Code is being drafted, with support and inputs from development partners, including the World Bank. The development of a single frame law is expected as a positive step towards harmonization and update to the various environmental laws and regulations. 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

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[45] Welfare and Competition (WELCOM): A Simulation Approach, World Bank Poverty and Equity Note (2020)
Baker, Jonathan B. and Salop, Steven C., "Antitrust, Competition Policy, and Inequality" (2015), *Georgetown Law Faculty Publications and Other Works*. 1462.

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.

102. The government has significantly strengthened its focus on environmental issues and the need to build a greener model of economy 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. 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.

103. Two actions in this proposed operation could potentially lead to negative environmental impacts. Based on the application of the provisions of the World Bank Toolkit,[46] the prior action supporting the privatization law will need consideration of responsibilities with regards to pollution management legacies to avoid longer-term adverse environmental impacts; and the prior action that supports the expansion of non-banking credit market would need to require non-banking actors to apply environmental due-diligence and monitoring of their borrower activities.

104. Legacy environmental issues are identified in the new privatization law as an important consideration for the Government in any ownership transition processes. With focus shifting towards the privatization of larger SOEs that have environmental obligations or liabilities, the government's simultaneous overhaul of the environmental code and the new privatization legislation supported under this operation are expected to provide a stronger regulatory framework for how legacy environmental obligations and liabilities should be treated. The new law identifies environmental obligations as a key factor that the government must consider during the privatization process. If necessary, the Law authorizes the government to append environmental obligations to any eventual privatization agreement. The World Bank will continue supporting the government through on-going engagements to deepen the environmental policy dialogue with the authorities, including through the DPO platform. Environmental considerations

[46] "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/Ren dered/PDF/561680WP0Box341IC10WBDPLTooklitCRA1.pdf

linked to these prior actions are also embedded in the World Bank's project engagements in the energy sector, in strengthening SOE reform institutions, and in the financial sector.

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

105. **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.

106. **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. Since 2019, the government has made its annual budget legislation available publicly prior to (for consultations and public comment) and after Parliamentary approval. A 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). The government also introduced e-procurement system, with 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. Debt management systems have also improved, and the government is in the final stages of upgrading and adopting a new debt management system, debt legislation, and a medium-term debt strategy.

107. **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 (Presidential Resolution #6300) 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.

108. **Uzbekistan continues to make good progress in improving its public procurement system.** A new Public Procurement Law was promulgated in April 2021, and its provisions are largely consistent with the World Bank's Procurement Regulations. Since 2021, the government been working on further improvements of the procurement legal and regulatory framework, including a full rollout of the e-procurement system.

109. **The CBU is assessed to maintain overall adequate operational control over the foreign exchange control environment and exchange reserve management.** An IMF Safeguards Assessment for the CBU has was conducted in 2021 and was made available to the World Bank by the CBU for review. The CBU has also been audited regularly by internationally recognized audit firms and received satisfactory audit reports. In addition to the 2021 IMF SA, a 2020-

2021 audit of the CBU's consolidated financial statements was conducted by an international audit firm, which issued an unmodified opinion on the financial statements. 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 audited financial statements of the CBU are not made publicly available and the Audit Report is for restricted official use.

110. 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 individual Foreign Currency Dedicated Accounts for each loan and credit 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 these dedicated accounts. Within 5 business days following the deposit of the amount of the loan and credits into these accounts, the Borrower will transfer the amount from the loan and credits into the TSA (US dollars and/or Uzbekistan som). The Borrower, within 30 days after the withdrawal of the loan and credits from these dedicated accounts, will report to the Bank: (i) the exact sum received into the dedicated account; (ii) the details of the account to which the 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 these dedicated accounts.

111. 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.

112. 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

113. 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).

114. 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 Development Policy Financing may submit complaints to the responsible country authorities, appropriate local/national grievance mechanisms, or the Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed to address pertinent concerns. Project affected communities and individuals may submit their complaint to the Bank's independent Accountability Mechanism (AM). The AM houses the Inspection Panel, which determines whether harm occurred, or could occur, from Bank non-compliance with its policies and procedures. It also houses the Dispute Resolution Service, which provides communities and borrowers with the opportunity to address complaints through dispute resolution. 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 Bank's Accountability Mechanism, please visit https://accountability.worldbank.org.

