



**The World Bank**

Uzbekistan: Supporting a Transparent and Inclusive Market Transition (P171751)

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT  
AND  
INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT

FOR A

PROPOSED IBRD LOAN IN THE AMOUNT OF US\$250 MILLION AND

A PROPOSED IDA SCALE-UP WINDOW CREDIT IN THE AMOUNT OF US\$85 MILLION AND

A PROPOSED IDA CREDIT IN THE AMOUNT OF US\$165 MILLION

TO THE

REPUBLIC OF UZBEKISTAN

FOR THE

UZBEKISTAN: SUPPORTING A TRANSPARENT AND INCLUSIVE MARKET TRANSITION  
DEVELOPMENT POLICY OPERATION

November 16, 2020

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

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Republic of Uzbekistan

**GOVERNMENT FISCAL YEAR***January 1, 2020 – December 31, 2020***CURRENCY EQUIVALENTS**

Exchange Rate Effective as of November 16, 2020

UZS 10,390

US\$1.00

**ABBREVIATIONS AND ACRONYMS**

ADB	Asian Development Bank	JICA	Japanese International Cooperation Agency
CBU	Central Bank of Uzbekistan	LDP	Letter of Development Policy
CPF	Country Partnership Framework	MTI	Macroeconomics Trade and Investment
DPO	Development Policy Operation	NPL	Non-performing Loan
DPL	Development Policy Loan	OECD	Organization for Economic Cooperation and Development
DSA	Debt Sustainability Analysis	PDO	Program Development Objective
DSSI	Debt Service Suspension Initiative	PEFA	Public Expenditure and Financial Accountability
EBRD	European Bank for Reconstruction and Development	PFM	Public Financial Management
EIA	Environmental Impact Assessment	PPG	Public and Publicly Guaranteed
EU	European Union	PPP	Public-Private Partnership
FDI	Foreign Direct Investment	RE	Renewable Energy
GBV	Gender-based Violence	SCD	Systematic Country Diagnostic
GDP	Gross Domestic Product	SCTSSP	State Commission for Tendering the Sale of State Property
GFS	Government Financial Statistics	SDG	Sustainable Development Goal
GHG	Greenhouse Gas	SOE	State-owned Enterprise
GRS	Grievance Redress Service	UFRD	Uzbekistan Fund for Reconstruction and Development
IBRD	International Bank for Reconstruction and Development	UN	United Nations
ICR	Implementation Completion and Results Report	US\$	United States Dollar
IDA	International Development Association	UZS	Uzbekistan som
IFC	International Finance Corporation	WB	World Bank
IFRS	International Financial Reporting Standards	WBG	World Bank Group
IMF	International Monetary Fund	WHO	World Health Organization
INDC	Intended Nationally Determined Contribution	WTO	World Trade Organization

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**REPUBLIC OF UZBEKISTAN**

**UZBEKISTAN: SUPPORTING A TRANSPARENT AND INCLUSIVE MARKET TRANSITION**

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## SUMMARY OF PROPOSED FINANCING AND PROGRAM

### BASIC INFORMATION

Project ID	Programmatic
P171751	No

### Proposed Development Objective(s)

(i) Improving the efficiency, sustainability, and transparency of resource allocation in the economy; and (ii) Enhancing economic inclusion and social resilience.

### Organizations

Borrower: MINISTRY OF FINANCE OF THE REPUBLIC OF UZBEKISTAN

Implementing Agency: MINISTRY OF FINANCE OF THE REPUBLIC OF UZBEKISTAN

## PROJECT FINANCING DATA (US\$, Millions)

### SUMMARY

<b>Total Financing</b>	<b>500.00</b>
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### DETAILS

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

## INSTITUTIONAL DATA

### Climate Change and Disaster Screening

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

### Overall Risk Rating

Moderate



## Results

Indicator Name	Baseline	Target
<b>Result Indicator 1:</b> The stock of outstanding loans classified as commercial by the Central Bank of Uzbekistan, as a share of the stock of all outstanding banking sector loans.	36 percent (end-2019)	More than 60 percent (end-2021)
<b>Result Indicator 2:</b> Number of state-owned commercial banks boards where the majority comprises independent directors, consistent with requirements in the Banking Law.	Zero (Jan 2020)	At least 5 (end-2021)
<b>Result Indicator 3:</b> An increase in cotton growing area with adopted climate-smart farm technologies.	160,000 hectares (end-2019)	300,000 hectares (end-2021)
<b>Result Indicator 4:</b> Retail prices of all unleaded petroleum (AI80 and above) and diesel (including ECO Diesel) are determined by the market and free of direct government subsidies.	Retail price set by government decree with provisions for direct subsidies (March 2020)	Retail price determined by commodity exchange trading and is not directly subsidized by any regulatory legal acts (end-2021)
<b>Result Indicator 5:</b> Megawatts of renewable energy generation capacity that have been transparently and competitively tendered as PPPs, consistent with the PPP Law, and whose tender process has been concluded.	100MW (September 2020)	500MW (end-2021)
<b>Result Indicator 6:</b> An improvement in government institutional arrangements to support a more systematic approach to privatization.	SCTSSP does not exist, and privatizations are approved on a case-by-case basis. (October 2020)	SCTSSP is established and has commenced the valuation and determination of sale methods for SOEs listed for divestiture under the approved Resolution (end-2021)
<b>Result indicator 7:</b> Increased transparency and accountability of the general government budget.	UFRD income and expenses not included in the consolidated government budget approved by Presidential Decree (2019)	UFRD income and expenses included in the consolidated 2020 and 2021 State Budgets, and all supplementary budgets in those years, that are approved by the Parliament (end-2021).
<b>Result Indicator 8:</b> A decrease in the annual number of people fined by the Government for violations of place of registration rules.	317,088 (2019)	Less than 125,000 (end-2021)
<b>Result Indicator 9:</b> The establishment of referral pathways for survivors of gender-based violence.	No legal basis for complaints or referral pathways for survivors of gender-based violence. (June 2019)	Referral pathway for gender-based violence survivors, compliant with WHO standards, has been adopted and disseminated. (end-2021)
<b>Result indicator 10:</b> A decreasing share of low-income allowance applications with income below the eligibility threshold that are rejected because of lack of registration with the Employment Service Center.	48 percent covering only the <i>Sirdarya Viloyati</i> pilot region (August 2020)	Less than 30 percent <i>nationwide</i> (end-2021)



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

**1. INTRODUCTION AND COUNTRY CONTEXT**

**1. This proposed standalone Development Policy Operation (DPO) of US\$500 million supports the Government of Uzbekistan in achieving a faster and more transparent and inclusive transition to a market economy.** It comprises a loan of US\$250 million, a concessional credit of US\$165 million, and a non-concessional credit of US\$85 million through the IDA Scale-Up Window. Despite the immense social and economic challenges created by the COVID-19 pandemic, Uzbekistan has continued to implement its ambitious reform agenda, while strengthening economic management and transparency. Reforms supported by this operation focus on: (i) improving the efficiency, sustainability, and transparency of resource allocation in the economy; and (ii) enhancing economic inclusion and social resilience. The proposed operation is central to the World Bank Group's (WBG) overall engagement with Uzbekistan, as described in the 2016–2020 Country Partnership Framework (CPF),<sup>1</sup> and is closely aligned with the World Bank's COVID-19 Crisis Response Approach Paper. This operation will be supported by parallel financing of ¥15 billion (about US\$140 million) by the Japanese International Cooperation Agency (JICA).

**2. The proposed operation would consolidate the gains of two previous standalone DPOs.** The two previous operations of US\$500 million each approved by the World Bank Board in June 2018 and June 2019,<sup>2</sup> respectively, supported the initial phase of Uzbekistan's transition. The operations were successful, with 20 out of 21 result indicators having been met; one indicator is delayed because of the COVID-19 crisis but is on track to being achieved by mid-2021.<sup>3</sup> More importantly, the reforms supported by those operations have contributed to visible improvements in the lives of citizens, reflected in rising wages, higher incomes from agricultural reforms, stronger private consumption growth, and greater opportunities for entrepreneurship.

**3. The COVID-19 crisis has delivered a sharp blow to past economic gains and has increased poverty.** Real gross domestic product (GDP) growth was robust at 5.6 percent in 2019, driven by several reforms enacted since 2017. Growth was also broad-based, helping accelerate poverty reduction. However, the COVID-19 crisis has since dramatically slowed economic growth, with GDP projected to increase by just 0.6 percent in 2020. Macro risks have become more elevated due to the pandemic, but internal and external balances remain sustainable, because of strong buffers built up before the crisis. After falling consistently for over two decades, Uzbekistan's poverty rate will increase in 2020. Using the poverty line appropriate for lower middle-income countries (US\$3.2 per person per day in PPP terms), the poverty rate is likely to increase to between 8.7 and 9.8 percent in 2020, compared with pre-crisis projections of 7.4 percent. As a result, up to 900,000 more people are likely to fall into poverty, with many more at risk of facing considerable hardship. Poor and vulnerable citizens have suffered from a sharp fall in remittances due to economic contractions in the Russian Federation and Kazakhstan (the main destinations for migrant workers from Uzbekistan) and travel restrictions that have stopped hundreds of thousands of seasonal workers from returning to work.<sup>4</sup>

**4. The Government responded quickly with rapid and sizeable anti-crisis support to save lives and protect the vulnerable, in line with the approach recommended in the World Bank's COVID-19 Response Approach Paper.**

<sup>1</sup>The CPF (105771-UZ; May 19, 2016) was revised after a 2018 Performance and Learning Review (P171751-UZ; June 26, 2018).

<sup>2</sup>The US\$500 million Development Policy Loan approved in June 2019 was augmented by a supplementary operation of US\$200 million in response to the COVID-19 crisis in April 2020.

<sup>3</sup>The result indicator on aviation in the second DPO was partially met (separation of SOEs) prior to the September 2020 deadline. The second part of the result indicator relating to the PPP process for airports was delayed due to the COVID-19 crisis, but is on track to being completed in the first half of 2021.

<sup>4</sup>World Bank simulations suggest that without remittance income Uzbekistan's poverty rate in 2018 would have increased from 9.6 to 16.9 percent of the population.



Heeding early warnings about the COVID-19 pandemic, the Government established an Anti-Crisis Commission at the end of January 2020, seven weeks before the first coronavirus case was detected in Uzbekistan. The Commission spearheaded the Government's policy response, prioritizing saving lives, preserving livelihoods, and sustaining the reform momentum. These priorities mirror the four pillars of the World Bank's COVID-19 Crisis Response Approach Paper. The Government has increased its total spending as a share of GDP by about 4 percent in 2020 through targeted and time-bound measures to mitigate the impact of the crisis, with emphasis on expanded health services and social protection, and financial support to small- and medium-sized businesses.

**5. Despite the COVID-19 pandemic, the government remains committed to continuing its reform program.** Recognizing that Uzbekistan's prosperity depends on the success of the ongoing transition, the Government has maintained its focus on removing the most binding impediments to the transition process despite the COVID-19 pandemic. The emerging private sector still has limited room to grow in the presence of several thousand SOEs that enjoy preferential access to resources and markets. Climate change is already a clear and present threat, to which Uzbekistan's population and Government have begun adapting. Gaps remain in Uzbekistan's social safety net, education, and health systems, and the inclusion of women in the economy. Land, capital, and labor markets remain beset with inefficiencies, excessive regulation, and the absence of adequate market institutions. The role of the state—through large public investments and the significant presence of SOEs—remains pervasive and, in large parts, inefficient.

**6. This proposed operation supports the Government's focus on enhancing transparency and accountability.** Non-transparent decisions can undermine the accountability of the Government to its citizens, hurts the efficient use of public and private resources, and gives rise to corruption and the capture of state resources by vested interests. These risks can be mitigated by more open and transparent decision-making, wider public disclosure and communication of information relating to reforms, and greater transparency of the economic and financial transactions of the Government. This proposed operation supports the Government's efforts to further enhance transparency, through a more accountable budget process, increased disclosure of public investment information, greater transparency and accountability of state-owned banks and enterprises, open and competitive state ownership divestiture processes, and a fairer and more transparent safety net system.

**7. This proposed DPO helps address Uzbekistan's climate change challenges.** Uzbekistan's climate vulnerabilities are particularly acute in the sectors of agriculture, energy, and water resource management.<sup>5</sup> In the agriculture sector, climate change is significantly increasing risks to water availability, as well as potentially increasing the incidence of pests and diseases. Droughts may become more frequent due to decreases in river runoffs, especially from the *Amu Darya* and *Syr Darya* Rivers. The energy sector is exposed to risks from climate variability that may impact energy supply (e.g., through disruptions due to increased extreme weather events) and demand (e.g., due to a rise in annual number of hot days). Some communities, particularly in areas near the Aral Sea, are already more vulnerable to climate change due to reduced water availability, lower agricultural productivity and food security, and poorer health outcomes. Actions in this proposed operation include measures to adapt and mitigate the impact of climate change, through lower water usage and greater climate-smart technology adoption in agriculture, reduced

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<sup>5</sup> Anticipated climate impacts include increases in monthly maximum temperatures across Uzbekistan, high variability of rainfall across different agroecological and climatic zones (i.e., annual precipitation decline in some central and eastern districts; moderate increase in areas surrounding the Aral Sea), and increased glacier melting with implications for water availability and river flow in the short to long term.



fossil fuel emissions through the removal of petroleum subsidies, increased private investments in renewable energy and other climate-smart infrastructure, and strengthened social assistance to climate-vulnerable communities.

**8. The proposed operation also supports the Government’s efforts to increase economic inclusion and the well-being of women.** Measures under this operation help address legacy constraints such as onerous internal migration controls and weaknesses in social safety nets. The operation also addresses gaps in the economic inclusion, safety, and well-being of women in Uzbekistan through measures to guarantee equal opportunities for women in employment and access to public services, and to strengthen protections for survivors of gender-based violence.

**9. The World Bank’s DPOs have supported greater agility while anchoring a comprehensive programmatic reform dialogue and the wider World Bank Group’s engagement in Uzbekistan.** The choice of a standalone DPO (as opposed to a programmatic DPO series) is explained by Uzbekistan’s fast-moving reform dynamics that require the agility afforded by standalone operations. The DPOs anchor a strong, comprehensive, multi-year, and multi-sector policy dialogue that has provided the Government with strategic support for its market transition process. This policy dialogue has been underpinned by the World Bank’s operational and analytical engagements in Uzbekistan across major reform priorities for the Government, such as agriculture, state-owned enterprise and bank reforms, and social protection.

**10. The overall risk of this operation is moderate, and the macroeconomic policy framework is adequate, reflecting the high level of political and public support for reforms and improved economic management.** An effective response to the pandemic enables the Government to continue with the implementation of important reforms to accelerate the transition. The reform environment is supported by a sustainable macroeconomic policy framework, as well as strong political and public support for the transition. Although social and environmental risks have increased as the Government tackles more complex structural reforms, the Government is aware of these risks and is working with the World Bank and other partners to strengthen existing mitigation mechanisms and to develop new measures.

## 2. MACROECONOMIC POLICY FRAMEWORK

### 2.1. RECENT ECONOMIC DEVELOPMENTS

**11. The COVID-19 pandemic has dramatically slowed economic growth in 2020 after years of robust expansions.** Real GDP growth is projected to decline to 0.6 percent in 2020, which represents a significant downgrade from the 5.9 percent forecast before the pandemic, and a substantial slowdown compared with 5.5 percent average growth in 2018 and 2019. On the supply side, larger increases in agricultural and gold production have offset contractions in non-gold mining, while activity in manufacturing, construction, and most services will slow sharply. Demand side conditions have also weakened, due to restrictions on mobility and economic activity, weaker external demand, and lower remittance inflows. Investment has contracted substantially amid dampened demand prospects at home and abroad. The expansion of private consumption has slowed sharply, as increased government transfers to households—part of the Government’s COVID-19 response (contributing to a larger budget deficit)—are only partially expected to offset reduced labor incomes and remittances. Exports are projected to decline, as a surge in gold exports and higher international gold prices are more than offset by weaknesses in non-gold shipments due to weak demand from all trading partners (Table 1).

**12. Poverty and unemployment have increased sharply—the first reversal after two decades of continuous economic growth and poverty reduction.** Between 2000 and 2019, real per capita GDP growth averaged almost 5 percent a year, resulting in the near elimination of extreme poverty and a sustained reduction in the national poverty rate. However, the resilience of these outcomes is now being tested by the COVID-19 crisis (Box 1). The share of households with at least one working member fell dramatically in April 2020 (by more than 40 percentage points)



following the imposition of stringent lockdown measures.<sup>6</sup> Although there was a 33 percentage-point rebound by June, as lockdowns were eased, households with at least one working member were still 11 percentage points below 2019 levels (Figure B1). New online job listings in August 2020 were down 74 percent year-on-year. The share of respondents reporting any self-employment income was down 30 percent year-on-year in August, with the impact felt more severely in urban areas (more than a 40 percent decline) than in rural areas (26 percent decline).

Table 1: Uzbekistan: Key Macroeconomic Indicators

	2017	2018	2019	2020	2020	2021	2022	2023
				PC*	(Projected)			
<b>National Income and Prices</b>								
				(Percent, unless otherwise noted)				
Real GDP growth (annual percent change)	4.5	5.4	5.6	5.9	0.6	4.8	6.0	5.5
GDP Deflator	19.4	27.5	19.2	18.3	16.1	10.3	8.1	6.2
Consumer price inflation (end of period)	18.8	14.3	15.2	12.4	12.1	9.3	6.1	4.9
<b>External Accounts</b>								
				(Percent of GDP, unless otherwise noted)				
Export of goods, of which	21.2	22.6	24.0	25.8	21.7	22.5	23.5	24.3
<i>Gold</i>	6.8	5.8	8.5	8.5	11.9	9.3	8.6	7.3
Imports of goods, of which	25.8	36.2	36.6	37.4	31.9	34.3	33.6	33.5
<i>Machinery and Equipment</i>	9.4	14.9	16.5	16.5	14.6	15.5	16.0	15.5
Remittances and other transfers	15.4	15.2	15.1	14.6	11.9	12.1	12.6	13.0
Services Balance	-3.8	-4.8	-3.9	-3.7	-3.3	-3.6	-3.5	-2.5
Current account balance	2.5	-7.1	-5.6	-4.7	-5.8	-6.1	-5.8	-5.2
Foreign direct investment, net	3.7	1.2	3.9	2.5	1.2	2.0	2.5	3.0
Gross international reserves (US\$ billion)	28.1	27.1	29.2	29.0	32.4	31.0	30.1	30.1
Gross international reserves (months of import cover)	14.4	9.7	7.0	7.3	10.8	9.5	8.3	7.6
External debt (percent of GDP)	34.1	34.3	43.5	44.5	50.5	54.1	53.5	52.6
<b>Consolidated Fiscal Accounts</b>								
				(Percent of GDP, unless otherwise noted)				
Revenues	24.7	27.8	28.2	25.3	25.7	24.8	24.4	24.6
Expenditures	23.4	26.0	28.2	25.8	30.1	28.6	26.7	26.1
Budget Fiscal Balance	1.3	1.8	0.0	-0.4	-4.4	-3.8	-2.3	-1.5
Policy lending	3.1	3.9	3.6	1.5	3.0	2.3	1.7	1.7
Overall fiscal balance	-1.8	-2.2	-3.9	-1.9	-7.4	-6.1	-4.0	-3.2
Total public debt	20.2	20.4	29.2	25.0	34.4	38.5	40.3	40.8
<b>Monetary Accounts</b>								
				(Annual percent change, unless otherwise noted)				
Broad money growth	41.0	13.2	17.8	27.6	17.9	18.2	18.9	16.4
Growth in credit to the economy	103.0	51.3	48.1	21.6	28.4	19.0	11.7	10.5
Credit to the economy (percent of GDP)	43.1	41.5	40.8	42.2	44.8	46.0	44.9	44.3
<b>Memorandum Items</b>								
Nominal GDP (som trillion)	303	407	512	642	592	688	793	889
Nominal GDP (US\$ billion)	58.2	50.4	57.9	-	-	-	-	-

\*PC = Pre-Crisis; Sources: World Bank and IMF staff calculations/estimates using data provided by the authorities.