6. SUMMARY OF RISKS AND MITIGATION

115. The overall risk to the operation is moderate. Uzbekistan continues to implement a strong and sustained reform program, and political and governance risks have moderated significantly since 2017 as reforms of increasing political, social, and economic complexity continue to enjoy strong political and public backing. While the COVID-19 crisis and the effects of the war in Ukraine have increased implementation challenges for the government, they have also provided momentum to address weaknesses in health and social safety net systems and created opportunities to build a more outward-oriented economy that is less reliant on single markets. Nevertheless, the complexity of the ongoing phase of reforms, and high uncertainties over the medium-term due to the war in Ukraine, require careful management of economic and social risks, and the maintenance of macroeconomic discipline. While ex-ante economic shocks emanating from the war in Ukraine could be substantial, Uzbekistan's effective macroeconomic management and strong buffers put it in a relative strong position to be able to adapt to these shocks as needed. The only substantial risk identified in this operation relates to institutional capacity for implementation and sustainability. Other risks are assessed as moderate (Table 6).

116. Institutional risks remain substantial due to the fast pace of reforms placing significant demands on administrative capacity. Uzbekistan's public institutions remain under substantial pressure to maintain a strong pace of reforms. These challenges are compounded by the high level of centralization within the public administration, which creates significant pressures on a small group of officials. 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 to develop clear sector strategies and policies, and to enforce strong governance over the sector. The government is actively making efforts in the short-term to continue attracting global experts and diaspora talent to return to Uzbekistan for temporary assignments, increasing knowledge and expertise in-house. Less progress has been made to decentralize government functions and fiscal responsibilities. 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.

117. Social risks to the achievement of the PDO are moderate and the government has taken positive measures to proactively mitigate them. Although reforms continue to enjoy strong public support, Uzbekistan is not immune to the materialization of social tension. Helping to minimize social risks to the achievement of the PDO, all reforms go through a process of public consultation, and reforms with large poverty and social impact are accompanied by analysis-based mitigation measures, such as social safety net increases. This approach was used successfully to liberalize bread prices and increase energy tariffs between 2017-2019 and will be used to mitigate potential social risks in this operation, such as those arising from policy decisions that follow the implementation of the prior actions.

The government has also increased efforts to more frequently communicate and disseminate information about reform progress and has become more open to citizen and media engagement. Greater media scrutiny of government policies and the conduct of public servants has led to several instances where significant reforms have been overhauled to address weaknesses. 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.

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	Moderate
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	Results		
Prior Actions under this operation	**Indicator Name**	**Baseline**	**Target**
Pillar 1: Strengthening market institutions and the environment for private sector growth.			
1. To modernize the legal framework for state-owned enterprise privatization, increase the transparency of privatization processes, and support increased private sector investments, the Borrower has submitted a law on privatization for parliamentary approval.	Number of annual privatization progress reports prepared and published in accordance with requirements of Article 22 of the new privatization legislation.	0 (August 2022)	At least 1 (end-June 2024)
2. To increase private investment in the mobile telecommunications sector and accelerate the expansion of mobile digital services, the Borrower has approved the privatization, through a transparent process, of a fully state-owned mobile telecommunications services provider.	Number of licensed mobile (telecommunications) network operators (MNOs) that are fully privately owned.	2 (August 2022)	At least 3 (end-June 2024)
3. To modernize the legal framework that governs the regulation and supervision of non-bank credit organizations and support the expansion of non-bank credit markets, the Borrower has enacted a law on non-bank credit organizations and microfinance activities.	Assets of registered Non-Bank Credit Organizations, as a percentage of total banking sector assets.	0.3 (2020)	At least 5 (end-June 2024)
4. To modernize the legal framework that governs insolvency and to support a resilient recovery through the restructuring of distressed but viable firms and distressed consumers, the Borrower has enacted a law on insolvency.	Percentage of filings for restructuring cases over total cases	0.1 (2021)	At least 5 (end-June 2024)
5. To strengthen the competition legal framework, the Borrower has submitted a law on competition for parliamentary approval that defines: (i) the operative rules applicable to enforcement investigations and merger notifications, including procedural requirements and safeguards; and (ii) the functions of the competition authority as a compliance agency, including its involvement in state-owned enterprises oversight and areas for inter-agency collaboration.	Number of anticompetitive practices sanctioned under the new competition law.	0 (August 2022)	At least 20 (end-June 2024)

Prior actions	Results		
Pillar 2: Improving state-owned enterprise management			
6. To improve the financial sustainability of state-owned enterprise operations, the Borrower has: (i) restricted state-owned enterprises from engaging in new commercial activities, or owning or acquiring shares in other enterprises, that are not consistent with their core business, in accordance with their respective strategic plans; and (ii) revised the performance assessment criteria for supervisory boards of state-owned enterprises to include the achievement of corporate organizational improvement outcomes and improved financial sustainability. 7. To reduce fiscal risks arising from state-owned enterprises, the Borrower has (i) required the assignment of financial risk ratings to all state-owned enterprises based on transparent business solvency, liquidity, and profitability criteria; (ii) established risk-based ceilings and approval procedures for the issuance of non-guaranteed debt by state-owned enterprises; and (iii) required state-owned enterprises to regularly provide financial data to the Ministry of Finance.	Submission of quarterly financial reports by SOEs to the Ministry of Finance.	0 (August 2022)	100% of large SOEs under the ownership management of the Ministry of Finance have submitted at least 4 quarterly reports (end-June 2024)
Pillar 3: Increasing social inclusion and resilience			
8. To improve the effectiveness of the social protection system in supporting vulnerable people, including those affected by climate change, the Borrower has approved a National Social Protection Strategy that has: (i) clarified institutional roles and responsibilities for the design and delivery of social protection; (ii) designated the Single Registry of Social Protection as the single window for social assistance delivery; and (iii) introduced a result-oriented budget system to achieve the Borrower's social protection policy goals.	Share of social assistance beneficiaries among the poorest 40 percent of people.	58% (2021)	65% (2023)
9. To reduce hiring discrimination barriers against women in the private sector, the Borrower has abrogated the requirement that private employers pay maternity benefits and has instead required such benefits to be paid from public funds.	Percentage of women employed in the formal private sector for more than 6 months who are eligible to receive maternity leave benefits paid through social insurance.	0 (August 2022)	100 (end-June 2024)

ANNEX 2: FUND RELATIONS ANNEX

IMF Executive Board Concludes 2022 Article IV Consultation with the Republic of Uzbekistan

FOR IMMEDIATE RELEASE

Washington, DC—June 22, 2022: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation1 with the Republic of Uzbekistan.

Despite shocks from the pandemic and the war in Ukraine, Uzbekistan's economy has shown resilience. The pandemic caused a sharp slowdown in 2020, particularly in trade, tourism, and transportation. Nonetheless, real growth remained positive at 1.9 percent. Year-end inflation fell to 11 percent. In 2021, helped by government stimulus measures, growth rebounded sharply to 7.4 percent. Despite global price pressures, tight monetary policy helped reduce inflation further to 10 percent by end-2021. With a recovery in trade and remittances, the current account deficit widened slightly to 7 percent of GDP. Government economic support in the form of social assistance, investment and policy lending widened the overall fiscal deficit by 2 percentage points to 6.2 percent of GDP.

Despite these shocks, the authorities continued to make progress on structural reforms. Recent reforms included: liberalizing domestic prices and reducing crop placement requirements for cotton and wheat; making public procurement more transparent through a public portal that also collects information on beneficial owners; doubling the size of the social safety net; improving corporate governance by appointing more independent members of supervisory boards; selling a mid-sized state enterprise and many smaller assets; and finalizing laws on public debt and the labor market.

Given Uzbekistan's close economic ties with Russia, the outlook for 2022 will depend upon spillovers from the war in Ukraine and sanctions on Russia. Remittances, trade, and financing from Russia are expected to slow, reducing growth in 2022 to 3–4 percent and increasing the current account deficit to 8½ percent. With higher global food and commodity prices, inflation is expected to remain over 10 percent. Uncertainty is high, however. Possible risks could arise from a further escalation of the war and the sanctions regime, a renewed flare-up of the pandemic, slower growth in other trading partners, higher food and energy prices, or lower gold prices.

The authorities' macro-economic policies in the near term are focused on mitigating the impact of the shock, by supporting the recovery, protecting vulnerable households, containing inflation, and safeguarding financial stability. At the same time, they intend to accelerate the pace of structural reforms to ensure strong, sustainable, and inclusive longer-term growth, while enhancing resilience. Building on the progress already made, their efforts are focused on reducing the role of the state in the economy and creating an environment conducive to private sector job creation, by further opening markets and enhancing competition.

Executive Board Assessment

Executive Directors commended Uzbekistan's authorities for their decisive policy response to the COVID-19 pandemic, which contributed to a strong economic recovery in 2021.