### 13. The COVID-19 pandemic and the cost of anti-crisis measures have substantially worsened the budget deficit.

Revenues were 2 percentage points of GDP lower in the first half of 2020 compared with the same period in 2019. This reflected lower tax and non-tax revenues due to anti-crisis tax deferrals and weaker dividends from non-gold commodity exporting SOEs. Large dividends from gold sales have offset other weaker revenue collections in the second half of 2020, resulting in a projected 2 percent increase in nominal revenue collections for the full year. Revenues from value added taxes, as a share of GDP, are projected to be lower relative to 2019 and to pre-crisis projections for 2020, due to weaker domestic demand and the temporary zero-rating of essential health and food products. Measures to reduce the impact of the crisis are projected to increase budget spending by about 4

<sup>6</sup> World Bank Listening to the Citizens of Uzbekistan, August 2020 CoVID Update

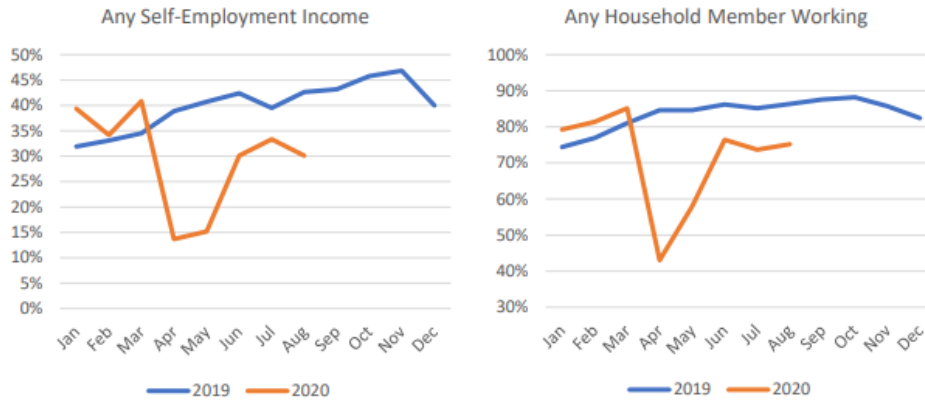


percentage points of GDP in 2020. Spending has increased for health care, transfers to low-income households, financial support to enterprises, and an expansion of public works. As a result, the budget deficit is projected to widen to 4.4 percent of GDP in 2020 against a pre-crisis projection of 0.4 percent.

**Box 1: Increasing vulnerabilities due to the COVID-19 crisis**

A high share of people cannot afford basic needs and are currently seeking assistance. According to data from the World Bank Listening to Citizens of Uzbekistan Survey, the share of people reporting lower food consumption rose sharply to 26 percent in April and remained elevated in August at 24 percent.<sup>7</sup> The share of people saying that they could not afford enough food was above 14 percent, the highest level recorded. Households also reported fragile finances: more than half said they did not have savings, and 38 percent could not pay emergency expenses of UZS 100,000 (about US\$9.7). Concerns about health are even higher: in August, the share of those being “very concerned” about health risks rose to above 72 percent, compared with 68 percent with similar concerns about the economic impact. About 13.5 percent of people reported receiving direct assistance at some point since the outbreak. Most assistance came as in-kind benefits or vouchers and was more common in urban areas. Flows of assistance were strongly associated with lower income, indicating that programs have been well targeted to vulnerable households.

**Figure B1 - Employment impact of the COVID-19 crisis**



(Source: World Bank Listening to the Citizens of Uzbekistan Survey)

**14. The consolidation of policy lending from the Uzbekistan Fund for Reconstruction and Development (UFRD) into the Government budget has improved fiscal policy coordination during the COVID-19 crisis.** Policy lending—largely lending by the UFRD to SOEs—is projected to double against pre-crisis projections, resulting in an overall fiscal deficit of 7.4 percent of GDP (see footnote in Table 2). As part of efforts to eventually consolidate all government spending into the budget, UFRD’s income and expenses were integrated into the 2020 budget through reforms to the budget code in December 2019 (supported under Prior Action 6 of this proposed operation). This measure is already helping to strengthen coordination between budget and UFRD spending. As a result of the consolidation, a significant share of gold mining receipts that would ordinarily accrue as revenues to the UFRD were recorded under the Government budget. A coordinated program of financial support for SOEs affected by the COVID-19 crisis was provided using a mix of funds from the Government’s anti-crisis budget (supporting recurrent spending needs) and via investment lending from UFRD (supporting continued capital improvements in SOEs). Although UFRD spending

<sup>7</sup> World Bank Listening to the Citizens of Uzbekistan, August 2020 CoVID Update.



increased sharply relative to pre-crisis estimates, policy lending in 2020 (at 3 percent of GDP) is projected to be about 25 percent lower than the annual policy lending between 2017 and 2019 (Table 2).

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

	2017	2018	2019e	2020pc	2020p	2021p	2022p
<b>Total Revenues, of which:</b>	<b>24.7</b>	<b>27.8</b>	<b>28.2</b>	<b>25.3</b>	<b>25.7</b>	<b>24.8</b>	<b>24.4</b>
<b>Tax revenues, of which</b>	15.2	17.4	19.1	18.2	18.7	18.9	18.7
<i>Income and profit taxes</i>	4.3	4.2	6.2	6.9	6.8	6.9	7.1
<i>Value-added taxes</i>	4.9	6.9	6.6	6.3	6.0	6.8	7.0
<i>Excise taxes</i>	2.5	2.4	2.0	1.9	1.9	1.7	1.8
<i>Mining Taxes</i>	1.1	2.1	2.9	1.9	2.7	2.0	1.4
<i>Taxes on international trade</i>	0.7	0.4	0.4	0.4	0.5	0.5	0.5
<b>Other revenues (tax and non-tax)</b>	<b>2.2</b>	<b>3.2</b>	<b>4.2</b>	<b>4.0</b>	<b>4.0</b>	<b>3.4</b>	<b>2.4</b>
<b>Extra-budgetary Funds</b>	<b>7.3</b>	<b>7.2</b>	<b>4.9</b>	<b>3.9</b>	<b>3.8</b>	<b>3.5</b>	<b>3.3</b>
<i>Pension fund</i>	5.9	5.9	4.8	3.6	3.4	3.2	3.3
<i>Other extra-budgetary expenditure</i>	0.4	0.4	0.1	0.3	0.4	0.3	0.0
<b>Total expenditures, of which:</b>	<b>23.4</b>	<b>26.0</b>	<b>28.2</b>	<b>25.8</b>	<b>30.1</b>	<b>28.6</b>	<b>26.7</b>
Social safety nets	6.2	5.8	6.0	5.8	6.8	6.8	6.5
Social and cultural expenditure	9.2	10.9	10.8	8.8	10.7	10.5	10.8
Public investment	1.1	1.3	4.0	2.2	2.9	2.8	2.4
Public administration	0.9	1.0	1.2	1.2	1.2	1.1	1.0
Economy	1.7	1.9	2.6	2.2	3.4	2.3	2.0
Interest expenditure	0.0	0.1	0.2	0.2	0.4	0.5	0.4
Other expenditure	4.3	5.0	3.4	5.4	4.7	4.6	3.6
<b>Budget Fiscal Balance (1)</b>	<b>1.3</b>	<b>1.8</b>	<b>0.0</b>	<b>-0.4</b>	<b>-4.4</b>	<b>-3.8</b>	<b>-2.3</b>
<b>Policy lending (2)</b>	<b>3.1</b>	<b>4.0</b>	<b>3.9</b>	<b>1.5</b>	<b>3.0</b>	<b>2.3</b>	<b>1.7</b>
<b>Overall fiscal balance (1 + 2)</b>	<b>-1.8</b>	<b>-2.2</b>	<b>-3.9</b>	<b>-1.9</b>	<b>-7.4</b>	<b>-6.1</b>	<b>-4.0</b>
<b>Statistical discrepancy</b>	<b>-0.2</b>	<b>0.7</b>	<b>-0.2</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Financing, of which</b>	<b>1.6</b>	<b>2.9</b>	<b>3.7</b>	<b>1.9</b>	<b>7.4</b>	<b>6.4</b>	<b>4.0</b>
Domestic	0.2	-1.2	-2.3	-1.2	1.6	1.0	1.2
External	1.4	4.1	6.0	3.1	5.8	5.1	2.8

*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.

**15. The higher fiscal deficit in 2020 has been financed primarily through an increase in external and domestic borrowing.** External financing includes the World Bank supplementary DPL of US\$200 million in April 2020, financial support from the IMF of US\$375 million (Rapid Credit Facility / Rapid Financing Instrument) and budget support from the ADB of US\$500 million (COVID-19 Active Response and Expenditure Support). The authorities also expect to raise funding from external markets through a proposed Eurobond issuance towards the end of 2020, and through an expanded domestic debt issuance program following a successful Treasury-bill pilot in 2019 (Table 3). Public debt is projected to increase to 34.4 percent of GDP by the end of 2020 from 29.3 percent in 2019 and 20.4 percent in 2018. The increase in public debt in 2019 was driven by higher disbursements from international financial institutions (IFIs)



following reforms to increase IFI project delivery, a US\$1 billion Eurobond issuance in early 2019, and several large one-off loans and guarantees to finance below-the-line infrastructure (such as financing for a US\$5.6 billion gas-to-liquid project in southern Uzbekistan) and capital modernization projects.

<b>Pre-COVID-19 Budget Financing Needs for 2020</b>	
<b>1. 2020 Budget Primary Balance (negative = surplus)</b>	<b>-580</b>
<b>2. Interest</b>	<b>239</b>
<b>3. Amortization</b>	<b>598</b>
<b>4. Total gross financing needs pre-COVID-19 (1+2+3)</b>	<b>257</b>
<b>Unanticipated Budget Financing Needs Arising from the COVID-19 Crisis</b>	
<b>5. Lower revenues</b>	<b>475</b>
<b>6. Additional budget expenditures</b>	<b>2,099</b>
<b>7. Less Reprioritization of existing budget</b>	<b>200</b>
<b>8. Net new additional deficit (5+6-7)</b>	<b>2,374</b>
<b>Revised 2020 gross fiscal financing needs (Post-COVID-19) (4+8)</b>	<b>2,631</b>
<b>Total 2020 Financing, of which:</b>	<b>2,668</b>
<b>GOU Eurobonds (expected in November or December 2020)</b>	<b>700</b>
<b>Domestic T-bills (net)</b>	<b>250</b>
<b>Development partner financing, of which:</b>	<b>1,718</b>
World Bank supplemental DPO financing (April 2020)	200
IMF RCF/RFI	375
Asian Development Bank emergency financing	500
<b>World Bank Proposed DPO (this operation)</b>	<b>500</b>
Government of Japan (via JICA) co-financing for this operation	143

**16. Inflation is expected to moderate from previously high levels due to weaker aggregate demand and smaller adjustments to administered prices.** Following a large exchange rate devaluation in September 2017, the liberalization of several regulated prices, and an increase in public wages, consumer price inflation breached double digits in 2017, before peaking in January 2018 at about 20 percent. Since then, and despite occasional spikes linked to increases in administered prices and periodic depreciation of the som, year-on-year inflation has followed a steadily moderating trend. Consumer price inflation remained elevated, but declined to 11.7 percent in August 2020, reflecting weaker aggregate demand, lower fuel prices, a moderation in public wage increases, and a COVID-19-related moratorium on further adjustments to administered prices in 2020. The decline in inflation allowed for a more robust monetary policy response to the COVID-19 crisis. In response to a weakening economic outlook, the Central Bank of Uzbekistan (CBU) eased monetary policy in 2020 for the first time since the start of the reforms in 2017, cutting the policy rate by 100 bps in April 2020 to 15 percent and further in September to 14 percent. The CBU began a phased transition to inflation targeting from January 2020, setting a goal of reducing inflation to 10 percent by end-2021 and 5 percent by end-2023.

**17. The COVID-19 crisis has significantly increased financial sector risks, but the banking system remains well-capitalized.** Risks to the banking sector have increased due to outstanding loans in crisis-affected sectors and increased anti-crisis lending by the Government. Due to increased lending, the capital adequacy ratio fell to 19.4 percent in August 2020 from 23.5 percent as at end-2019 and the ratio of liquid to total assets declined to 10.3 percent in August from 11.3 percent as at end-2019. Non-performing loans (NPL) increased to 2.4 percent in August 2020 from 1.5 percent as at end-2019, although this increase could have been larger if not for anti-crisis loan



deferments announced in April 2020 for firms in affected sectors. The eventual removal of anti-crisis deferments could increase NPLs further, but banks remain well capitalized and backed by the CBU through liquidity support. Credit growth remains high, at 21 percent from January to August 2020, but has moderated compared to 48.1 percent in 2019,<sup>8</sup> 51 percent in 2018, and 103 percent in 2017.

**18. The current account deficit is projected to increase only slightly as a share of GDP in 2020, with strong gold sales and lower imports offsetting a sharp decline in other exports and remittances.** Since 2018, Uzbekistan's current account has been in deficit following decades of surpluses. Total exports are projected to decline from 24 percent of GDP in 2019 to 22.5 percent in 2020. This decline would have been steeper if not for a 44 percent increase in gold exports offsetting a 27 percent decline in dollar terms in non-gold exports such as energy, non-gold metals, and food products. Imports are projected to fall from 36.6 percent of GDP in 2019 to 31.9 percent in 2020, largely due to lower machinery, equipment, and consumer imports. Despite a lower trade deficit, an expected 15 percent decline in remittances is likely to lead to a current account deficit of 5.8 percent of GDP in 2020 slightly higher than 5.6 percent in 2019. The current account deficit in 2020 is financed through increased borrowing from multilateral and bilateral development partners. Foreign direct investment (FDI) and portfolio investments, which financed a larger share of the current account deficit in 2019, are projected to fall by almost 3 percent of GDP in 2020 because of the COVID-19 crisis.

## 2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

**19. An economic rebound is projected in 2021, backed by gains from structural reforms, anti-crisis spending, and a revival in trading partner growth.** Growth in 2021 is projected to rebound to 4.8 percent. This projection is subject to considerable uncertainty related to the COVID-19 crisis, with the duration and depth of the pandemic still unknown. If the stabilization of COVID-19 cases in Uzbekistan continues to allow the Government to avoid widespread lockdowns in favor of less disruptive localized measures, employment gains in recent years and higher wages and agricultural incomes are likely to support a rebound in private consumption. This will be further augmented by a partial recovery in remittances as growth prospects for the Russian economy improve gradually. An economic recovery in the Russian Federation (GDP growth for 2021 projected at 2.7 percent) and China (projected GDP growth at 6.9 percent) is also expected to boost export volumes of non-gold commodities, chemicals, horticulture, and manufactured goods. An increase in government support to the vulnerable population at a higher level than prior to the crisis, the continuation of sizeable anti-crisis spending, and public investments are expected to further support increased demand. On the supply side, a pick-up in industrial growth (benefiting from improved export opportunities to China and the Russian Federation and continued strong public investment) and in services, especially transport, trade, and catering (benefiting from increased private consumption from stronger rural incomes due to agricultural reforms and a partial recovery in remittances) are likely in 2021. Agricultural growth is also expected to remain buoyant in 2021 as new horticultural investments initiated since 2017 reach production maturity.

**20. The lingering impact of a prolonged pandemic is likely to significantly widen the budget deficit over the medium term.** Anti-crisis measures, especially healthcare and safety net spending, and a scale-up in public investment projects are now expected to continue in 2021, in response to uncertainty about the global recovery and subdued private sector demand. As part of additional anti-crisis measures, the Government has also announced a one-year delay to previously anticipated large utility tariff adjustments. These measures are compounded by projected weaker revenues in 2021, with a recovery in VAT and income taxes only partially offsetting the large decline

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<sup>8</sup> In December 2019, almost all UFRD on-lending via commercial banks was transferred out of the banking system and to the accounts of the UFRD. As a result, end-2019 credit growth, net of UFRD activities, was about 24 percent. For consistency UFRD on-lending is included in credit numbers.



in, excise, non-tax revenues (e.g., SOE dividends) and pension contributions.<sup>9</sup> As a result, the budget deficit is projected to be 3.8 percent of GDP in 2021 (against pre-crisis projections of 1.8 percent), declining to 2.3 percent of GDP in 2022 as anti-crisis measures are gradually ended. The deficit is expected to be financed through increased borrowing from international financial institutions and development partners, and from domestic and foreign currency bonds. Assuming improved global and domestic economic conditions, medium term fiscal consolidation is expected to start in 2022 to bring the budget back to balance.

**21. Inflation is likely to slow to single digits in the medium term, especially if credit growth continues to moderate.** Twelve-month inflation is projected to reach about 12 percent at end-2020, before moderating further to about 9 percent by end-2021. Subdued demand, moderate adjustment in non-utility price controls (with necessary adjustment having already been made in recent years), and a reduction in credit growth will be the main factors limiting inflation over the medium term. This projection is subject to downside risks, especially from higher-than-projected credit growth increases, particularly from the UFRD. This risk, however, is moderated by the Government's continued banking reforms, including through measures supported under this DPO to reduce preferential lending, end all UFRD on-lending activity via commercial banks, and integrate the UFRD into the Government budget.