Directors noted, however, that the spillovers from the war in Ukraine are slowing growth and, together with a possible resurgence of the pandemic, create significant uncertainty to the outlook. Against this backdrop, they welcomed the authorities' continued commitment to sound macroeconomic policies and structural reforms, which are critical to ensuring macroeconomic stability and promoting inclusive growth.

Directors commended the authorities' commitment to fiscal sustainability. They agreed that fiscal consolidation could be slowed this year, relative to the approved budget, to provide additional, targeted support to vulnerable households, particularly given the low risk of debt distress. Directors welcomed the authorities' plans for a gradual fiscal consolidation in the coming years, the introduction of medium-term fiscal and revenue frameworks, and the strengthening of the fiscal rules. They emphasized the need to continue enhancing revenue collection and spending efficiency, while addressing potential fiscal risks from state-owned enterprises (SOEs).

Directors welcomed the central bank's prompt monetary policy tightening in early 2022 and its commitment to lower inflation, which are key to anchor expectations and achieve the medium-term inflation target. They emphasized the need for continued exchange rate flexibility to mitigate spillovers from external shocks.

Directors supported the plans to reduce the role of state-owned banks in the financial system, which should also help strengthen the transmission of monetary policy. To safeguard financial stability, they recommended strengthening the central bank's supervisory and macroprudential frameworks, while continuing to closely monitor banks. They encouraged the authorities to continue implementing their AML/CFT strategy, including working on a new AML/CFT law.

Directors commended the authorities' reform progress and called for accelerating structural reforms. They particularly welcomed the measures to reduce the role of the state in the economy, by privatizing state-owned banks and SOEs, opening markets to private businesses, and enhancing competition and governance. In this context, Directors stressed the importance of ongoing governance reforms, including strengthening anticorruption institutions and corporate governance of SOEs. They also welcomed the plans to reform the energy sector, which is key to reduce the economy's energy intensity and carbon emissions.

Uzbekistan: Selected Economic Indicators, 2019-2023

	2019	2020	2021	2022	2023
			Est.	Proj.	Proj.
National income 1/					
Real GDP growth (percent change)	5.7	1.9	7.4	3.4	5.0
GDP per capita (in U.S. dollars)	1,801	1,766	2,002	2,072	2,275
Population (in millions)	33.3	33.9	34.6	35.3	36.0
Prices			(Percent change)		
Consumer price inflation (eop)	15.2	11.2	10.0	12.1	11.3
GDP deflator	17.9	11.6	13.6	11.6	13.1
External sector			(Percent of GDP)		
Current account balance	-5.6	-5.0	-7.0	-8.3	-7.2
External debt	42.5	57.5	57.8	61.2	59.0
			(Level)		
Exchange rate (in sums per U.S. dollar; eop)	9,516	10,477	10,820	…	…
Real effective exchange rate (ave, 2015 =100, decline = depreciation)	65.5	65.5	65.2	…	…
Government finance			(Percent of GDP)		
Budget revenues	27.7	26.6	27.7	30.4	28.6
Budget expenditures	31.4	31.0	33.4	34.4	31.6
Budget balance	-3.8	-4.3	-5.8	-4.0	-3.0
Adjusted revenues 1/	27.0	25.6	26.0	29.0	26.9
Adjusted expenditures 1/	27.3	28.9	30.6	32.8	29.8
Adjusted fiscal balance	-0.3	-3.3	-4.7	-3.8	-2.9
Policy lending	3.5	1.1	1.5	0.6	0.5
Overall fiscal balance	-3.8	-4.4	-6.2	-4.4	-3.4
Public and publicly guaranteed debt	28.4	37.6	35.8	38.2	37.2
Money and credit			(Percent change)		
Reserve money	17.8	15.4	28.3	10.3	14.8
Broad money	13.8	17.9	30.3	15.5	23.4
Credit to the economy	48.1	34.4	18.4	18.3	16.4

Sources: Country authorities; and IMF staff estimates.

1/ IMF staff adjusts budget revenues and expenditures for financing operations of the Fund for Reconstruction and Development (FRD), equity injections, policy lending, and privatization.

ANNEX 3: LETTER OF DEVELOPMENT POLICY

O'ZBEKISTON RESPUBLIKASI
MOLIYA VAZIRLIGI

MINISTRY OF FINANCE
REPUBLIC OF UZBEKISTAN

"4" November 2022 y. № 01/38-35-1906
"__" ______ 20__ y. № ______

David Malpass
President
World Bank Group

Dear Mr. Malpass,

I am writing to update you on Uzbekistan's progress in implementing the historic and ambitious economic and social transformation. This is the first of such updates since the launch of the new National Development Strategy 2022-2026.

Introduction

Six years ago, President Shavkat Mirziyoyev announced a historic and radical shift in Uzbekistan's economic, social, and political policies. Each of these six years has represented a step change in Uzbekistan's transformation from a state-led and centrally planned economy towards a market economy where the private sector leads. In the first five years of this transformation—under the 2017-2021 Development Strategy, Uzbekistan made substantial progress towards this goal, beginning with measures to fully liberalize the current account and unify the exchange rate, expanding into sweeping overhauls of the tax system and business environment, and setting strong foundations to downsize the state's role in the economy. A hallmark of Uzbekistan's reform program during this time has been the strong focus on the well-being of our citizens—whether it is to protect the poor against the costs of structural adjustment, or to ensure that the benefits of our reforms extend far and wide to all parts of the country. Today, *propiska*, once a significant constraint to internal labor mobility, is no longer a shackle, and people are free to find opportunities everywhere in the country. The laws of Uzbekistan now mandate equal pay for equal work—the first step in addressing the exclusion and discrimination of women in the economy. Uzbekistan has moved full steam towards implementing its obligations under the Convention on the Rights of Persons with Disabilities, and for the first time, educational policies are being developed and implemented based on high quality standardized assessment data.

These successes are also our shared successes with the World Bank—each of them supported under successive Development Policy Operations that have helped embed a strong, sequential, and inclusive reform process. These operations have also played a critical role in supporting Uzbekistan to minimize the harshest impacts of the multiple crises that have affected our economy and citizens: first, the the initial costs of the reforms, and then toll of the COVID-19 pandemic and the impact of recent global economic developments.

One year ago, following the successful completion of the 2017-2021 Development Strategy, President Mirziyoyev launched the next phase of our reforms under the 2022-2026 National

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Development Strategy (NDS). This strategy sets out ambitious goals to halve the poverty rate by the end of the Strategy and to firmly anchor Uzbekistan towards becoming an upper-middle income country by 2030. This proposed Development Policy Operation, like those that came before it, has played an important role in advancing critical reforms that set the foundations for the next phase of Uzbekistan's reform agenda. In the remainder of this letter, I will elaborate more on these reforms and highlight the government's key reform priorities for the medium-term.

Towards a market-led economy

Uzbekistan's transition to an inclusive, competitive, and private sector-led market economy remains the main instrument towards achieving the goals of the 2022-2026 NDS. This entails an all-encompassing challenge for Uzbekistan, spanning the creation of effective market institutions to accelerate productivity and efficiency, the withdrawal of state control over the economy to create room for private sector growth, and the need for an effective enabling environment that encourages competition, dynamism, and innovation.

Privatization and State-owned Enterprise Reform

Accelerating the reduction of the state's economic footprint through the privatization of state-owned enterprises (SOEs)—and improving the discipline of any SOEs remaining in government ownership—is a necessary condition for a strong market economy to grow roots in Uzbekistan.

Over the last five years, Uzbekistan has enacted a strong sequence of reforms to improve SOE performance and reduce the number of SOEs in the economy. These reforms have focused on both sector-level SOE reform priorities—such as the unbundling and liberalization of the energy and transportation sectors, and broader institutional framework measures to strengthen legal foundations for more effective privatization and SOE ownership management reforms. The first of these framework laws was supported under last year's Development Policy Operation and covered the management of SOEs and other state assets such as property. The law overhauls Uzbekistan's legal framework for the sound and effective management of SOEs and brings our standards into much closer compliance with international good practice.

Earlier this year, a second important law was submitted to Parliament establishing a framework for privatization. The 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 enshrines 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.

The enactment of these two laws sets a strong foundation for Uzbekistan to accelerate the SOE reform and privatization process. To date, several hundred small SOEs have already been privatized, but the law will establish stronger processes, checks, and balances to allow larger enterprises to be privatized in a manner that benefits all parties: private investors, the state, and the public. These reforms are essential to increase job creation through private sector growth and will be a welcome reduction in fiscal pressures and risks.