**22. The exchange rate regime remains broadly flexible.** Since the liberalization of the exchange rate in 2017, the CBU has continued to maintain a neutral intervention policy, offsetting domestic gold production with foreign exchange sales, and intervening only to avoid disruptive market conditions. The som has depreciated against the US dollar by about 9 percent since January 2020, with most of the adjustment happening between April and May. Although the exchange regime is now largely flexible to shifting market conditions, there is significant room to further improve the exchange rate market through better market infrastructure such as the introduction of trading and auction platforms and more frequent rate setting by the CBU.

**23. Increases in imports of capital goods coupled with sluggish export recovery will keep the current account elevated over the medium term.** As the Government continues with reforms to modernize and strengthen the operational performance of SOEs, especially in sectors such as energy and mining, capital imports are expected to revert to their pre-crisis levels over the medium term. Conditional on projected growth in trading partner economies (especially China, the Russian Federation, and the Republic of Korea), exports are expected to rebound moderately in 2021, especially of horticulture, gold, and a gradual resumption of shipments abroad of other commodities and manufacturing. A full reversion to pre-crisis levels, however, is likely to take longer, with demand from other major trading partners (such as the EU) projected to remain subdued over the medium term. Portfolio and FDI inflows, which fell significantly in 2020, are also likely to lag relative pre-crisis trends due to weaker global investment conditions. A larger share of the current account deficit is likely to be financed by borrowing from financial markets and development partners (Table 4).

**24. Budget deficit financing is likely to increase public and publicly guaranteed debt by more than previously projected.** Public and publicly guaranteed (PPG) debt, as a share of GDP, is expected to increase by 5 percent 2020 and a further 4 percent in 2021, before stabilizing at about 40 percent of GDP by 2025. Most of this increase will be externally financed, as domestic capital markets are still at a nascent stage of development.<sup>10</sup> A significant part of the external borrowing will be at concessional rates from IFIs and other development partners. Based on the recent reaffirmations of Uzbekistan's sovereign credit rating, and the heavy oversubscription and competitive pricing of the

<sup>9</sup> Blanket anti-crisis tax deferrals are expected to end in favor of targeted support measures for individual businesses that continue to be affected by the COVID-19 crisis in 2021. Reforms enacted in 2019 significantly reduced social contributory payments for employees but maintained pension entitlements. Any pension payments not covered by declining pension fund contributions are met from the consolidated budget.

<sup>10</sup> Furthermore, the UFRD's charter prohibits the use of UFRD funding for short-term budget stabilization needs, as UFRD funding is explicitly intended for long-term development projects.



debut Eurobond issuance of Uzbekistan’s largest state-owned commercial bank (National Bank of Uzbekistan),<sup>11</sup> prospects are good of raising funds in international capital markets.

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

	2018	2019	2020	2021	2022
		Est.	Projected		
<b>Financing Requirements</b>	<b>10.5</b>	<b>9.0</b>	<b>10.6</b>	<b>11.4</b>	<b>10.3</b>
Current Account Deficit	7.1	5.6	5.8	6.1	5.8
Amortization	3.4	3.4	4.9	5.3	4.5
Of which: Public Sector	0.8	0.8	1.0	1.1	1.4
<b>Financing Sources</b>	<b>10.5</b>	<b>9.0</b>	<b>10.6</b>	<b>11.4</b>	<b>10.3</b>
FDI and portfolio investments	1.2	4.0	1.2	2.0	2.5
Public Sector Debt	5.5	10.6	7.9	6.2	5.4
Other flows (net)	-0.4	3.0	2.1	1.8	1.8
Use of reserves	3.2	-2.6	-0.6	1.4	0.6
Errors and omissions	1.0	-6.0	0.0	0.0	0.0

Sources: World Bank and IMF staff calculations.

**25. A new annual sovereign external borrowing ceiling, approved by Parliament, is improving public debt discipline.** Parliament established a US\$4 billion borrowing ceiling on new external loans in 2020, as part of measures to strengthen budget accountability and parliamentary oversight (supported under Prior Action 6 of this operation). As a result of the COVID-19 crisis, the Government will seek authorization from Parliament to increase the external borrowing ceiling to US\$5.5 billion to meet the higher budget financing gap. It plans to seek authorization the same amount in 2021, but this time covering both domestic and external borrowing.<sup>12</sup> The Government has decided to move to a medium-term approach after it adopts its Medium-Term Debt Strategy in 2021, and as wider reforms to strengthen the medium-term budget framework are implemented.

**26. Risks to debt sustainability are low.** A joint World Bank-IMF Debt Sustainability Analysis (DSA) conducted in May 2020 found that that the most significant risks were worse-than-expected external inflows, mainly remittances and lower exports (Figure 1). Public debt-to-GDP was expected to increase moderately over the medium term, while total external debt-to-GDP was expected to decline modestly. Mitigating these risks were low rollover risks and high foreign exchange reserves. A recalibration of the model to account for the worsened medium term economic conditions shows the risk to debt sustainability remaining low. Using the updated assumptions, PPG external debt and total external debt are expected to stabilize at about 40 and 50 percent of GDP, respectively.

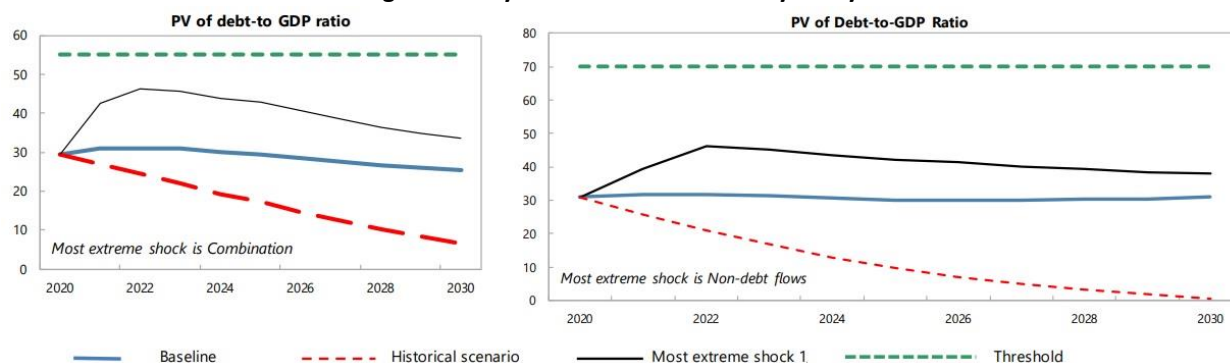
**27. As a new and yet unproven debtor of good standing in international financial markets, Uzbekistan opted not to participate in the G20 Debt Service Suspension Initiative (DSSI).** Uzbekistan is new to sovereign capital markets, having issued its first sovereign Eurobonds only in 2019. With foreign exchange reserves of about 50 percent of GDP, an untapped market of 34 million people, and a strong track record of reforms, Uzbekistan is likely to be among the few countries with net positive private financial inflows in 2020. Uzbekistan’s desire to establish a track record as a credible and creditworthy international borrower, its ability to access international financial markets at competitive pricing, and its relatively low level of debt service obligations to G20 countries in 2020 were the reasons why it opted not to participate in DSSI this year.

<sup>11</sup> On October 15, 2020, NBU successfully placed bonds amounting to US\$300 million at a yield of 4.85 percent, against a target of 5 to 5.25 percent.

<sup>12</sup> The 2020 limit covers external borrowing only, whereas from 2021, borrowing limits will cover total PPG debt.



Figure 1: May 2020 Debt Sustainability Analysis



**Box 2: Improvements to debt transparency and management in Uzbekistan**

**Prior to 2017, almost all external public debt data in Uzbekistan was secret.** In official publications, only total external public and publicly guaranteed (PPG) debt stocks were reported, and no other information about domestic government borrowings and total external debt was published.

**Debt transparency and management have been significantly strengthened as part of an ambitious fiscal transparency reform process.** Measures include:

- **Debt disclosure and reporting reforms**, including Uzbekistan entry into the IMF’s Enhanced General Data Dissemination System (e-GDDS) in May 2018, the publication of all external debt legal authorizations via the official government gazette, and the disclosure of detailed debt information through new annual, quarterly, and monthly reports from the Ministry of Finance.
- **Institutional reforms**, including the creation of a new Debt Management Office in the Ministry of Finance responsible for the management and reporting of public domestic and external debt, and a new research department at the CBU responsible for the collection, analysis, and timely dissemination of macroeconomic data (including domestic and external debt).
- **Legal and regulatory measures**, including an annual borrowing limit authorized by Parliament in the Budget Law, and regulations strengthening investment analysis and selection criteria for debt-financed projects.
- **Enhancements to debt management procedures**, including through the adoption of a new debt management system to centralize public debt oversight and reporting.
- **The establishment of a payment guarantee fund** providing the Ministry of Finance with improved fiscal authorization and supplementary funding to honor debt obligations.

**In a short period of time, Uzbekistan has transformed its approach to debt management.** Uzbekistan has made all debt and reserve information publicly available. Information on external debt is now published regularly, including borrower information, the amount and terms of the loans, the rationale for debt financing, and detailed repayment schedules. Similar information is also available for the nascent domestic debt program. Information about new loans is regularly disseminated via public social media channels to increase citizen awareness of where debt-financed expenditure is being directed.

**28. Debt transparency and management are central to the Government’s fiscal transparency reforms.** Following several important steps to transform Uzbekistan’s debt transparency, the authorities have developed an ambitious plan to address remaining gaps in debt transparency and management systems, with strong support from the World Bank and the IMF (Box 2). The Government is in the process of developing new debt management legislation to Parliament, for finalization by mid-2021, that strengthens debt discipline and codifies the improvements made by the Ministry of Finance over the past few years. A new medium term debt strategy will be approved in the first half of 2021 to better anchor Uzbekistan’s debt management. The Government is also in the process of consolidating all debt data from various sources in the Ministry of Finance website and intends to expand the scope and coverage of



fiscal risk information (including non-guaranteed SOE debts), consistent with good international practice, and with support from the World Bank and the IMF.

**29. Uzbekistan’s macroeconomic policy framework remains adequate for the proposed operation, despite shocks from the COVID-19 crisis.** Uzbekistan entered the crisis with higher fiscal and external buffers than most of its peers. Foreign exchange reserves are equivalent to 10 months of imports and even after the COVID-19-related fiscal expansion in 2020, public debt is modest at about 34.4 percent of GDP. Besides the robust buffers, the macro-fiscal framework has been strengthened substantially with support from this and the earlier DPOs, providing the authorities with the tools and the space to react to additional economic shocks. Improved fiscal and debt management and transparency, the central bank’s new inflation targeting framework that has been backed by several reforms that have already improved the transmission of monetary policy, and continued flexibility in exchange rate management, are an essential part of the robust policies being implemented by the authorities. The post-COVID-19 outlook remains vulnerable to further uncertainty and downside risks, including: (i) prolonged health and economic crises resulting in even higher anti-crisis spending; (ii) return to high government-directed credit growth; (iii) additional external shocks impacting domestic economic performance and financial sector stability; (iv) adverse weather conditions; and (vi) the occurrence of a major natural disaster.<sup>13</sup>

**30. The World Bank is working with the IMF in supporting Uzbekistan’s reform program.** The IMF is providing extensive technical assistance to the Government and has increased staff monitoring. Technical assistance is being provided 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 AND COVID-19 RESPONSE

#### *Economic and Social Transformation*

**31. Despite the unprecedented challenge from COVID-19, the Government is committed to implementing the 2017–2021 Development Strategy, the guiding framework for Uzbekistan’s ambitious structural reform agenda.** Since the onset of the COVID-19 crisis, the preservation of gains from the economic transition, and the continued implementation of further reforms to implement the Development Strategy, are top priorities guiding the Government’s anti-crisis response. Announced by President Mirziyoyev in February 2017, the Development Strategy focuses on greater economic, social, and political openness and on transitioning to a competitive and market-oriented economy. The strategy has five pillars: (i) enhancing state and public institutions; (ii) securing the rule of law and reforming the judicial system; (iii) promoting economic development; (iv) fostering social development; and (v) ensuring personal and public security through inter-ethnic and religious tolerance and constructive foreign policy. In early 2019, the Government (with support through the second DPO engagement) adopted a further 2019–2021 “Reform Roadmap” to provide further clarity about its reform priorities. It contains five focus areas: (i) maintaining macroeconomic stability; (ii) accelerating the market transition; (iii) strengthening social protection and citizen services; (iv) transforming the Government’s role in the market economy; and (v) preserving environmental sustainability. To further align the reform process under these strategies with its commitments to achieve the Sustainable Development Goals (SDGs), the Government established a new SDG oversight mechanism in 2018 to

<sup>13</sup> An earthquake in 1966, with its epicenter at the heart of Tashkent, measuring 5.1 on the Richter scale with a depth of 3km, killed between 15 and 200 people, left over 300,000 homeless, and destroyed most buildings in the city including an estimate of between 75,000 and 95,000 homes.



better align reforms with Uzbekistan’s national SDG goals and targets, and more consistently measure progress toward the achievement of its SDG commitments.

**32. Uzbekistan’s first phase of economic reforms under the Development Strategy focused on the liberalization of prices, an overhaul of the business and trading environment, and increased outward orientation.** 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.

**33. The focus of the economic reform has now become the reduction of the state’s economic footprint.** Despite significant reforms to improve the private sector business environment in recent years, progress toward the Development Strategy’s objectives remains constrained by the state’s near-total control over factor markets and the continued operations of about 3,000 SOEs, including many that benefit from monopoly rights in priority economic sectors (such as mining, telecommunications, and transportation). Since 2019, the Government has increased its attention to lifting these constraints, working closely with the World Bank and other development partners to identify a well-sequenced and prioritized program to reduce the state’s economic footprint. In the past 18 months since the approval of the second DPO, the Government has adopted ambitious strategies to overhaul the energy, agriculture (including agricultural land) and financial sectors, and is implementing measures to achieve the objectives of these strategies. Following the creation of an agency to manage all state shares in SOEs in 2019,<sup>14</sup> the Government has also started a process to reform and privatize SOEs.

**34. The economic reform agenda is complemented by ambitious social and political reforms.** Since 2015, the World Bank has partnered with the International Labor Organization (ILO) to conduct third party monitoring of the cotton harvest. ILO’s report for the 2019 harvest concluded that “systematic recruitment of students, teachers, doctors and nurses has completely stopped”, and that systematic child labor has been eradicated in Uzbekistan. The report noted, however, that recruitment of staff from state institutions, agencies and enterprises continues at the local level, although the number of pickers forced to work fell by 40 percent, to 102,000, compared with the 2018 harvest. The abolishment of the state procurement targets for cotton in 2020 could help eliminate or further reduce the use of forced labor (the 2020 data will be announced by the ILO in early 2021). The report also noted that cotton pickers’ wages had increased in line with ILO and World Bank recommendations, with most workers reporting that working conditions had improved compared with the previous year. Since 2017, the Government has also initiated several other social reforms to modernize social safety nets, improve education and health care services, expand access to public services, increase religious freedoms, and relax severely restrictive internal migration controls. Political reforms have focused on increased regional and international people-to-people and trade links, increased press and media freedoms, and the establishment of elected regional and local governance. Collectively, these reforms have helped underpin substantial social support for the reforms, which continues to be strong.<sup>15</sup>

**35. Recognizing the complexity of this next phase of reforms, the Government has placed a strong emphasis on transparency as part of the reform agenda.** Learning from the experiences of other transition economies, especially on complex policy issues such as land reform and privatization, the Government has taken an increasing number of

<sup>14</sup> Supported by the June 2019 DPL.

<sup>15</sup> Data from the August 2020 Listening to the Citizens of Uzbekistan conducted by the World Bank show that 86 percent of the population agreed with the statement that “the country is generally on the right track on political, social, and economic reforms.” A similar share of respondents expressed their optimism for the economic future of the country, although risks of rising prices and job losses remain the most important concerns (and reforms linked to those risks are the least popular).



measures to strengthen the transparency of the transition process. This includes measures to strengthen public procurement processes, introduce a transparent electronic auction system for government sales of land and assets, increase fiscal, debt, and data transparency, seek public consultations of major regulations and laws, and adopt transparent and competitive tendering processes for public investment projects.

**36. Uzbekistan’s development strategy also includes strong commitments to improving energy efficiency and reducing fossil fuel use intensity—consistent with the Government’s commitment to climate change mitigation.** Uzbekistan’s voluntary commitments on climate change mitigation and adaptation under its Intended Nationally Determined Contribution (INDC), submitted to the United Nations Framework Convention on Climate Change in 2017, focus on improving energy efficiency and reducing the fossil fuel intensity of the economy. In its INDC, Uzbekistan committed to decrease specific emissions of greenhouse gases per unit of GDP by 10 percent by 2030 (compared with 2010). This commitment assumes financial and technical support from international organizations and financial institutions, access to advanced energy-saving and environmentally-sound technologies, and climate finance. Uzbekistan also committed to continuing efforts toward climate change adaptation, to reduce the risk of 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 include the removal of fossil fuel subsidies, energy sector reforms to reduce technical losses and increase tariffs to remove subsidies, and the approval of a long-term electricity strategy that commits to non-hydro renewable energy increasing from zero to 30 percent of the total electricity generation mix by 2030.

#### ***The Government’s COVID-19 Response***

**37. A Republican Anti-Crisis Commission, led by the Prime Minister, is managing the Government’s policy response to the crisis.** The Commission has been given four objectives: (i) to safeguard the health and productivity of citizens through an effective medical response; (ii) to preserve income and livelihoods, especially for the poorest and most vulnerable; (iii) to prevent long-term damage to the economy; and (iv) to safeguard the economic transition and reform program. Development partners, especially the World Health Organization (WHO), are providing analytical and advisory support to the Commission. The Commission is also being supported by health policy experts from the Republic of Korea, China, and the United States.

**38. Local transmission of the COVID-19 virus is yet to be contained.** The first confirmed case of the virus was detected in Uzbekistan on March 15, 2020, and since then there have been about 70,500 confirmed cases. As of November 16, 2020, there were 2,119 active cases and 598 deaths. In March 2020, authorities moved quickly to close learning centers, cancel public gatherings, and adopt emergency health policy measures. Subsequently, more restrictive lockdowns were announced, such as stay-at-home orders and the closure of public transportation, all non-essential businesses, and public spaces. Uzbekistan also closed its borders to non-trade activity in late March. These measures were significantly relaxed in May, but the rapid rise in cases again forced a second round of stringent (but less than the first measures) closures until mid-August. Since then, measures have been eased, and case numbers have averaged about 350 a day, with the number of active cases stabilizing at around 2,500 since end-August.

**39. The authorities have so far announced two large anti-crisis packages, comprising financial and regulatory measures, to support the health and economic policy responses.** A first anti-crisis package, budgeted at about US\$1 billion, was announced on March 20. Health spending is targeted toward a large scale-up in testing (and acquisition of domestic test-kit production capability), purchasing new health equipment, boosting frontline worker salaries, and creating temporary health infrastructure facilities. Social measures include an expansion in the level of low-income allowances and the number of beneficiaries, unilateral extensions of targeted social assistance eligibility periods, measures to expand disability payments for people who are quarantined or infected, regulations to



safeguard parents and other caregivers of infected people, provisions to expand unemployment insurance payments, and measures to simplify application and eligibility assessment procedures. Economic measures include a range of tax and expenditure measures to provide both relief and regulatory forbearance for tax and debt payments, and measures to ease cash-flow constraints for businesses. Measures will also provide debt relief and financial support for key SOEs, such as the national airline and the main gas exporter. A second anti-crisis package, announced on April 3, seeks to support the economy with a range of tax exemptions, a reduction in import tariffs for medical supplies and food, an extension of deadlines for loan repayments, and additional social safety net payments.

**40. Anti-crisis measures are largely in line with emerging good practice.** The Government's health response has been endorsed by the WHO and other partners. Economic policy measures are largely consistent with emerging good practice on responding to dual demand and supply shocks to the economy and safeguarding vulnerable households and economically important firms. Some measures, such as an expansion of public works, have proven more difficult to implement with social distancing requirements, but the authorities have remained agile in reallocating spending to other areas to ensure continued support for a rapid economic recovery post-crisis.

**41. Consistent with the Government's commitments to greater openness and public accountability, the authorities have taken additional measures to increase the transparency of how anti-crisis money is being spent.** Some measures, particularly fiscal support for SOEs and subsidized lending and credit to firms and households, are both consistent with emerging international practice but are also measures that the Government is trying to curtail as part of the reform program. To balance the need for these measures with the risks, the Government has committed to the transparent reporting of its anti-crisis expenditure policies. Since April 2020, the Government has regularly published and widely disseminated updates on the volume and areas of anti-crisis spending.

## 4. PROPOSED OPERATION

### 4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

**42. Consistent with the Government's priorities to implement an inclusive and sustainable market transition, the Program Development Objective (PDO) of the proposed operation is: (i) improving the efficiency, sustainability, and transparency of resource allocation in the economy; and (ii) enhancing economic inclusion and social resilience.** Under the first pillar, the operation supports measures to curtail subsidized and state-directed bank lending, end state-mandated cotton production, reduce inefficient fossil fuel subsidies, improve the investment environment for public-private partnerships in renewable energy and other infrastructure sectors, establish a systematic approach to the management and privatization of state-owned enterprises (SOEs), and improve fiscal transparency. Under the second pillar of the PDO, the operation supports measures to end almost all internal migration controls, establish legal frameworks to address gender-based violence and ensure equal opportunities for women, and expand social assistance to vulnerable households while strengthening the effectiveness of the safety net system.

**43. The use of standalone DPOs has strengthened the World Bank's agility in supporting a dynamic reform program, while anchoring a strong and programmatic broader reform policy dialogue.** With major reforms occurring across the breadth of the economy and society, the pace and sequence of reforms can vary significantly across different areas, depending on the level of administrative capacity, the availability of technical assistance and expertise, and the level of political support. Reform opportunities in these still early stages of Uzbekistan transition emerge (and continue to evolve) organically, shaped by internal political dynamics that are often hard to anticipate. The emergence of these opportunities creates unanticipated windows for the World Bank and other development partners to help advance important reforms, but this requires greater operational agility—of the kind provided by standalone DPOs. The core objective of each of the Bank's DPOs continues to be on sustaining an inclusive market



transition and each DPO has maintained a sustained and sequenced reform engagement in sectors that are critical to this objective such as agriculture, financial sector reform, energy, SOE reforms, fiscal transparency, and social protection reforms. Through this approach, the DPOs have helped anchor the WBG's broader country engagements in a strong and programmatic policy dialogue centered on key transitional issues (see Annex 5).

**44. This proposed operation substantially deepens the reforms that were started under the first two DPOs, while creating a strong foundation for the next phase of reforms.** The first standalone DPO, approved by the World Bank's Board in June 2018, focused on reducing price and market distortions, improving the financial transparency of SOEs, boosting foreign and domestic trade, increasing agricultural productivity, and tackling short-term constraints in the social safety net system to safeguard vulnerable citizens from the transition process. The second standalone DPO, approved by the Board in June 2019, followed up with measures to strengthen financial stability, remove burdensome export and domestic trading constraints, unbundle and separate policymaking and operational responsibilities from vertically integrated SOEs in the aviation and energy sectors, improve the environment for utility tariff cost-recovery, address weak incentives for employers to formalize jobs (especially for women), and address systemic constraints in the social safety net system. These first two DPOs have created a strong foundation for the substantially deeper reforms that are being implemented under this proposed operation. Simultaneously, the reforms in this operation represent the start of a new phase of the transition that addresses the next set of complex issues, such as factor market liberalization, the end of state cotton and wheat production, and SOE and state-owned bank privatization.

#### 4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

##### Pillar 1: Improving the efficiency, sustainability, and transparency of resource allocation in the economy

**45. The old model of heavy state control over factors of production, the absence of market institutions, and a nontransparent decision-making process that lacked accountability resulted in low total factor productivity, widespread exclusion, and unsustainable pressures on the country's environment and natural resources.** Until recently, land, labor, and financial markets were almost exclusively controlled by the state, either via direct ownership of assets (in the case of land and the banking sector) that were non-transparently allocated (often on preferential terms to SOEs), or via the significant restrictions on labor mobility. The near absence of market institutions and an oversized state production footprint via SOEs, and the control of agricultural production, further exacerbated the misallocation of resources across and within sectors. Onerous regulations, state monopolies over productive sectors, and severe curtailments of non-state agricultural production were also the defining features of the old model, which came at the cost of weak creation and suppression of private entrepreneurship. It also created sustainability challenges even as climate-related risks increased significantly. The bold structural reforms that were launched in 2017 have sought to systematically dismantle the inefficient, unsustainable, and non-transparent legacy of the old state-led command-and-control model. These reforms were at the center of the two previous DPOs and continue to serve as the foundation for this operation.

##### ***Banking Sector Reform***

**46. Historically, the state has been the dominant owner, lender, and borrower in Uzbekistan's financial system.** State-owned banks have played an important role in the state's complex (and inefficient) approach to financing industrialization, accounting for 86 percent of total sector assets and 89 percent of outstanding credit. Until recently, the principal activity of state-owned banks was to lend to SOEs in priority sectors of the economy at heavily



discounted rates, de-facto playing the role of development banks. Private banks, in contrast, mostly serve the private sector on commercial terms but are small.<sup>16</sup>

**47. A large share of directed lending happened via a complex process of on-lending—from the UFRD via state banks to SOEs.** Since its establishment in 2006, the UFRD has played an important role in financing industrial development through concessional loans to SOEs, but at a high cost to financial sector efficiency and stability. The UFRD has recapitalized banks and restructured large SOE loans on several occasions, and with growing frequency since 2017. By mid-2019, UFRD was the largest shareholder of, and lender to, the banking system, accounting for about two-thirds of preferential lending through the banks.

**48. Corporate governance and risk management in the banking sector is weak.** Boards of state-owned banks are dominated by public officials who do not have operational independence and have limited banking sector expertise. Improving corporate governance has rightly been prioritized by the Government as a first a critical first step towards improving the stability and operational effectiveness of the banking system.

**49. Reforms supported under the first two DPOs helped strengthen prudential supervision and modernize institutional and legal frameworks for banking.** By end-2017, the Government had taken several measures to improve risk management through strengthened stress testing (supported under the first DPO in coordination with the IMF), as well as banking regulation and supervision capacity. In November 2019, supported by the second DPO,<sup>17</sup> Parliament approved new banking and central bank legislation to provide a robust legal basis for developing a modern bank regulatory and supervisory framework, and strengthen the CBU’s mandate and autonomy. Since then, authorities have focused on implementing requirements to operationalize the new laws, including further improvements to the CBU’s regulatory and supervisory framework, strengthening the Government’s ownership and shareholder oversight of state-owned banks, and reducing market-distorting policy lending.

**50. Since the approval of the new laws in the current phase of reforms, the Government has begun correcting market distortions and restructuring state ownership in the banking sector.** In November 2019, the Government introduced measures (via Presidential Decree 5877) to restrict, with two temporary exceptions,<sup>18</sup> all state-directed lending below the central bank’s reference rate starting on January 1, 2020. The resolution also fully liberalized lending rates starting from January 1, 2021 and restricted government interventions to the use of explicit on-budget interest rates subsidies. In December 2019, measures were adopted (via Presidential Resolution 4487) to transfer almost all UFRD on-lending out of the banking sector and back to the balance sheet of UFRD. Collectively, these measures aimed to significantly curtail directed lending and interest rate distortions in the banking sector. These measures also aim to strengthen the focus of banking operations on increasing private sector lending, increase financial stability, and improve the transmission of the CBU reference rate as part of the newly established inflation targeting framework.

**51. The Government has begun to implement its recently adopted financial sector reform strategy to significantly reduce the number of state-owned banks through a transparent and competitive privatization process, and to modernize corporate governance and transparency of banks in state ownership.** Adopted in May 2020, the strategy outlines an implementation roadmap to prepare at least six out of 13 state-owned banks, representing 45 percent of assets in the banking sector, for privatization between 2021 and 2025. State ownership

<sup>16</sup> Seventeen private banks operate with an average capital of US\$40 million, with the smallest having only US\$12 million and the larger ones between US\$60 and US\$110 million. Ten of the private banks have market shares below 0.5 percent of total assets.

<sup>17</sup> With generous support from the Strengthening Financial Sectors Initiative (FIRST).

<sup>18</sup> Cotton and grain financing and social housing mortgage loans are exempt until the end of 2020. From 2021, all bank lending must be at least at the CBU reference rate.



responsibilities and oversight for the transformation and privatization of state-owned banks have been centralized in the Ministry of Finance, under a dedicated State-Owned Banking unit. This unit is also responsible for the development of corporate transformation and restructuring plans and asset quality reviews of state-owned banks. After a wide advertisement process to find high quality local and international directors, 23 independent directors have been appointed to 10 state-owned banks<sup>19</sup>, as part of efforts to strengthen the oversight of state-owned bank boards.

**Prior Action 1:** To increase the efficiency of financial resource allocation and strengthen transparency in the banking sector in implementation of the Government’s approved banking law and financial sector reform strategy, the Borrower has: (i) prohibited all new on-lending to State Owned Enterprises (“SOEs”) by state commercial banks using subsidized funds from the Uzbekistan Fund for Reconstruction and Development (“UFRD”); (ii) required all new commercial bank lending in local currency, from 1 January 2020, to be at interest rates at or above the central bank reference rate, except for government loans for mortgage lending and the production of raw cotton and grains; and (iii) appointed at least one independent director, consistent with requirements in the Banking Law, to each of the boards of at least ten state-owned commercial banks.

**52. The measures in this prior action are expected to quickly lower distortions from preferential lending and, over time, increase banking sector efficiency and transparency.** The outstanding stock of preferential loans as a share of total state bank lending decreased from 77 percent at end-2018 to 52 percent at end-August 2020. This is almost entirely the result of an increase in interest rates from new lending activity, and the curtailment of preferential lending to just the two exempted sectors which represent less than 10 percent of total new banking sector lending. As a result of the measures, the share of commercial lending to total lending in the banking sector, the result targeted under this operation, is expected to increase significantly. The measures are also already contributing to improved monetary policy transmission, enabling the CBU to lower the policy rate in response to the COVID-19 crisis. The prior action is also expected to lead to an increase in the share of commercial banks where the majority of board directors are independent, the second result targeted under this operation. In the longer term, these measures are expected to help reduce state control over the banking sector, increase financial stability and efficiency, and increase the availability and quality of financial services for the private sector. These measures represent a strong starting point for banking sector reform, but significant work remains to ensure a strong and transparent privatization process, deepen the financial sector, and increase financial inclusion.

### ***Agriculture***

**53. Despite favorable resource endowments, Uzbekistan’s agriculture sector is characterized by significant production and market distortions that lead to low productivity.** Agriculture is the largest economic sector, accounting for about one GDP and one quarter of the workforce. Many agricultural workers are women and youth who live in rural areas, where the poorest are located. Since the early 1990s, farmers have operated under a centrally planned state production system that allocates farmland for production of cotton and wheat. Under this system, farmers were subject to production targets and mandatory procurement rules—in the case of cotton 100 percent of production was surrendered to the state under mandatory procurement. Farmers had no say in what seeds and technology to use on their fields, being forced to use blanket input use recommendations developed centrally, untailored to local environmental, soil, and water conditions. Prior to 2017, more than 70 percent of arable land was administratively allocated for state-controlled production of cotton and wheat, commodities that generate lower

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<sup>19</sup> Confirmed by the Ministry of Finance via Letter No. 02/02-29-02-35/1054



profits, are more labor intensive, and have lower labor productivity than most horticulture products suitable for production in Uzbekistan.

**54. Uzbekistan’s agriculture sector is highly vulnerable to climate change.** An increase in extreme temperatures and rainfall events due to climate change is increasing the risk regarding water availability, but also increased incidence of pests, insects, and diseases. Impacts on irrigated agriculture are expected to reduce crop yields by 20 to 50 percent through 2050,<sup>20</sup> increase water scarcity and deficit and the desertification and water/soil salinity of the Aral Sea region. Changes in precipitation and water availability are expected to exacerbate the impacts of droughts and extreme weather events, affecting around 20 percent of the population. Cotton and wheat are water-intensive, consuming 90 percent of water in agriculture and 75 percent of water used in the entire country.

**55. State-led cotton and wheat production, and the limited diversification of agriculture, were a missed opportunity and have increased climate vulnerabilities.** Uzbekistan’s agriculture sector has high potential to increase value added and productivity<sup>21</sup> through more climate-resilient and efficient cotton and wheat production and increased horticultural and livestock production. Agriculture has contributed more than any other sector of the economy to total job creation in recent years (2012–16). Horticulture is highly productive, uses significantly less water than cotton, and has the largest job creation potential, generating 50 percent of the value of crop production and 40 percent of gross agricultural output just from about 10 percent of total arable land.<sup>22</sup> Poor public services, high taxation, and government monopolies on fruit and vegetable exports left the sector in neglect. With cotton and wheat accounting for a large utilization of all water resources, the sector is also at significant risk to the effects of climate and environmental change.

**56. Since 2017, a steady reform program, supported by the first two DPOs, has helped trigger a recovery in agricultural growth.** Starting with incremental reductions in cotton and wheat growing areas (supported by the first DPO), a big wave of reforms in 2018 removed almost all export restrictions on horticulture products and liberalized bread prices (supported by the second DPO). Further reductions in cotton and wheat growing areas were also enacted, along with the slow easing of land restrictions, and almost all areas assigned for cotton production was transferred to private textile companies that facilitate raw cotton production through contract farming and process cotton into higher-value products such as yarn and textiles. In 2019, wheat and cotton farm-gate prices, set by the state, converged with market prices, and Uzbekistan is close to its target of ending exports of raw cotton in favor of processed exports. After years of stagnant outcomes, and reflecting the strong supply response to reforms, the sector grew by 2.5 percent in 2019, despite a reduction in total sown area by 2.2 percent. Horticulture exports have been the driver of this turnaround, with exports almost doubling in under three years, from US\$570 million in 2017 to US\$1.2 billion in 2019. Robust agricultural growth of 2.8 percent has contributed significantly to preserving positive, albeit small, amounts of GDP growth in 2020. And the agriculture and agri-food sectors remain a promising source of new and better jobs through potential for expanded food processing and value addition in the textiles sector.<sup>23</sup>

**57. Significant market and institutional constraints still need to be addressed to increase resource efficiency and climate resilience in agriculture.** Key issues include the continuance of the state order system, weaknesses in land tenure and security, a still-nascent private financial sector that is not yet capable of handling large costs and

<sup>20</sup> Reducing the Vulnerability of Uzbekistan’s Agricultural Systems to Climate Change (World Bank 2013).

<sup>21</sup> Uzbekistan Country Private Sector Diagnostic (IFC/WB 2019).

<sup>22</sup> Uzbekistan Agri-Food Job Diagnostic (WB 2020).

<sup>23</sup> Uzbekistan Agri-Food Job Diagnostic (WB 2020).



risks. Logistics, quality infrastructure, seed and input quality, and insufficient research and development also constrain sector productivity.

**58. At the end of 2019, the Government approved an ambitious agricultural strategy, based on a framework of sustainability, climate-resilience, and greater market orientation.** Recognizing the imminent threats posed by environmental issues such as water shortages, land degradation, falling soil carbon, and climate change, and acknowledging the weak performance of the sector in recent years, the strategy sets out an ambitious and transformative agenda to end state production, improve land tenure and security, increase the transparency of land distribution, and redirect state agricultural financing to private sector enabling investments. The strategy has moved quickly from vision to implementation by tackling the biggest and most binding constraint to further change in the agriculture sector. In March 2020 (Presidential Resolution 4633), the Government abrogated the state cotton order production and procurement targets, which previously had required all cotton produced in the country to be surrendered to the state, and for all cotton-growing areas to meet (stringent) annual production targets. With historically severe penalties (including the loss of land ownership) levied against farmers who missed the target, the policy was widely viewed by observers as a binding constraint to ending forced and child labor in the cotton sector. The targets were also viewed as contributing significantly to agricultural practices that were environmentally suboptimal and discouraged adaptation to climate risks. With the end of mandatory state procurement, farmers will have increased freedoms to determine, based on market conditions and availability of technologies, how and how much cotton to grow. They will also have increased post-harvest freedoms in determining cost-optimal harvest strategies, the most common of which being the non-harvesting of residual cotton after the main harvest.

**Prior Action 2:** In accordance with the Borrower’s agricultural modernization strategy to increase climate resilience, diversify agriculture, increase the transparency and efficiency of land distribution, and eliminate state agricultural production, the Borrower has abrogated the state cotton order system by removing mandatory cotton production targets and mandatory state procurement of cotton.

**59. The removal of the state cotton order system helps advance a systematic cotton sector reform program in Uzbekistan.** Since 2017, the Government has enacted several reforms to strengthen the cotton sector. In addition to enacting measures to end systematic child and forced labor,<sup>24</sup> the Government has reduced cotton growing areas,<sup>25</sup> removed cotton growing subsidies in marginal areas, and equalized state farmgate prices with market benchmarks. Simultaneously, the Government has encouraged the creation of private sector led cotton clusters, to encourage private capital mobilization, introduce climate-smart technologies, and increase value addition and decrease raw cotton exports.