Simultaneously, the government is also continuing to advance reforms to strengthen the financial discipline of SOEs and ensure that their managements and supervisory boards are performing to high standards. Consistent with requirements in the SOE management legislation, the government has introduced new measures—supported under this Development Policy Operation—that restricts SOEs from expanding their activities beyond their core business and sets out clearer expectations of what government expects from SOE supervisory boards—a strong focus on performance and financial sustainability. These measures are complemented by new regulations that enhance the monitoring and oversight of SOE financial performance by the Ministry of Finance. Notably, the regulations introduce new risk-based borrowing ceilings using transparent methodology that is linked to the financial health and creditworthiness of the SOEs.

The privatization and SOE reform agenda will remain a high priority for the government in the coming years. Uzbekistan has learned lessons from other privatization and SOE reform experiences and has rightly focused on laying effective legal and institutional frameworks to ensure that the process of change is conducted with integrity and transparency. These reforms are intended not only to reduce the state's role in the economy—but also to enable a vibrant, competitive, and capable private sector. Key priorities over the medium-term include the acceleration of the privatization process for larger SOEs that have been identified for sale, and to complete historic partial privatizations of many of Uzbekistan's largest SOEs through equity offerings that will increase market discipline and deepen Uzbekistan's capital markets.

Financial sector reform

Our resolve to continue with financial sector liberalization and state-bank privatization continues to be steadfast despite tighter global financial market and investment conditions around the world. Preparations to privatize state owned commercial banks continues, and I am confident that this process will gather significant momentum as investment conditions improve.

In the interim, the government is deepening financial markets and reducing the dominance of the banking system in the financial market. The passage of new legislation to regulate non-bank credit organizations (NBCOs), supported under this operation, is one example of this work. The legislation overhauls the environment for NBCOs to operate and be effectively regulated. NBCOs have served as a dynamic agent of financial deepening and inclusion in other successful transitions, and I am hopeful that it will serve a similar role in Uzbekistan. Simultaneously, the government has also advanced new legislation on insurance, and measures to further develop and regulate capital markets. I expect that these sectors will become an important area of reform focus in the coming years, alongside further institutional reforms to strengthen and liberalize the commercial banking sector.

Private sector development and competition

Uzbekistan needs more private sector firms and more competition. This requires a business environment that is fair to all firms—private or state-owned. It also requires effective regulations that reduce monopoly tendencies, while allowing firms with bright ideas to succeed rapidly—and firms that fail to restructure or exit the market and free up resources. Following a series of reforms enacted since 2017 to liberalize the economy, reduce regulations, and improve the environment for private sector investment, a newly enacted law on insolvency, and a new competition law under consideration by Parliament, represent significant measures to strengthen the private sector environment. These laws, supported under this Development Policy Operation, have taken several years to develop and refine to Uzbekistan's context, and significantly modernize the legal environment for insolvency and competition. Importantly, the provisions of both laws, where relevant, will apply to SOEs in equal proportion, further cementing the government's commitment to competitive neutrality between state- and privately-owned businesses.

Laws are only as effective as the quality of their implementation. Over the next few years, further measures will be needed to further liberalize the economy, including sectors where the state continues to have a dominant market share. These sectors, such as chemicals, telecommunications, and aviation, have already been identified in earlier Presidential Resolutions as areas for deeper reforms. The new laws will provide a stronger foundation for these reforms to move forward more quickly. I am confident that reforms in these sectors—

where the private sector has consistently expressed a strong investment interest, and where Uzbekistan enjoys advantageous endowments—will form an important part of the reform agenda going forward.

Other market reforms

The reforms supported under this operation are only a subset of the broader market reforms that the government has continued to advance. A reform that is pending but which will be completed next year is the establishment of a new energy regulator to improve the quality of regulatory oversight in the energy sector. This is an important step in supporting the adjustment of energy tariffs to ensure that they reflect full cost recovery, and to the greater liberalization and market-orientation of the energy sector. Another important area of focus over the coming year will be urban and agricultural land reform, where a series of earlier Presidential Resolutions and new legislation relating to private urban land ownership will be implemented through the development of further subsidiary regulations and laws. I look forward to working closely with the World Bank and other partners to advance these reforms and further improve the economy's market orientation.

Leaving no one behind

Uzbekistan's commitment to an inclusive transition is as strong as its commitment to market orientation—it is our earnest goal that this is a reform agenda that leaves no one behind. This must be a transition that benefits all rather than a few. Reforms enacted since 2017 have dismantled several limiting barriers that have prevented our citizens from accessing opportunities and pathways to greater prosperity.

The approval of a new Social Protection Strategy marks the culmination of six years of policy modernization towards poverty reduction and social protection. Unlike many countries that take a "strategy-first" approach before commencing implementation, Uzbekistan has leaned heavily into policy experimentation —enacting a wide range of policy reforms to strengthen systems, practices, and culture relating to poverty and social protection before approving a new and watershed policy that redefines the future fabric of Uzbekistan's social protection system. The new strategy represents an important conclusion to an arc of reforms to overhaul the social protection system through the launch of the Single Registry of Social Protection, redefine and more accurately measure poverty and need in Uzbekistan, and firmly embed the role of social protection policy as a critical—if not essential—government responsibility.

Looking to the broader inclusion agenda, the government has continued to identify gaps that limit the economic and social inclusion of our citizens. Continuing a strong sequence of reforms to address labor mobility barriers, address gender inequalities and gaps in gender-based violence and disability rights frameworks, the focus of the government this year has been on further measures to reduce gender discrimination in the workplace. A significant source of that has been obligations on private sector (but not public sector) employers to cover maternity benefits. By assuming this responsibility under public social insurance funding, Uzbekistan is in greater alignment with best practices and conventions set out by the International Labor Organization. Importantly, private sector employers will have even more incentive to harness the potential of Uzbekistan's capable and high-potential female workforce.

Social protection and broader inclusion measures have been at the heart of *every* World Bank Development Policy Operation since the engagement started in 2017, spanning five operations. I have no doubt that this will remain the case for at least five more. Over the coming years, we will continue to focus on refining the social protection system to ensure that it is working for those who need it the most. At the same time, we will expand our focus to accelerate reforms to improve active labor market programs and the effectiveness of our poverty reduction policies.

Conclusion

As has been the case with each of these letters in the past, the reforms I have outlined remain a very small fraction of broad economic, social, and political reform program under way. The multiple shocks we have faced as we have implemented these reforms has only hardened our resolve to continue down the path of reforms.

The World Bank, and more specifically the World Bank's Development Policy Operation engagements, have been a steady partner to this reform process. Almost all major reforms enacted since 2017 have been supported through this engagement. It is my sincere hope that this tradition will continue long into the future. As we begin to tackle more complex reforms that require deeper engagements, and as the many shocks that have affected Uzbekistan subside, I believe that there will be opportunities to build a more programmatic Development Policy Operation engagement that provides certainty and commitment on both sides.

As we enter a seventh year of reforms, our enthusiasm and hunger for continued reforms remains strong. The past is becoming further and further distant to the point that it is no longer possible to go back because the old status quo has been forgotten. I would like to reiterate the gratitude of the Government of Uzbekistan to the World Bank for its partnership and support in this journey. I look forward to continuing to work with you and your team, and to you visiting Uzbekistan soon.

Sincerely

Timur Ishmetov
Minister of Finance
of the Republic of Uzbekistan

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Operation Pillar 1: Strengthening market institutions and the environment for private sector growth.		
Prior action #1: Privatization Law	Potentially adverse environmental impacts if environmental damage legacies of SOEs haven't been properly managed and transferred.	Risks of negative poverty impacts, negative distributional effects, negative social impacts (before mitigation).
Prior action #2: Privatization in telecommunications sector	Neutral, with caveats as under PA#1	Neutral
Prior action #3: NBCO Law	Potentially adverse environmental impacts if non-banking actors don't enforce due-diligence and monitoring of their borrower activities.	Risks of negative social impacts if women are unable to access loans given limited collateral and women face continued discrimination in the banking sector
Prior Action #4: Insolvency Law	Neutral	Neutral in short-term, with positive indirect benefits in the longer-term.
Prior action #5: Competition Law	Neutral	Positive poverty and social impacts through lower prices and greater product variety.
Operation Pillar 2: Improving the management of state-owned enterprises.		
Prior action #6 SOE governance	Neutral	Positive
Prior action #7: SOE fiscal risk management	Neutral	Neutral
Operation Pillar 3: Increasing social inclusion and resilience.		
Prior action #8: Social protection strategy	Neutral	Positive poverty impacts, positive distributional effects
Prior action #9: Maternity benefits	Neutral	Positive poverty and distributional effects