**60. The measures in this operation are expected to accelerate the adoption of climate-resilient agricultural practices.** As a direct result of the removal of cotton production and procurement targets, farmers will have greater freedom of choice in the technology they can use to produce cotton and other crops. Most importantly, and based on emerging evidence, this will have a rapid and positive impact on environmental sustainability by improving climate-resilience through increased private investments in climate-smart and water-saving technologies that are adjusted to local climate, water, and soil conditions. This is a departure from the past when input use was centrally determined and imposed on farmers and expand freedoms for farmers to adapt more rapidly to changing climatic conditions. These greater freedoms are already creating incentives for cotton farmers and cluster operators to conduct soil testing for precision agriculture, increase the use of organic fertilizers, and to reduce agricultural water

<sup>24</sup> The ILO has been monitoring the cotton harvests since 2015, reporting the substantial reduction in the use of forced labor, from 14 percent of all cotton pickers in 2015 to 6 percent in 2019. The results of the ILO monitoring of the 2020 cotton harvest will be available in early 2021.

<sup>25</sup> Between 2016 and 2020, the cotton growing area has decreased by about 22 percent.



use through deep ploughing, soil laser leveling, and drip/sprinkler irrigation. Progressive measures to increase farmer freedoms has already led to an increase in the number of hectares where farmers have adopted climate-smart technologies (the targeted result of this operation) from zero in 2017 to at least 160,000 ha in 2019.<sup>26</sup> This is expected to grow more quickly in the short-term with the approved measures, accelerating the agriculture sector's investments to adapt to climate change. Over time, these changes will help promote greater diversity in crop production, increasing resilience for farmers and reducing the risk from market and climate change-induced shocks. Diversifying to fruit trees and increasing energy efficiency of agricultural processes coupled with more rational use of fertilizers, are also expected to help mitigate climate change.

**61. This is only the first phase of reforms to modernize agriculture in Uzbekistan.** Despite the impact of COVID-19 on food security, the Government has reaffirmed its decision to abrogate mandatory state production and procurement of wheat, in favor of maintaining strategic food reserves purchased in the commercial market. Collectively, the measures taken so far to reform agriculture represent important steps in advancing the Government's agriculture strategy. However, significant work remains to reform land tenure and security and the crop placement system, enable farmland subleasing, modernize irrigation systems, and improve farming technology and logistics. Several of these reforms are complex and are likely to take many years to achieve, but collectively, they will help increase the profitability of the agriculture sector and rural incomes and enable the release of land areas currently designated for cotton and wheat growing to other higher productivity job creation opportunities, largely in horticulture value chains.

#### ***Fossil Fuel Subsidies***

**62. Fossil fuel subsidies in Uzbekistan are estimated to be about 7.4 percent of GDP and are a major contributor to greenhouse gas emissions, and the country's status as one of the most energy-intensive in the world.** Subsidies in oil, natural gas and electricity have declined significantly since 2010, when total fossil fuel subsidies were estimated at about 30 percent of GDP.<sup>27</sup> Despite this decline, largely the result of price and tariff liberalizations, the subsidies were estimated at US\$132 per person in 2019, with an average subsidization rate of 54 percent.<sup>28</sup> Natural gas subsidies are the most dominant share of total energy subsidies. Petroleum subsidies are smaller but still accounted for about 2 percent of GDP in 2019, and petroleum prices in Uzbekistan are among the lowest in the world. The energy sector continues to be a source of large subsidies for the rest of the economy, and fossil fuel subsidies have played a significant role in driving energy inefficiency. Uzbekistan is one of the most energy-intensive countries in the world, with energy intensity three times that of Germany and 35 percent higher than in Kazakhstan. Energy subsidies in Uzbekistan are not well targeted, with more wealthy households consuming higher volumes of energy. Subsidized prices have curtailed the ability of SOEs to renew infrastructure and undercut efforts to attract private sector investment, contributing to aging petroleum sector infrastructure and the slow pace of new resource exploration.

**63. Since 2017, the Government has, with support from the first two DPOs, taken significant measures to reduce fossil fuel subsidies.** Measures to strengthen the financial transparency of the electricity and gas sectors (supported under the first DPO) have provided improved information about the shortfall in the cost recovery of tariffs, helping to better quantify the true extent of electricity and gas fossil fuel subsidies. The Government has taken systematic measures to improve tariff methodology and regulatory environment (supported under the second DPO) and has steadily increased both tariffs. Electricity tariffs are now close to cost recovery, while gas tariffs are still in the process of being reformed. The Government has also liberalized petroleum retail prices, ending the regulation of premium

<sup>26</sup> Source: Uztexileprom. Climate-smart technologies include organic fertilizer use, and the following water saving technologies: soil testing, deep ploughing, drip irrigation, and soil laser leveling.

<sup>27</sup> UNECE Environmental Performance Review 2020

<sup>28</sup> IEA Energy Subsidy Review 2019



(but sparingly consumed) petroleum products (AI-91 and higher). But until recently, retail prices of the most consumed petroleum products, AI-80 petroleum, and diesel, remained heavily regulated.

**64. Taking advantage of the slump in global oil prices, the Government has removed all remaining retail petroleum and diesel subsidies.** In April 2020, as part of priority measures to strengthen the financial stability of the oil and gas industry (Presidential Resolution 4664), the Government removed all regulated pricing for AI-80, diesel, and ECO diesel (a branded variant). Effective May 1, 2020, petroleum refineries have been able to sell their commodities directly through commodity exchanges at market prices. The measures also introduced requirements for the intra-industry (regulated) price of oil condensate to be benchmarked to the global commodity exchange price of Brent oil.

**Prior Action 3:** To reduce inefficient fossil fuel subsidies, the Borrower has abrogated the State's regulation of the retail price of AI-80 petroleum, diesel, and ECO diesel.

**65. The measure is expected to help Uzbekistan meet its NDC commitments of reducing greenhouse gas emissions and could be strengthened further over time with adjustments to tax policy.** Uzbekistan has committed to reducing its greenhouse gas (GHG) emissions by 10 percent of its 2010 level by 2030 and renewed its commitment to this target in October 2019 through the approval of a strategy to transition to a greener economy. The strategy also contains commitments to double the energy efficiency and significantly reduce carbon intensity of GDP by 2030. Although the adopted measures represent a strong step, the Government's wider commitment to reach cost recovery in the natural gas and electricity sectors over the medium term will be critical to eliminating fossil fuel subsidies in the economy. Over the longer term, the impact of these measures on further efforts to decarbonize the economy could be strengthened through a recalibration of the fossil fuel excise tax regime.

**66. The measures in this operation are expected to reduce direct fossil fuel subsidies in the economy, lower climate emissions, and increase fiscal space for higher-value public investments.** Under the result supported by this proposed operation, petroleum products will continue to be sold via commodity exchange-determined prices that are free of any direct price controls or subsidies by the Government. Indirect subsidies for the poor and vulnerable – by means of social safety net adjustments, may be implemented as part of general revisions to social allowances in line with inflation and other risks. Over time, and as petroleum prices increase, the measures are likely to create additional fiscal space, and increase incentives for consumers and firms to adopt more energy efficient practices.

### **Renewable Energy**

**67. Uzbekistan's high potential for renewable energy generation has been constrained by market distortions and institutional deficits.** Renewable energy development is a high priority for the Government, both to address immediate energy needs and to reduce the power sector's environmental impact as part of Uzbekistan's contributions to mitigating climate change. Renewable energy will also support a shift away from depleting stocks of natural gas reserves (which also have high export value) and help bridge gaps in electricity demand and supply. Renewable energy accounts for around 15 percent of total generating capacity, almost all of it hydropower. Less than 0.5 percent of total generation potential from renewable sources has been utilized, with the two biggest sources—solar and wind energy—virtually untapped. Constraints on further renewable energy development include an inadequate institutional framework, subsidized pricing of existing energy services, and the financial weakness of *Uzbekenergo*, the state energy company. The most significant institutional challenges are the absence of: (i) a clear legal framework for the renewable energy sector; and (ii) an effective regulatory framework that allows energy generated by renewable sources to integrate with existing national energy infrastructure.

**68. In 2019, a new Renewable Energy Law, supported by the second DPO, was enacted to provide a legal framework for the development of the renewable energy sector.** The new law addressed institutional gaps in the



transparent and competitive development of renewable energy. Its enactment has already helped attract private sector investments, creating opportunities for climate change mitigation and adaptation. The law sets out rights for private renewable energy producers, including guaranteed access to the power grid. It also creates a special fund<sup>29</sup> to incentivize renewable energy development through financial support for the introduction and scale-up of clean, renewable energy technologies. These changes will support a shift away from more carbon-intensive energy sources such as gas. In addition, embedded renewable energies provide adaptation co-benefits by reducing distribution requirements and help bridge gaps in electricity demand and supply (thereby improving reliability and supply).

**69. Weaknesses in the PPP framework are constraining the Government’s objective of rapidly decarbonizing the economy through private renewable energy generation and other climate change mitigating investments.**

Uzbekistan’s renewable energy sector has attracted considerable private sector interest. In response to this interest, a new PPP law was adopted by Parliament, in 2019, setting out a comprehensive framework for long-term cooperation between the Government and private sector. The law sets out institutional arrangements, procedures to strengthen the transparency and competitiveness of the initiation and awards processes, and the scope of financing arrangements and investor benefits that the state may commit to when signing a PPP agreement. However, since the approval of the law, further constraints have emerged in the legal framework that have held back progress on several proposed PPP projects in the renewable energy and infrastructure sectors. Most notably, the adoption of a Currency Regulation Law in mid-2019 restricted the state from entering foreign-currency denominated financial commitments for domestic transactions. The law also did not include protections for investors from significant changes to legislation governing PPP arrangements from those that were in force at the time of signing the agreement, creating significant uncertainties for investors. Furthermore, the law fails to provide sufficient clarity on certain public disclosure and transparency responsibilities vested with the PPP Agency and the implementing private sector partner. While these gaps could create challenges across the economy, in the short term they are most acutely constraining the finalization of renewable energy and energy efficiency PPP projects that have the potential to reduce carbonization in the economy. Addressing these constraints has been a priority for the Government, which is working with several development partners, including the WBG, EBRD, and ADB, to strengthen the PPP regulatory and legal framework, strengthen institutional capacity and risk management, prepare a high-quality PPP project pipeline, and attract reputable international PPP investors to Uzbekistan.

**70. To further strengthen the PPP legal environment, the Government has submitted amendments to the PPP Law and the Currency Regulation Law that address these constraints.**

Amendments to the two laws have been submitted for parliamentary approval (Cabinet of Ministers Letter 02/I-II22), proposing several amendments. The proposed amendments to the Currency Regulation Law provide an exception to allow the Government to enter foreign currency denominated financial commitments for PPP projects. Proposals to amend the PPP Law include: (i) the inclusion of provisions to provide due notice of any significant legislative changes to investors in PPP projects that are already signed and under implementation; (ii) authorization for the Government to compensate such investors for any demonstrable losses arising from the worsening of investment terms due to the legislative change; (iii) a requirement for the PPP Agency to publish comprehensive information regarding the status of existing PPP projects under implementation, including details of procurement activity and prices paid; and (iv) a requirement for the Government to more widely disseminate, including via media channels, tender advertisements.

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<sup>29</sup> Which will be established on-budget.



**Prior Action 4:** To enhance the enabling environment and transparency of public-private partnerships (“PPPs”) in the renewable energy and other infrastructure sectors, the Borrower has submitted legislative draft amendments to the PPP and Currency Regulation Laws, for Parliamentary approval, to: (i) allow the Government to enter foreign currency financial commitments in PPP concession agreements and allow financial compensation to be paid to investors against losses which may arise from changes to legislation in force on the date of the partnership agreement; and (ii) strengthen public information disclosure requirements for PPP tenders and PPPs under implementation.

**71. These measures are expected to significantly accelerate the process of decarbonization in the economy through increased renewable energy generation and other investments that can mitigate the effects of climate change.** The amendments to the currency regulation and PPP laws are expected to speed up the commercial closure of several renewable energy PPP projects that are going through tender processes this year. The measures are likely to help support a significant increase in finalized solar projects over the course of 2021, as part of the Government’s intentions to tender, via a transparent and competitive process, solar energy projects of about 1.4 gigawatts in the next few years. They are also expected to attract high quality renewable energy investors that were previously reluctant to bid amid legal uncertainties. The easement of investor constraints paves the way for an accelerated implementation of the Government’s decarbonization intentions of leveraging private sector PPP investments to increase the share of solar and wind energy production (the result supported under this operation) to about 5 gigawatts, or 30 percent of the total electricity generation capacity by 2030, from nearly zero currently.<sup>30</sup> As this new renewable energy generation capacity comes on stream, a critical part of the Government’s broader low-carbon electricity strategy will be to decommission up 5.9 gigawatts of coal and gas thermal power plants by 2030. Although these measures will help all PPP projects, about 80 percent of the current PPP pipeline (in anticipated project costs) is focused on renewable energy, energy efficiency, and water projects that can help Uzbekistan mitigate, and adapt to, the effects of climate change. Specific climate-related projects that have been held back by investment climate uncertainties linked to this prior action include: the modernization of district heating and delivery; the renewal of water supply infrastructure and management (with an explicit focus on reducing water wastage); an ambitious modernization of existing gas thermal energy production and ageing transmission infrastructure, which has the potential to significantly lower Uzbekistan’s GHG emissions; expanding the creation of environmentally sustainable solid waste management facilities that adopt modern environmentally friendly technologies and are run by solar energy; and introducing greener (electric) public transportation networks. These investments, whose progress has been held back by investment climate uncertainties addressed through this reform, include PPPs in solid waste management and the modernization of district heating in Tashkent, together with improvements to modernize and reduce GHG emissions of existing natural gas production facilities and ageing transmission infrastructure.

**72. Although these measures could increase fiscal and foreign exchange risks to the Government, they are consistent with good international practice, and are important pre-requisites to attract high-quality foreign investment for PPP projects.** Given the significant needs of the energy sector, the Government has appropriately determined the need to denominate such agreements in foreign currencies. Although power purchase agreements can be signed in local currencies, such contracts are still rare in developing countries. In the case of transitioning economies such as Uzbekistan, firms with foreign-exchange denominated export revenues and national-currency denominated expenditures prefer to hedge risks driven by high fluctuation of national currency rate by currency swaps. Moreover, Uzbekistan’s still nascent financial market is unlikely to provide cost-effective options to enable foreign investors to hedge their foreign currency risks. Restrictions on interest rate and currency swaps and other

<sup>30</sup> The decarbonization goals are part of a long-term low-carbon electricity strategy approved by the Government in early-2020.



hedging instruments are still in the process of being lifted following the liberalization of the current account in 2017. The success of further expansion of infrastructure financing will also depend on the availability of a strong derivatives framework that would allow a proper interest rate risk distribution between the project companies and hedge providers to ensure that lenders are protected from unforeseen project cost overruns related to an increase in interest rates. While this potentially increases risks to government finances, these risks have been moderated through institutional measures to create a central PPP agency that is tasked with providing fiscal risk assessments and mitigation strategies, and through the Government's approach to identify high-quality partners, often IFIs, to support the development of the PPP pipeline building and transaction processes. Uzbekistan's large dollar-denominated commodity export base (gold, metals, natural gas), and the Government's overall discipline and prudence in economic management also help reduce potential fiscal risks from this measure.

### **State-Owned Enterprise Reform**

**73. About 3,000 tier-1 SOEs account for about 18 percent of employment and 20 percent of exports; together with wider public sector operations, the state produces about half of Uzbekistan's GDP.**<sup>31</sup> SOEs in Uzbekistan operate in many economic sectors that could be better served by the private sector and carry a significant cost through quasi-fiscal deficits. In some of these sectors (e.g., airlines, telecommunications, and public transport), they enjoy near monopoly power and thwart private sector entry. SOEs operate alongside the private sector in various subsectors (Figure 2), such as light industry, fruits and vegetables, hospitality services, chemical industry, banking, and insurance). However, they often have preferential and subsidized access to land and finance, and a preferential regulatory regime, again at the expense of a level playing field for the private sector. Although explicit on-budget subsidies to SOEs are small (at about 1 percent of GDP), 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.<sup>32</sup> 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.<sup>33</sup>

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

**75. Since the start of the reforms in 2017, and with the support of the first two DPOs, the Government has taken important steps to strengthen financial transparency of large SOEs and address institutional weaknesses.** With support from the first DPO, the Government adopted measures requiring its two biggest (and costliest in terms of explicit and quasi fiscal deficits) SOEs—*Uzbekenergo* and *Uzbekneftegaz*—to adopt international financial reporting standards and produce updated audited financial statements compliant with the new standards. Progress has been strong, with both utilities almost nearly up to date with audits compliant with International Financial Reporting

<sup>31</sup> 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.

<sup>32</sup> World Bank Public Expenditure Review (2019)

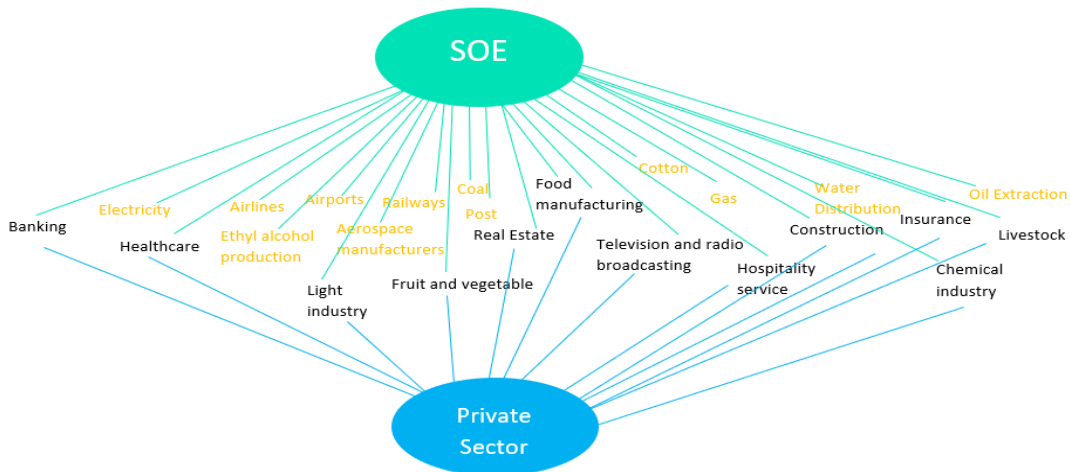
<sup>33</sup> For example, losses in natural gas supply are estimated at 1.2 percent of GDP.



Standards (IFRS). With the support of the second DPO, the Government adopted measures to unbundle the vertically integrated state-owned airline, which was responsible for aviation policy, sector operations, and regulation. Similar unbundling exercises have been carried out in the energy and (non-air) transportation sectors. To address institutional weaknesses, the Government established a new agency—the State Asset Management Agency (SAMA)—for SOE management, tasked with strengthening the Government’s oversight of SOEs and advising government on privatization decisions. The agency is preparing a strategic framework for SOE reform, covering privatization and corporate governance issues.