ANNEX 5: OVERVIEW OF REFORMS SUPPORTED UNDER PREVIOUS DPOS

Sector	Reforms supported in previous engagements	Reforms being completed in this DPO	Results to date and expected over longer-term
Areas of support across all DPOs since 2017			
Financial Sector	• Strengthened prudential requirements to comply with Basel Core Principles, and stress testing requirements • Modernization of banking legislation • Ending UFRD on-lending via commercial banks • Ending almost all preferential lending by state banks • Strengthening independent governance of Bank boards	• Expansion of financial sector markets through non-bank credit organizations legislative and regulatory overhaul.	• 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 **Expected longer-term results:** • More efficient financial intermediation through greater competition and product innovation • Deeper domestic financial markets and greater financial inclusion • Improved financial sector stability
Improving the 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	• New competition law • New insolvency law	• Average import tariffs fell from 13 to 8 percent • Foreign exchange access, once the biggest firm constraint, is no longer a problem • Record increases in 2019 and first three quarters of 2020 in domestic trading businesses • Average tariffs have fallen from 13 to 7.9 percent **Expected longer-term results:** • Increased private sector growth • Greater competition and product innovation • Increased private sector job creation
SOE reform and privatization	• Creation of SOE reform agencies • Unbundling of vertically integrated national airline SOE • Increased financial transparency of energy SOEs	• New privatization law • Privatization of mobile telecommunications operator	• Identification and transfer of all SOE shares to new agency and initiation of privatization process. • Forthcoming PPPs of domestic airports

	• SOE reform framework to improve the performance of the largest SOEs • Identification of at least 15 percent of all SOEs to be fully privatized via a competitive process • New unified corporate governance legislation	• Stricter regulations to enforce SOE's core business focus • Harder budget constraints on financially weaker SOEs	• Close to 500 small SOEs have been privatized or liquidated since the start of the process. • Corporate governance and financial transparency reforms for the largest SOEs remain on-track. **Expected longer-term results:** • Removal of all SOE dominance and monopoly protections • Hard budget constraints in force for SOEs • Competitive neutrality • Increased private sector entry and FDI into SOE dominant sectors • Fewer large SOEs
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 • New public debt law enshrining debt ceiling and measures to enhance fiscal discipline when public debt nears the ceiling	• Enhanced financial reporting and transparency requirements to improve fiscal risk monitoring	• The full 2021 Budget will be publicly consulted before submission to Parliament, the first time in Uzbekistan's history • Substantial reduction in off-budget spending, from over 6 percent of GDP to less than 1 percent of GDP projected in 2022 • The 2022 Budget will be the first in Uzbekistan's history to fully consolidate all public spending into the approved parliamentary budget law. In 2018, more money was being spent outside the consolidated budget. **Expected longer-term results:** • Fiscal consolidation • Greater alignment of fiscal footprint to government's development strategy • Increased transparency and accountability for public spending • Lower fiscal risks • Greater efficiency of SOE operations drives more environmental and climate sustainability.

Social protection, labor markets, and social inclusion	• Ending 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), 2020 (COVID) • Creation of a unified social registry • Improved seasonal contractual conditions and obligations. • Tax reforms to address disproportionate labor taxes discouraging formal employment • Decriminalization and abolishment of internal migration restrictions • 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 • New poverty line based on international best practices • New labor code enshrining equal work for equal pay and other protections for workers • Ratification of UN Convention on the Rights of Persons with Disabilities	• New social protection strategy that enshrines the single registry as the primary delivery mechanism • Revision of maternity benefits regulations to remove barriers to greater private sector female employment	• Record increases in registrations of income taxpayers (especially female taxpayers) • Largest social assistance beneficiary expansions since independence • Social assistance levels revised significantly upwards to meet new poverty line adopted by the government • Complete transformation of safety net system with single registry, with transparent data on applications and decisions • The single registry is now in operation across all regions of the country. The focus of policy reforms has shifted to streamlining types of assistance, expanding coverage, and increasing payments in line with new poverty measures. **Expected longer-term results:** • Lower poverty through more adequate and better targeted social safety nets • Lower fiscal administrative costs of safety net delivery • Increased economic participation of women, youth, and disabled persons (evidenced by self-employment, waged jobs)
Reforms Supported under Previous DPOs.			

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 Full liberalization of wheat market	• A revival of agriculture growth and record horticultural exports • Estimated 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 **Expected longer-term results:** • Increased agricultural productivity to accelerate the structural transformation process • Higher export earnings • Greater job creation in the economy from value-addition • Increased climate sustainability of agriculture
Energy	• New renewable energy legal and institutional framework • New energy tariff policy and methodology; 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 • 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. **Expected longer-term results:** • Full recurrent and capital cost recovery of all public utilities • Increased private sector investments in energy • More reliable and climate friendly energy supply