**76. Following a comprehensive inventory of all SOEs, the Government has approved new measures to transform the corporate governance of large SOEs and privatize a substantial number of smaller SOEs.** In October 2020, the Government adopted a resolution (Presidential Decree 6096) aimed at reducing the state’s share in the economy and improving the performance and governance of large SOEs. The first part of this resolution sets out ambitious corporate governance improvements that 32 of the largest SOEs (by valuation) must implement within the next year: the adoption of IFRS accounting standards, requirements for annual independent audits, and the preparation of corporate improvement and financial recovery strategies (with support from competitively sourced management consulting expertise). In addition, all large SOEs must obtain international credit ratings in 2021. The second part of the resolution identifies 39 medium-size SOEs that will immediately begin a process of pre-privatization to improve operational performance and financial transparency. A final decision to sell these enterprises will be made once the pre-privatization process is complete. The third part of the resolution identifies a list of 479 smaller SOEs, about 17 percent of all SOEs, for immediate valuation and sale through a competitive and transparent auction process. These enterprises are estimated to be valued at less than UZS 100 million (about US\$10,000) each and were selected based on their poor financial performance and the existence of domestic private sector capacity that can absorb the operations of these enterprises. The Government’s intention in selling these enterprises is to quickly transfer and create additional private sector capacity and assets, while minimizing social and financial risks that may arise with larger and more profitable businesses that require further pre-privatization assessments.

Figure 2: Mapping of SOE-dominated sectors



Note: Yellow highlights sectors/sub-sectors with SOE participation only.

Source: World Bank (EFI Competition Team) analysis based on publicly available information as of April 2019

**77. The approved resolution also includes strong measures to increase competitive neutrality, and the transparency and effectiveness of the privatization process.** Within two months, a comprehensive inventory must be completed of all benefits and preferences for SOEs that weaken a competitive business environment, and to prepare regulations to cancel these preferences. The resolution also directs the Anti-Monopoly Commission to



conduct a full audit of the Government’s electronic trading platform to ensure that all public tender processes are conducted in full transparency, and to ensure that all steps involved in any sale process are fully traceable. Separately, with substantial support from EBRD, the Government is expected to table a new privatization law that provides the strategic framework for privatization. To ensure government accountability over valuation decisions, a new State Commission for Tendering the Sale of State Property (SCTSSP) has been established with the Prime Minister as the Chair of the Commission. The SCTSSP will be responsible for providing quality assurance over the valuation, the determination of sale method, and the sale process, and will provide the final clearances at each stage prior to government shares in SOEs being tendered.

**Prior Action 5:** To improve the financial transparency and performance of state-owned enterprises (SOEs) and reduce state ownership of assets, the Borrower has: (i) required 32 of the largest SOEs by financial valuation to (a) adopt international financial reporting standards, (b) prepare enterprise financial recovery strategies, and (c) obtain international credit ratings starting from 2021; and (ii) approved a list of SOEs that will be divested of government ownership via a competitive process.

**78. Effective implementation of further SOE reforms and privatization measures could create significant room for private sector growth.** The approved resolution sets out a strong commitment to strengthen corporate governance and begin the process of privatization for smaller and medium enterprises. Accompanying the resolution are ambitious timeframes, with the bulk of the work being done in 2021, pandemic conditions permitting. As a follow-up to this resolution, the Government will also adopt several subsidiary regulations in the coming months to further clarify the Government’s framework for SOE liquidation,<sup>34</sup> the conversion of SOEs into PPPs, and privatization and restructuring decisions for several larger SOEs. These measures, if successfully and transparently implemented, could create significant opportunities for the expansion of small and medium private sector businesses across the country, while also improving the Government’s financial position and reducing fiscal risks.

**79. Lessons from other SOE reform programs highlight several large risks that must be carefully monitored.** To achieve the ambitious goals set out under the approved SOE reform resolution, 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 are the risks emerging from social obligations to employees negatively affected by the privatization, and the future employment decisions of the private sector buyer. The adopted resolution requires the State Tender Commission to consider any outstanding social obligations before issuing final sale clearances. The Government is also 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<sup>35</sup>. The Government is also working closely with the World Bank and other partners, such as the EBRD and ADB, to improve privatization and corporate governance frameworks to ensure consistency with best

<sup>34</sup> Over 1,000 of the poorest performing SOEs are estimated to be potential candidates for liquidation.

<sup>35</sup> Further details on social mitigation measures are provided under the Poverty and Social Impact Assessment section of this document.



practice approaches to the SOE reform agenda. The Government also continues to move ahead with a few test privatizations, on competitive terms, to increase investor and citizen confidence in the privatization process.<sup>36</sup>

**80. The measures supported under this operation are expected to reduce and streamline the state's share in the economy in a more systematic and orderly manner.** In the short run, the proposed privatization of nearly 17 percent of SOEs, via a competitive process, will help accelerate the efficient transfer of assets from the state to the private sector. The effective functioning of the SCTSSP chaired by the Prime Minister (the result supported under this operation) will help ensure a robust and transparent privatization process, helping to assess and mitigate social risks, ensure fair value to the Government from sales, and provide high-level political backing for privatizations. Measures to strengthen the corporate governance of SOEs are also expected to improve resource efficiency, increase public shareholder value, and reduce fiscal risks.

### ***Fiscal Transparency***

**81. Insufficient fiscal transparency and accountability amplifies fiscal risks and undermines effective allocation of limited public resources.** Public resources to fund central government operations are collected, allocated, spent, and accounted for in a complex manner that involves multiple legal frameworks, accounting systems, reporting lines, and transparency requirements. Adding to the complexity are various transactions and directed lending operations involving government agencies, government extra-budgetary funds and off-budget accounts (including the UFRD and Agriculture Fund), state owned banks, and SOEs. Prior to 2018, estimates of off-budget balances ranged between 6-9 percent of GDP.

**82. Since 2018, and with considerable support from the World Bank and IMF, Uzbekistan has made strong progress in improving public debt transparency.** The Ministry of Finance now regularly publishes detailed information on all new external loans, including the source and intended use of funds. Before a new external loan is signed and disbursed, the Government must seek financial commitment authorization from the President or the Cabinet of Ministers. This authorization is published, and provides, in substantial detail, information about the project, the cost of funds, and the repayment profile. Prior to 2018, almost all this information was not publicly disseminated. Although relevant details about external loans are available, they are not yet available in a single location. There is also room to strengthen the coverage of reporting to include loans of SOEs that are not guaranteed.

**83. There has also been progress strengthening fiscal transparency and accountability, most notably in the budget preparation process.** Prior to 2018, there were no requirements to publish or seek formal parliamentary approval of the state budget. In mid-2018, the Government required annual budget publication and dissemination of the budget, including citizen budgets (supported by DPO 2). Despite these reforms, budget accountability and oversight remain an issue, as a significant proportion of government spending (estimated at 6 percent in 2019)<sup>37</sup> occurs off-budget through extrabudgetary funds, and off-budget accounts, with the UFRD representing the largest source of off-budget spending. The Government has closed many of these funds since mid-2018.

**84. In December 2019, the Government announced a significant overhaul of the budget approval and accountability process.** Under a newly approved Budget Law (ZRU-590) amending the 2013 Budget Code, Parliament has been vested with the responsibility of reviewing and approving budget legislation. This effectively transfers oversight of the budget process from the executive to the legislature and provides for a substantially more robust and public consultation and debate process on the budget. For the first time, starting from the 2020 Budget, the draft budget will be submitted to Parliament in November, with parliamentary approval required before the start of

<sup>36</sup> The Government recently commenced a process to privatize *Coca Cola Ichimligi Uzbekistan Ltd*, and 10 small/medium sized SOEs from various sectors such as insurance, wine and vodka distilleries, and glass manufacturing.

<sup>37</sup> World Bank Public Expenditure Review (2019)



the new fiscal year on January 1. Following the approval of the annual budget law, the Government is now required to provide quarterly budget execution progress reports to Parliament and appear before the Budget Committee to answer questions. The law also devolves responsibility for the consideration and approval of local budgets to the newly established local deliberative bodies,<sup>38</sup> whose membership is appointed by means of direct citizen election, introduced by the Government as part of the political reform process. Furthermore, the new law also introduces a formal procedure for supplementary spending: supplementary expenditure (including of the UFRD) exceeding 3 percent of the approved parliamentary ceiling must be re-approved by Parliament. The new law also requires the revenues and expenditures of the UFRD, one of the biggest sources of off-budget spending (estimated at about 4 percent of GDP in 2019), to be consolidated into the state budget. Incomes and expenses of the UFRD are also subject to the same quarterly reporting and supplementary authorization processes as the state budget. The measure is intended to help improve coordination between budget and UFRD spending, reduce UFRD overspending against budgeted levels, and improve fiscal reporting. It helps address one of the most significant weaknesses constraining the effectiveness of fiscal management and transparency of fiscal reporting.

**Prior Action 6:** To increase fiscal transparency and strengthen public ownership of the State Budget, the Borrower has enacted amendments to the Budget Code of the Republic of Uzbekistan to: (i) vest the Parliament, *Jokargy Kenes*, and regional *kengashlar* with the responsibility of approving their respective budgets; and (ii) incorporate the income and expenses of the Uzbekistan Fund for Reconstruction and Development in the State Budget Law draft.

**85. The measures have already started to deliver benefits during the COVID-19 crisis and are expected to substantially improve fiscal transparency and accountability.** As a result of the fiscal consolidation measures, the Government has been able to utilize resource windfalls from gold sales (which accrue as incomes to the UFRD) more efficiently to finance the significant increase in anti-crisis spending. In adherence to the requirements on supplementary spending, the Government has also successfully sought reauthorization from Parliament to enable higher anti-crisis spending in 2020, and Parliament has continued to hold quarterly reviews of budget execution with a focus on spending effectiveness during the pandemic.

**86. The Government remains committed to further fiscal and debt transparency reforms.** From the 2021 Budget, the Government intends to integrate all externally financed expenditure (including development partner projects) into the consolidated budget, which is expected to further reduce off-budget balances to between 1 and 2 percent of GDP. The authorities are also making progress with efforts to close and consolidate remaining off-budget spending, most notably through a commitment to close all ministerial off-budget accounts over the medium term. As part of anti-crisis measures, all revenues to these funds<sup>39</sup> were redirected to the consolidated budget account. This measure is expected to accelerate the off-budget consolidation process in 2021. The authorities are also working to further enhance debt transparency, through the development of a medium-term debt strategy, new debt legislation intended to increase debt transparency and discipline, and the development of a single debt information portal on

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

<sup>39</sup> Many off budget accounts are funded by non-tax revenue collections that are shared via formal agreement between the Ministry of Finance and revenue collecting government agencies. Formally, any spending from these accounts must be for purposes authorized by Cabinet. In practice, expenditure is difficult to monitor.



the Ministry of Finance’s Debt Management Office website. The portal will collate all debt information published by the CBU, the Ministry of Finance, and via the official legal gazette.

**87. Measures supported under this operation will improve fiscal reporting, increase accountability and, over time, help reduce fiscal risks.** The full compliance of the 2020 and 2021 Budget Laws against the approved measures supported in this action (the result indicator under this proposed operation) will help establish a strong foundation for future reforms to the budget process. It will also help ensure—during a time of elevated fiscal risks due to the pandemic—that the UFRD’s operations are fully consolidated into the budget and considered in coordination with decisions on the Republican Budget or any changes to anti-crisis spending measures. The measures also accountability by improving links between citizens and the budget process. Over time, and as further fiscal transparency reforms are implemented, and as citizen and civil society capacity is built, the supported measures will lower fiscal risks and improve the efficiency of public spending.

### **Pillar 2: Enhancing economic inclusion and social resilience**

**88. Economic opportunities, especially for women, strengthened social protection and shared prosperity are important priorities in the 2017–2021 Development Strategy.** Since 2019, the Government has, with increasing openness, acknowledged the need for a systematic approach to poverty reduction and increased incomes for citizens. Wide access to high-quality public services, especially health and education, as well as ensuring that people are not left behind in the economic transition, are especially important priorities. Recognizing that an early emphasis on inclusion, especially the inclusion of women, is critical to a successful transition and to maintaining public support for the reforms, the authorities have enacted several measures to reduce gender workforce discrimination, expand safety nets and strengthen public services. Reforms under this pillar build on the successes achieved since 2017, and further deepen the implementation of the Government’s inclusion and social resilience reform agenda.

#### ***Internal Migration***

**89. Active measures to reduce rural-urban migration have led to Uzbekistan having one of the lowest rates of internal migration in the world.** There is a large mismatch between where workers live, and where economic growth is proceeding most rapidly (Figure 3). The primary instrument to control internal migration was the *propiska*, a system of population control from Soviet times that serves as a residency permit. Officials have in the past resisted economic pressure toward greater urbanization trends. While this has slowly begun to change following the 2017 reforms, *propiska* restrictions, as well as wider structural issues such as the cost of housing in main urban areas, still pose binding constraints on the free mobility of labor within the country.<sup>40</sup> For example, registration rules prohibit migration to urban centers (particularly to Tashkent).

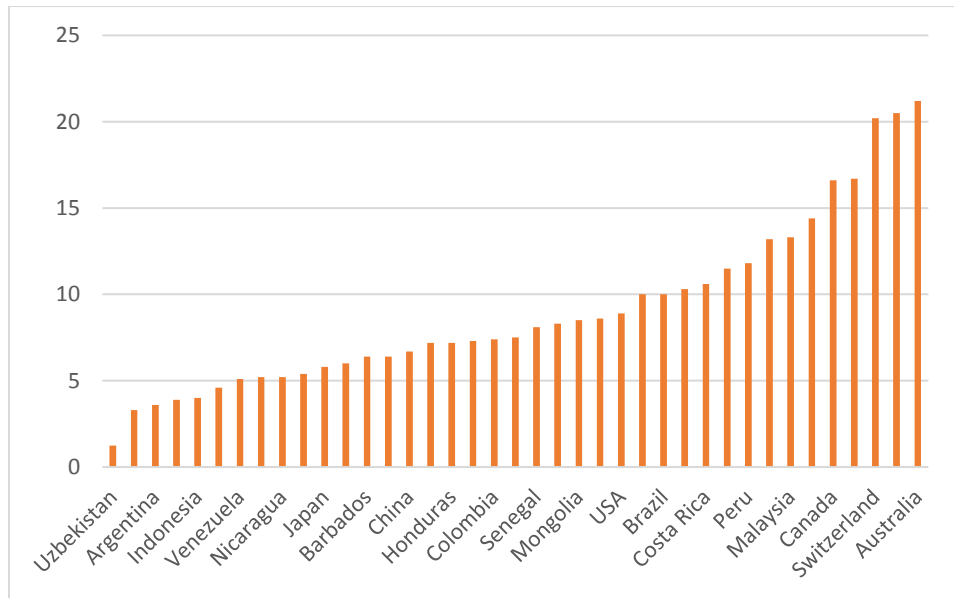
**90. Until recently, *propiska* played a significant role in determining access to formal jobs and public services.** To discourage illegal internal migration, *propiska* registration was required for school enrolment, health care, registration with utilities, and several other public services. Civil and criminal penalties were imposed on employers who were caught hiring workers without *propiska*, as well as the employees they hired. Several studies point to the *propiska* regime as a source of significant rent-seeking and worker mistreatment by employers.

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<sup>40</sup> *Propiska* policies and high urban housing costs are the most important constraints identified by respondents in the *Listening to the Citizens of Uzbekistan* (L2CU) survey.



Figure 3: Comparative rates of internal (domestic) migration



**91. In 2018, and supported by the second DPO, the Government removed restrictions banning employers from hiring workers without *propiska*.** Following the start of market reforms in 2017, many steps have been taken to ease the *propiska* regime. These include removing most quotas and limits on the issuance of permits in all areas outside Tashkent City and region, reducing the legal sanctions for citizens who do not have appropriate permits, and removing requirements to have a *propiska* to obtain certain basic services such as health and education. The registration system for visiting tourists, who are also subject to *propiska* requirements, has been overhauled to allow automatic electronic registrations by hotels and landlords. This addressed one of the biggest constraints to tourism development and legalized the home-sharing (e.g., via services such as AirBnB) market. In January 2019, as part of a broader series of reforms to enhance sustainable urbanization, the Government removed rules barring employers hiring workers without local *propiska*.

**92. In March 2020, the Government adopted measures that have dismantled most of the old *propiska* system.** Under these measures (Presidential Decree 5984), the system was replaced by a new residential registration process that could be submitted and approved online. The requirement for a *propiska* endorsement in internal passports was abolished, ahead of measures to fully abolish the use of internal passports—an unpopular and evocative vestige of historically stringent internal migration controls. Restrictions were imposed to define and limit the situations where citizens were required to produce registration information, and most restrictions limiting access to public services without *propiska* or registration were lifted.<sup>41</sup> Citizens are now free to relocate and reside permanently anywhere in the country, except for Tashkent City. Citizens relocating to Tashkent City are granted (without any caps or quotas) a one-year temporary approval that must then be renewed electronically each year. Under ordinary processing times, citizens in both categories can receive registration confirmation electronically within a day, often sooner.<sup>42</sup> The

<sup>41</sup> Proof of local registration is still required access to education and local health services, although this is now eased by the absence of constraints to obtaining local registration.

<sup>42</sup> Subject to documentation requirements to establish either ownership or tenancy in the place of new residence. In the case of leased dwellings, documentation requirements include permission from the owner of the property.



measures have also expanded the previously strict and carefully managed eligibility criteria for permanent registration in Tashkent, most notably to include buyers of properties from existing stock.<sup>43</sup>

**Prior Action 7:** To increase domestic labor mobility, improve access to public services such as health and education, and expand economic opportunities for citizens, the Borrower has: (i) reduced restrictions on the issuance of new residency registrations by expanding eligibility criteria for registration in Tashkent; and (ii) simplified and digitized residency registration procedures.

**93. This measure is likely to have a significant impact in increasing economic opportunities, especially for those relocating from the poorest parts of the country, increasing access to public services, and enhancing productivity.** With the removal of all quotas and lengthy assessment processes, registrations in Tashkent are expected to increase over time. Although this measure addresses the legal environment for internal migration, increased migration to Tashkent is likely to remain gradual and constrained by housing supply constraints in the short to medium term, which may also limit immediate demand surges for public services, such as education, to allow the Government to increase capacity. In addition to these measures, the Government remains committed to fully removing the temporary registration system in Tashkent within the next few years. Collectively, these measures are likely to expand economic opportunities for citizens, ease labor supply constraints faced by the private sector, reduce corruption, and increase access to public services.

**94. In the short term, the approved measures are expected to substantially reduce administrative penalties paid by citizens without registration documents.** Although data are unreliable, estimates of the number of people without *propiska* prior to the reforms numbered ranged between 70,000 and 200,000, although this may be underestimated. The previously harsh administrative and criminal penalties associated with improper *propiska* documentation was intentionally designed to encourage rigorous compliance with internal migration regulations. The removal of these restrictions is expected to significantly reduce the number of citizens fined for place-of-stay violations (the result targeted under this operation), representing a significant advancement in social justice.

#### ***The Economic Participation and Well-being of Women***

**95. Uzbekistan's gender gaps are evident in data on employment, access to services, and women's voice and agency.** On average, only 20 percent of Uzbekistani women participate in the labor market, compared with 46 percent of men. In turn, women and female-headed households report lower monthly incomes and are especially vulnerable to shocks such as the Covid-19 pandemic. Women also incur large burdens from inadequate access to quality services such as water and schools. Only between 38 and 43 percent of households in *Ferghana*, *Andijon*, and *Namangan* regions have access to piped water in their dwellings, forcing women in these regions to spend 12 to 28 hours per month collecting water. Across Uzbekistan, only 24 percent of children aged 3 to 6 attend preschool, and poor access to preschools, especially in rural areas, is a primary constraint preventing women from entering the labor force. Finally, women lack voice and representation in Parliament and in local decision-making committees. The share of women in Parliament is just under 30 percent and all *hokims* in 14 regions and the city of Tashkent are male.<sup>44</sup>

**96. Although data on Uzbekistan are not available, in Central Asia, the high prevalence of gender-based violence is harmful to not only women's health but also their labor force participation and gender equality more broadly.** While there are no survey data on gender-based violence prevalence in Uzbekistan, in neighboring Tajikistan, according to the 2017 Demographic and Health Survey (DHS), the percentage of women who had experienced

<sup>43</sup> Measures were enacted in 2018 to enable buyers of new homes to obtain permanent *propiska*. This has now been expanded to cover existing home sales.

<sup>44</sup> As of October 13, 2020.



physical violence since age 15 increased from 19 percent in 2012 to 24 percent in 2017. In Kyrgyz Republic, based on the 2012 DHS, 23 percent of all women age 15 to 49 have experienced physical violence at least once since age 15.

**97. Weak or restrictive laws related to family, gender-based violence, and economic opportunities are likely to limit women’s empowerment.** A lack of gender equality in business and institutional laws is strongly associated with lower levels of economic participation by women. Gender-based violence has direct consequences for women’s labor force participation in terms of job loss and lost productivity. One study estimates that the lost wages due to family violence amounted to 1.6 percent of GDP in Nicaragua and 2.0 percent in Chile. In addition, job opportunities may have unintended negative consequences for women if work changes relations within the household and their husbands respond with increased domestic violence.

**98. In September 2019 two landmark laws were enacted to guarantee gender equality and provide a national legal framework to protect women from violence and oppression in Uzbekistan.** The law on gender equality guarantees equal opportunities for women and men, and the non-discrimination based on sex for employment, access to public services, including resources such as land and concessional finance, and in electoral candidacy. It sets out a comprehensive list of implementation measures that the Government is required to take to establish and enforce compliance with the legislation. The first two measures, adopted in March and May 2020 (Resolution of the Cabinet of Ministers No. 192 of 2020 and Ministry of Justice Order 2352-8), have initiated a comprehensive review of all laws and regulations in the country to check for compliance with the new law. The measures also set out a process for how those non-compliant measures will be amended and corrected to ensure compliance with the legislation. These measures follow an earlier repeal of regulations in 2019 that prohibited women from being employed in several sectors of the economy, and in over 50 different occupational classifications.

**99. The law to protect women from violence establishes a legal basis for police complaints against gender-based violence, opening the door for the systematic protection of survivors.** Although violence against women is illegal under existing criminal laws, no provisions existed for the registration of gender-based violence cases, nor for measures that are recommended to support and protect women affected by gender-based violence. The passage of the new legislation establishes gender-based violence as a distinct type of criminal offense, and sets out special requirements for the registration, processing, and enforcement of these cases. The first major measure to implement this legislation was the approval by the Cabinet of Ministers (Resolution No. 3 of 2020) of a framework for protection orders. It enables law enforcement officials to issue and enforce protection orders safeguarding survivors of gender-based violence (GBV) from the individuals suspected of committing acts of violence. It also sets out procedures for the ongoing monitoring of compliance with the enforcement order, including regular follow-ups with survivors, and empowers law enforcement officials to arrest and detain individuals who do not comply with the order.

**Prior Action 8:** To reduce barriers limiting the full economic participation and safety of women, the Borrower has issued regulations to further implement legislation: (i) guaranteeing non-discrimination on the basis of sex for employment, electoral candidacy, and for access to state resources; and (ii) for the issuance, enforcement, and monitoring of protection orders for survivors of gender-based violence.

**100. Substantial work remains to fully implement both laws, but their enactment represents an important step toward a more inclusive transition process.** Significant work remains to shift the many legal, social, and cultural constraints that limit the full economic participation and well-being of women in Uzbekistan. Further implementation measures will be required to increase enforcement of equal opportunities legislation, create safe avenues for complaints, and strengthen the voice and participation of women in the civil service and in politics. Work is also needed to address inequities in property rights relating to the joint ownership of assets, especially when those assets can serve as collateral for women to access finance. Under the gender-based violence law, the Government has committed to providing support including free legal, economic, social, psychological, medical, and other services, to



GBV survivors including those with protection orders. GBV survivors can access these services through placement in special centers or by calling hotlines. The adoption and wide dissemination of a referral pathway compliant with WHO standards (the result targeted under this operation)<sup>45</sup> will enable the police, government officials, *mahalla* leaders, and service providers to guide survivors to a holistic set of services and allow the Government to fulfill its obligations under the new law. The government remains committed to implementing these measures effectively, and progress will be reviewed regularly by a newly established special Commission for Gender Equality and the Ministry for *Mahalla* and Family Support. A special parliamentary committee, under the leadership of the Chairwoman of the Senate, has also been established to regularly review and assess progress in implementation of both laws. The early enactment of the laws, and the progress that has been achieved since their approval, are likely to help increase the economic participation of women.

### **Social Safety Nets**

**101. Uzbekistan has a well-articulated and comprehensive social protection system compared with countries with similar incomes, but up to one-third of the poor are not included in any scheme.** The system includes contributory social insurance, noncontributory social assistance, labor market programs, and social care services. Most social protection expenditure in 2018 was for social insurance programs (about 83 percent of the total social protection spending), and social assistance spending accounted for around 15 percent. Social insurance programs by far cover the largest share of the population, especially contributory pensions, but it is social assistance that ensures a higher coverage of the poor. Within social assistance, poverty targeted low-income family allowances are the largest program and account for most social assistance spending. There is scope to improve the targeting accuracy of the program. About 63 percent of the poor—defined by those living under the US\$3.2 LMIC poverty line—are not reached by low-income allowances. Among the poor who receive support, only half are lifted above the poverty line. The number of households receiving low-income family allowances declined continuously until 2017, when the total coverage (about 435,000 families) was almost half that in 2013. However, since 2018, the Government has consistently increased budgets for the three types of low-income family allowances and the number of beneficiary families increased to 541,147 in 2018 and around 547,000 in 2019 (Figure 4).

**102. Weaknesses in social safety nets have been exacerbated during the COVID-19 crisis, further accentuating the need for reform.** The amount of support, as well as the duration of the benefit, varies across the three types of family allowances, with the allowance for a family with children of age 0 to 2 being entitled to a longer duration (12 months' benefit) and more benefits. Because of cycling<sup>46</sup> and reapplication requirements, many of these families received benefits for only six months, so that the assistance had limited impact. The sharp increase in the number of people living in poverty—an estimated 450,000 to 900,000 additional people—has exacerbated some of the limitations of the Government's existing safety net system, most notably its coverage, inadequate budget, and bureaucracy.

**103. Even prior to the COVID-19 crisis, the Government had recognized these challenges and had begun to address them, with support from the first two DPOs, by expanding existing safety net budgets and accelerating the creation and piloting of a single registry.** Current government policies require all major reforms and draft resolutions that have a large poverty and social impact to incorporate adequate measures to minimize the impact on the poorest and most vulnerable. These measures usually involve using existing safety nets and expanding budgetary allocations to *mahallas* to increase allowances and coverage numbers.<sup>47</sup> In 2019, the Government

<sup>45</sup> The implementation of this measure will be supported by the World Bank and other development partners.

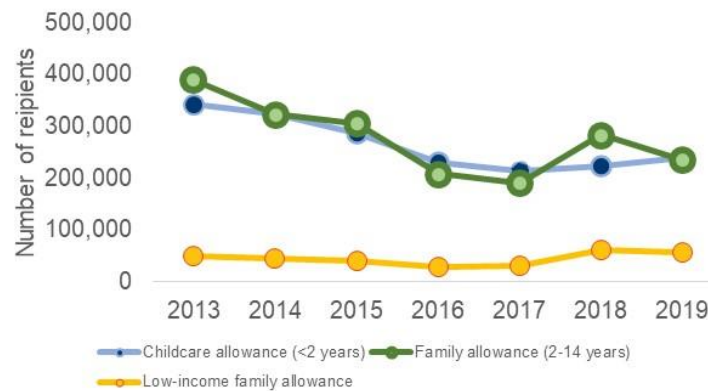
<sup>46</sup> Limited social assistance budgets are often "cycled" by mahallas to different low-income assistance beneficiaries over the year to provide support to a larger number of beneficiaries, but at levels per household below what is needed to lift them above the poverty line.

<sup>47</sup> For example, increased budgetary allocations to *mahallas* to minimize the impact of foreign exchange liberalization measures was a prior action in the first Development Policy Operation.



approved the creation and piloting of a single registry (supported by the second DPO) to manage the administration of the three low-income family allowances. The single registry enables the Government to collect and verify individual level data to develop a more objective and transparent poverty-based targeting mechanism. The first pilot phase of the single registry began in October 2019 in the *Syrdarya* region, with good progress made in implementing the pilot over the 16 months. The main objectives of the single registry are to: (i) increase coverage of the poor while maintaining fiscal discipline and reducing administrative costs; (ii) improve transparency in the identification and selection of beneficiaries; and (iii) increase the system’s flexibility to respond to changing conditions. As a result, the registry is expected to increase both the absolute number and share of poor households assisted by family allowances (coverage of the poor), and the proportion of cash allowances received by the poorest 40 percent of the population (targeting accuracy).

Figure 4: Recipients of low-income allowances



**104. In response to the COVID-19 crisis, the Government expanded existing low-income allowances in March 2019, increasing support for an additional 60,000 families.** In addition, in April 2020, the Government waived re-registration requirements for existing beneficiaries and automatically extended the payment of benefits to families with children, child-care benefits, and material assistance (which were scheduled to expire between March and June 2020) from six months to one year without re-registration requirements. Measures were also adopted later to simplify eligibility conditions and application processes for low-income allowances (Presidential Decree 5996 and Cabinet of Ministers Resolution No. 307 of 2020).

**105. To accelerate progress in transitioning to the single registry, the Government has approved the rollout of the system to all regions in the country and is committed to further improving procedures and systems to minimize the potential exclusion errors.** In August 2020, the Government enacted measures to fully roll out the single registry system based on lessons learned from the pilot in *Syrdarya* (Presidential Resolution 4797). While the Government has an ambitious plan to roll out the system nationwide by the end of this year, a full transition to the new system is likely to occur over the next 12 months. The implementation of the pilot has proceeded relatively smoothly, although one area for further improvement has been the relatively high risk of exclusion errors—such as the high rate of rejections of people qualifying under income criteria for assistance. Almost half of the applications from poor families (families with reported income below the eligibility threshold) are rejected by the single registry in *Syrdarya*. This rejection rate is high compared with international benchmarks. Reasons for rejections are linked to inconsistent application of eligibility criteria set forth in Cabinet regulations, gaps in data-exchange protocols between the registry and Employment Support Centers (accounting for 70 percent of all rejections), the quality and comprehensiveness of government databases used for verification (i.e., cadastral, car registry), incomplete information, and insufficient awareness of procedures from applicants. To minimize the risk of these issues being replicated nationwide, the



authorities, with substantial support from the World Bank Strengthening Social Protection System project and UNICEF, are focusing their implementation efforts to further improve systems and operational procedures based on independent assessments of the targeting outcomes and implementation processes. The Government is also increasing citizen awareness through broad information campaigns and is strengthening institutional capacity to apply regulations and procedures correctly and consistently.

**Prior Action 9:** To increase support for vulnerable households during the COVID-19 crisis and to further strengthen the efficiency and transparency of the social safety net system and its responsiveness in targeting people affected by future sources of vulnerability, including climate vulnerable groups, the Borrower has: (i) increased by 10 percent the number of beneficiaries receiving low-income family allowances and waived re-registration requirements for existing low-income family allowance recipients, in response to the COVID-19 crisis; and (ii) approved the transition of all regions in the country to using the Single Registry of Social Protection to process applicant registration, beneficiary selection, program enrollment and payment orders.

**106. These measures are expected to increase the outreach and number of poor families receiving assistance through low-income family allowances and, over time, support a transition to a more transparent and effective social safety net.** The COVID-19 measures are expected to benefit at least 60,000 additional low-income families and support an additional 60,000 existing beneficiaries in maintaining assistance. An effective rollout of the single registry, which reduces rejection rates relative to the current pilot (the result targeted under this operation), is also expected to create a substantial increase in the coverage of poor families. Over time, the full rollout of the unified social registry is expected to substantially improve coverage, targeting, and transparency in how social safety nets are administered in Uzbekistan.

**107. A more robust safety net system will also help strengthen the social and economic resilience of communities already impacted by climate change and vulnerable in the future to the effects of climate change.** The reforms supported under this measure have a strong focus on expanding safety net coverage to those most in need at the present time, and in increasing the efficiency and effectiveness of the safety net system to respond to the materialization of future risks. In both cases, climate-vulnerable groups are likely to benefit from these measures. The effects of climate change have already had an impact on communities in *Karakalpakstan*,<sup>48</sup> where some of the poorest citizens in the country live, reducing food and nutritional security through more frequent droughts and lower soil fertility, and through a reduction in the quality of water supply. In the short to medium term, the measures supported under this reform are likely to reduce exclusion errors and increase safety net coverage of poor households in the region.<sup>49</sup> The new unified registry system also enables the Government and the social safety net system to be more agile and responsive through quickly established windows to rapidly address needs from climate-exacerbated disasters that may arise, such as increased droughts, floods, mudflows, and avalanches.

<sup>48</sup> UNICEF climate change assessment in *Karakalpakstan* June 2011.

<sup>49</sup> The same report by UNICEF explicitly notes the constraints of the existing safety net system and the rotation of social allowances leading to inadequate benefits and increased.



**Table 5: Prior actions and analytical underpinnings**

Prior Actions	Analytical Underpinnings
<b>Pillar 1: Improving the efficiency, sustainability, and transparency of resource allocation in the economy</b>	
<p><b>Prior Action 1:</b> To increase the efficiency of financial resource allocation and strengthen transparency in the banking sector in implementation of the Government’s approved banking law and financial sector reform strategy, the Borrower has:</p> <ul style="list-style-type: none"> <li>(i) prohibited all new on-lending to State Owned Enterprises (“SOEs”) by state commercial banks using subsidized funds from the Uzbekistan Fund for Reconstruction and Development (“UFRD”);</li> <li>(ii) required all new commercial bank lending in local currency, from 1 January 2020, to be at interest rates at or above the central bank reference rate, except for government loans for mortgage lending and the production of raw cotton and grains; and</li> <li>(iii) appointed at least one independent director, consistent with requirements in the Banking Law, to each of the boards of at least ten state-owned commercial banks.</li> </ul>	<p>World Bank TA reports on financial sector development (2019), strengthening banking regulations (2018), and the development of a financial sector strategy (2020); IMF Article IV and subsequent staff visit concluding statements. World Bank Reform Roadmap 1 (2017) and 2 (2018). The World Bank has been involved in supporting the development of the draft law. All these studies have identified the dual distortionary effect of UFRD on-lending via the commercial banking system, and the use of heavily discounted state-directed lending as interfering with financial sector allocative efficiency, the effectiveness of monetary policy transmission and inflation management, and access to finance by the private sector. They also highlight weaknesses in corporate governance and operational and financial transparency in the banking sector.</p>
<p><b>Prior Action 2:</b> In accordance with the Borrower’s agricultural modernization strategy to increase climate resilience, diversify agriculture, increase the transparency and efficiency of land distribution, and eliminate state agricultural production, the Borrower has abrogated the state cotton order system by removing mandatory cotton production targets and mandatory state procurement of cotton.</p>	<p>World Bank analytical support on the development of an agricultural modernization strategy (2019), agri-food diagnostic study (2020), growth diagnostic study (2018), agricultural growth assessment (2020), cotton-textile clusters’ assessments (2019 and 2020), and cotton pricing reforms (2020). Reports highlight the significant inefficiencies of the state agricultural production system and land tenure and distribution practices, and the many binding constraints it poses on agricultural productivity, individual economic freedoms and welfare, and the long-term climate resilience of the agricultural sector in Uzbekistan. The IFC 2019 Country Private Sector Diagnostic and the World Bank’s report Central Asia’s Horticulture Sector: Capitalizing on New Export Opportunities in Chinese and Russian Markets (2020) provide an in-depth assessment of the potential for horticulture.</p>
<p><b>Prior Action 3:</b> To reduce inefficient fossil fuel subsidies, the Borrower has abrogated the State’s regulation of the retail price of AI-80 petroleum, diesel, and ECO diesel.</p>	<p>World Bank TA to energy sector market development, ESMAP Subsidies in the Energy Sector report; IEA World Energy Outlook 2018 estimated Uzbekistan spends 2% of GDP in oil-related fossil fuel subsidies, a fifth of its total fossil-fuel subsidies.</p>
<p><b>Prior Action 4:</b> To enhance the enabling environment and transparency of public-private partnerships (“PPPs”) in the renewable energy and other infrastructure sectors, the Borrower has submitted legislative draft amendments to the PPP and Currency Regulation Laws, for Parliamentary approval, to:</p> <ul style="list-style-type: none"> <li>(i) allow the Government to enter foreign currency</li> </ul>	<p>World Bank, IFC and ADB transactional advisory support for PPPs has identified constraints linked to foreign currency commitments and investor protections against major changes to the legal investment framework. Ongoing work by IFC and EBRD on capital market development notes.</p>



<p>financial commitments in PPP concession agreements and allow financial compensation to be paid to investors against losses which may arise from changes to legislation in force on the date of the partnership agreement; and</p> <p>(ii) strengthen public information disclosure requirements for PPP tenders and PPPs under implementation.</p>	
<p><b>Prior Action 5:</b> To improve the financial transparency and performance of state-owned enterprises (SOEs) and reduce state ownership of assets, the Borrower has:</p> <p>(i) required 32 of the largest SOEs by financial valuation to (a) adopt international financial reporting standards, (b) prepare enterprise financial recovery strategies, and (c) obtain international credit ratings starting from 2021; and</p> <p>(ii) approved a list of SOEs that will be divested of government ownership via a competitive process.</p>	<p>Analytical work done under this and previous DPOs, along with support via the Institutional Building Loan (P168180); and analytical support to the Government from the EBRD and ADB. Key findings: need for full identification of all SOEs, clear and transparent criteria for ownership and divestiture, stronger financial and operational transparency and independence from state direction, improved cost-recovery of SOEs providing regulated public services, legal and regulatory changes for transparent and competitive privatization, and stronger social safety net and labor market policies to buffer potential displacement costs on those most vulnerable.</p>
<p><b>Prior Action 6:</b> To increase fiscal transparency and strengthen public ownership of the State Budget, the Borrower has enacted amendments to the Budget Code of the Republic of Uzbekistan to:</p> <p>(i) vest the Parliament, Jokargy Kenes, and regional kengashlar with the responsibility of approving their respective budgets; and</p> <p>(ii) incorporate the income and expenses of the Uzbekistan Fund for Reconstruction and Development in the State Budget Law draft.</p>	<p>World Bank Public Expenditure Review (2019), IMF Fiscal Transparency Assessment (2018/19), PEFA (2019). The general government’s full economic footprint is underreported, with significant off-budget activity, largely from the UFRD and other large off-budget funds. Budget non-transparency, the centralization of the authorizing environment, and limited accountability mechanisms are also identified as potential drivers of inefficient spending. WB TA on national citizen engagement highlight the absence of sufficient local government and citizen ownership in the budgeting process.</p>
<p><b>Pillar 2: Enhancing economic inclusion and social resilience</b></p>	
<p><b>Prior Action 7:</b> To increase domestic labor mobility, improve access to public services such as health and education, and expand economic opportunities for citizens, the Borrower has: (i) reduced restrictions on the issuance of new residency registrations by expanding eligibility criteria for registration in Tashkent and (ii) simplified and digitized residency registration procedures.</p>	<p>World Bank working paper on free movement and affordable housing finds that rate of internal labor migration Uzbekistan is one of the lowest in the world, and that <i>propiska</i> and high housing costs are the main drivers. The World Bank’s Listening to Citizens of Uzbekistan survey data suggest that 90 percent of the population would support lifting <i>propiska</i> restrictions.</p>
<p><b>Prior Action 8:</b> To reduce barriers limiting the full economic participation and safety of women, the Borrower has issued regulations to further implement legislation: (i) guaranteeing non-discrimination on the basis of sex for employment, electoral candidacy, and for access to state resources; and (ii) for the issuance, enforcement, and monitoring of protection orders for survivors of gender-based violence.</p>	<p>World Bank multi-donor trust fund on cotton sector reform, forthcoming gender assessment for the Systematic Country Diagnostic, the World Bank’s Voice and Agency study; UN assessments on progress with Beijing Platform implementation, ADB Gender Assessment, FAO study of gender, agriculture, and rural development. Studies show low levels of female political and public participation, significant inequities in formal employment, and low tertiary education enrollment. Legal constraints limit property rights and access to resources. Studies also show regulatory and legal weaknesses in protections for women against domestic violence.</p>



**Prior Action 9:** To increase support for vulnerable households during the COVID-19 crisis and to further strengthen the efficiency and transparency of the social safety net system and its responsiveness in targeting people affected by future sources of vulnerability, including climate vulnerable groups, the Borrower has:

- (i) increased by 10 percent the number of beneficiaries receiving low-income family allowances and waived re-registration requirements for existing low-income family allowance recipients, in response to the COVID-19 crisis; and
- (ii) approved the transition of all regions in the country to using the Single Registry of Social Protection to process applicant registration, beneficiary selection, program enrollment and payment orders.

World Bank TA on social safety net assistance (2017-2020). World Bank, UNICEF, ILO joint assessment of the social protection system in Uzbekistan. Studies show significant underbudgeting, weaknesses in coverage and targeting, and the need for streamlining and systematizing the safety net system.

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

**108. This proposed operation is fully consistent with the new focus areas of the 2018 Performance and Learning Review (PLR) (126078-UZ; June 26, 2018), which adjusted the 2016–2020 CPF (105771-UZ; May 19, 2016).** Adjustments to the CPF were made following a clear signal from the Government regarding its intentions to undertake a deeper and broader program of economic and social reform. The first pillar of the PDO, improving efficiency, sustainability, and transparency of resource allocation in the economy, is consistent with the first and second focus areas in the revised CPF (supporting a Sustainable Transformation toward a Market Economy and Reforming State Institutions and Citizen Engagement). Measures in this pillar focus on increasing the factor market efficiency and strengthening the sustainability of the agriculture and energy sectors. The second pillar of the PDO, enhancing economic inclusion and social resilience, supports the third CPF focus areas of investing in people, with measures to improve economic opportunities for rural citizens, increase the economic participation and well-being of women, and improve social safety net coverage. Both the revised focus areas under the PLR, and the pillars of the PDO, are consistent with the findings of the first Systematic Country Diagnostic (SCD), and the emerging findings of the second SCD under preparation.<sup>50</sup>

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

**110. The full span of the WBG’s operational, analytical, and policy engagements have contributed to the World Bank’s DPO engagements, including this operation.** These include: (i) a public expenditure review of budget and

<sup>50</sup> A second Systematic Country Diagnostic is under preparation for Board delivery in the second half of FY21, ahead of a new Country Partnership Framework that will be submitted to the Board in FY22.



SOE spending; (ii) analytical projects in the energy sectors supporting institutional and regulatory reforms of the electricity and gas sectors; (iii) implementation support for the Agricultural Modernization Project to further deepen the agricultural reform program; (iv) implementation support for the Institutional Building Loan Project to improve fiscal transparency and risk management, and support the SOE reform process; (v) analytical work on citizen engagement, including the *Listening to the Citizens of Uzbekistan* (L2CU) survey which provide support to improve citizen engagement platforms; (vi) several IFC advisory support programs in the financial sector and to support effective PPP management; and (viii) the IFC Country Private Sector Diagnostic for Uzbekistan, which has underpinned the World Bank's engagement and support for private-sector focused reforms that maximize financing for development. Analytical findings and policy recommendations from all these complementary engagements have contributed to this proposed operation. Trust fund support from the Government of the Republic of Korea has also supported the preparation of just in time policy notes and background papers on SOE reform, expanding the Bank's COVID-19 monitoring through adjustments to the L2CU survey, and in supporting financial sector reforms. Further details are provided in the table of analytical underpinnings (Table 5).

**111. The transformative reform agenda supported under this proposed operation is consistent with priorities for funding under the IDA Scale-Up Window.** Uzbekistan's historic transformation aims to rapidly increase incomes and the availability of more and better jobs. As results achieved in 2019 show, this transformation is already generating returns through increased economic growth and job creation and is playing an important role in buffering the economy and society from the worst of the effects of the COVID-19 crisis. The proposed measures under this operation are expected to further deepen this transformation, while also producing important results, such as crowding in increased private sector investments and enabling greater freedoms for farmers, within the next 12 months. The operation also strengthens social and economic resilience, through improvements to the safety net system, and greater fiscal and SOE transparency to reduce fiscal risks. Indirectly and over time, and through a more stable domestic energy supply, this operation will also support increased regional energy market integration.

#### 4.4. ADJUSTMENTS TO THE COUNTRY PROGRAM IN RESPONSE TO COVID-19

**112. The Bank's priority in FY21–22 is to sustain Uzbekistan's ambitious reforms in the context of a new post-COVID normal.** The Bank's current pipeline supports the emergency response and strengthens the economy post-COVID. The FY21 pipeline includes eight operations for US\$1.1 billion (IBRD and IDA). Three Investment Project Financing (IPF) operations have been adjusted to strengthen resilience and improve recovery prospects (in digital development, innovation, and energy sectors), and five projects (this proposed operation, a guarantee for the first independently produced solar power project, and IPFs in tax administration, financial sector development, and statistics capacity building) are being adapted. Under IDA19, up to US\$650 million may be front-loaded in FY21 to directly support the anti-crisis response. New IBRD lending will focus on the post-COVID-19 "new normal" with an effective withdrawal of the state from its control and ownership of the economy, while supporting the growth of an inclusive and private sector-led market economy. Areas of support include energy, banking sector liberalization, labor market reforms, privatization of SOEs, and rural job growth from the agricultural transformation. More than one-quarter of 15 analytical and advisory projects to be delivered in FY21 are high-priority tasks focused on supporting the Government in shaping COVID-19 policies, including the development of a poverty reduction strategy.

**113. New and existing operations are being aligned to the priorities of the World Bank's COVID-19 Response approach paper.** The engagement on the new poverty strategy and the forthcoming SCD and CPF will provide further opportunities to refine the medium-term pipeline to the effects of the COVID-19 pandemic.

- a. **To save lives and protect the poor and vulnerable**, the Bank approved (in April) a US\$95 million IDA emergency COVID-19 project (augmented with a US\$4.3 million Pandemic Emergency Facility grant) to shore up health and safety net systems, and a US\$200 million supplementary DPO to overcome a short-



term cash crunch following unprecedented health and social expenditure demands. These operations supported essential COVID-19 health procurement, expanded low-income family allowances, and streamlined unemployment benefits. Adjustments to the *Emergency Medical Services Project* (P159544) also supported additional emergency medical equipment procurement. The *Strengthening the Social Protection System Project* (P166447), approved in FY20, is also supporting implementation of COVID-19 social measures.

- b. *To save livelihoods, preserve jobs, and ensure more sustainable business growth and job creation***, the Bank is working with the Government to accelerate implementation of the new *Agriculture Modernization* (P158372) and *Ferghana Valley Rural Development* (P166305) projects, as these offer immediate opportunities to expand rural access to credit and financing amid COVID-19 financial disruptions. US\$7.6 million of EU funded grants under the *Horticultural Development Project* (P164226) are being repurposed to target farmers affected by the crisis. US\$92 million in the *Regional Roads Project* (P146334) will be used to boost temporary jobs for unemployed workers, and adjustments to the *Modernizing Higher Education Project* (P128516) supported emergency purchases of distance-learning modules to maintain tertiary instructional delivery. IFC is also working on boosting working capital finance for *Ipoteka* Bank (US\$10 million; approved) and *Hamkor* Bank (US\$20 million; under review).
- c. *To strengthen policies, institutions and investments for resilient, inclusive, and sustainable growth***, the Bank will deliver an electricity transmission and modernization project (US\$300 million), and three projects to transform financial sector (US\$15 million), tax (US\$60 million), and statistical (US\$50 million) institutions. This proposed DPO will also help support ambitious reforms to remove factor market constraints and accelerate measures to transform agriculture. It has a focus on rebuilding better through reforms to the social safety net system and measures to build a cleaner and greener economy. IFC is also working on investments and advisory services in renewable energy generation, chemicals and fertilizers, agricultural finance, cotton production, and banking.

**114. Development partner coordination has increased in response to the challenges of the COVID-19 crisis and the need to sustain reform momentum.** A new socio-economic task force, led by the World Bank and UNDP, was created at the request of the Government to coordinate partner assistance in shoring up the Government's health, social, and economic policy response to the crisis. Through this and other coordination platforms, the Bank ensured that the FY21 pipeline remains focused on reform areas of strong government demand for the Bank's knowledge and high relevance for economic recovery and transition. In addition, and despite turbulent global financial sector conditions, Uzbekistan remains an area of active interest to private sector investors. This is especially the case in the energy sector, where the WBG plays a leading role along with ADB and EBRD in supporting increased private sector participation through demonstrative projects such as this proposed operation.

#### **4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS**

**115. The positive influence of public consultation and accountability mechanisms on the reform program is growing.** 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 citizen engagement processes for most measures supported under the prior actions of this DPO. Several of the measures supported under this operation, such as SOE reforms, and measures to increase the economic participation of women, were substantially revised after stakeholder consultations. For example, private sector consultations strongly encouraged the Government to develop dedicated legislation to support the privatization process, leading to the inclusion of requirements for a new privatization law in the SOE



reform measure. Substantial input from local and international women’s groups helped address several gaps in initial drafts of the gender-based violence and equal opportunities laws. In recent years, public accountability has started to evolve from these one-way feedback mechanisms into a more dynamic engagement between government and the public. Recent examples of this shift include the development of a new tax code and the passage of new disabilities legislation, where the Government opted to co-produce these regulations, from the beginning of the process, through joint taskforces comprising government officials and representative associations such as taxpayer, audit, and disabilities NGOs. Increasing scrutiny from the public and the media have also helped strengthen social accountability. Media investigations have led to strengthened property rights in the event of mandatory land acquisitions, the prosecution and dismissal of public officials for various breaches and offenses (most notably during cotton harvests), higher wages for teachers and medical workers, and expansions in social safety net assistance. Local deliberative bodies are taking a more active role in monitoring the still heavily centralized government service delivery model, and in holding regional officials appointed by the center to account. In addition, virtual “receptions” for public engagement and face-to-face office hours enable the public to meet with senior government officials and members of the Cabinet. While these initiatives are under government control, it is a regulatory requirement for all such officials to hold weekly open office sessions, and to publish information about these sessions online.

**116. Several prior actions in this DPO have been shaped by changing norms between how citizens and the Government interact with each other in Uzbekistan.** Building on measures in DPO 2 to increase plain language “citizen budget” documentation and availability, Prior Action 6 in this proposed operation takes significant further steps to increase accountability and citizen engagement in the budget process. In 2020, and for the first time in Uzbekistan’s history, the national budget was considered, revised (in consultation with the Government), and approved by a body directly elected by, and representing, citizens. New deliberative bodies, which were created explicitly to address the significant gaps in local accountability (especially over regional officials appointed by the center), have now been empowered to approve and oversee over local budgets. While data are not available at the regional level, there were several revisions to the budget following Parliament’s initial consideration of the draft budget law, many of which—such as funding allocations for local infrastructure renewals—were explicitly linked to concerns raised by parliamentarians on behalf of their constituents. Robust quarterly reviews of budget implementation by Parliament have been widely covered by the media, where a substantial part of the debate has been informed by public feedback and media oversight over anti-crisis spending.<sup>51</sup> Since the approval of measures supported in Prior Action 6, the Government has continued to expand accountability measures and citizen engagement in the budget process. In October 2020, the entire 2021 Budget was released for public consultations by the Ministry of Finance. Consultations occurred *prior* to parliamentary submission. A summary of public consultations, and any changes to the Budget as a result, are expected to be included in the report to Parliament accompanying the submission of the draft Budget law. In agriculture, a stakeholder consultation process, and third-party monitoring and feedback mechanisms to oversee cotton harvests, has played a significant role in accelerating the Government’s decision to end state mandatory cotton procurement and production targets (Prior Action 2). Measures supported in Prior Actions 4 (PPPs) and 5 (SOE reforms) also include provisions for wider dissemination and public transparency of information and decision-making, with the explicit purpose of improving public accountability and oversight—especially over government processes that carry higher fiscal and social risks. Measures supported in Prior Action 9 are being accelerated by the Government in direct response to citizen concerns about the robustness and adequacy of the safety net system during the COVID-19 crisis. Collectively, these measures

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<sup>51</sup> These reviews are a new requirement under the same measures adopted in Prior Action 6.



are first steps to a more citizen-centric and responsive government and help strengthen the effectiveness and inclusion of the ongoing transformation in Uzbekistan.

**117. The proposed operation will serve as the basis for the disbursement of about US\$140 million of budget support by the Government of Japan and was prepared in close collaboration with a range of partners that are supporting Uzbekistan’s economic and social transition.** As part of the Government of Japan’s COVID-19 support to Uzbekistan, the Japanese International Cooperation Agency (JICA) will provide ¥15 billion (about US\$140 million) of budget support to the Government as parallel financing against this operation, following Board approval. In addition to the close partnership with JICA officials to design and implement the proposed operation, the Bank continues to support reform implementation in Uzbekistan in close coordination with other partners. The IMF and the World Bank work closely to assess the adequacy of the macroeconomic framework that anchors their respective operations and engagements. Both agencies remain committed to close cooperation to ensure that technical assistance is well-coordinated and effective. The United Nations Development Program (UNDP) has provided considerable analytical and legal support to the Government and to the World Bank on the measures to guarantee equal opportunities and end gender-based violence. In addition to the Government of Japan, the Bank is also working closely with ADB, the EU, and the Government of France, which are also providing budget support to the authorities. The Bank is also working closely with EBRD and ADB on energy, SOE, PPP, and financial sector reform, 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 USAID on the trade and WTO reforms. Importantly, the Bank and the International Labor Organization (ILO) share a strong common interest in eradicating forced labor and improving labor market outcomes.

## 5. OTHER DESIGN AND APPRAISAL ISSUES

### 5.1. POVERTY AND SOCIAL IMPACT

**118. Overall, the proposed 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. Four actions are expected to have positive poverty and/or distributional implications, including relaxing constraints to internal mobility, the improvement of social safety nets, measures to improve gender equality and the safety of women, and measures to strengthen fiscal transparency and local budget involvement. Two actions could potentially increase the short-term incidence of poverty and/or entail short-term negative social impacts, while at the same time generating progressive distributional outcomes. These are policy actions to reform the banking sector and remove petroleum subsidies. The action relating to the removal of the cotton state order is expected to have a positive distributional impact but could have negative poverty impacts on certain vulnerable groups. Where negative effects are present, they are not unprecedented or irreversible, and mitigation measures through the social protection system (and being considered as part of future utility tariff reforms) could moderate the expected poverty impacts relating to these actions.

**119. The reform of the banking sector, and most notably the reduction of preferential lending, may have negative poverty effects.** Although support to small entrepreneurs is a small share of overall state-directed subsidized lending, these programs are progressively distributed. As a result, without mitigation, the reduction in preferential lending is expected to reduce financial support to program beneficiaries, who are predominantly low-income families. To partially mitigate this effect, the Government has exempted social housing lending, one of the larger social lending programs of government, from the new restriction on preferential lending. The intention of this exemption is to provide a buffer for the most vulnerable affected by this measure, while still supporting a strongly downward trend in preferential lending. By contrast, the Government lending program to encourage entrepreneurship, which is considered as relatively poorly targeted to the most vulnerable citizens, will be set at the central bank reference rate. On balance, reduced lending on preferential terms to firms is likely to have indirectly progressive distributional



effects, as employment in privileged sectors is more remunerative than average. However, reduced lending also moderately increases the risk of job losses in previously advantaged firms.

**120. Measures to end the state production and procurement targets for cotton are likely to have net positive effects but could negatively affect certain vulnerable groups.** Positive social and poverty-related effects stem from withdrawing a crucial driver of the use of forced labor in the cotton sector. As a defining human rights issue, reducing these risks will result in large positive social value. However, a reduction in the expected size of the cotton sector could have negative employment implications for workers located in low growth areas. Low-income people and women are over-represented among those who voluntarily work in cotton harvesting. A substantial proportion of marginal cotton growing areas have been released from cotton growing requirements since 2016 (about 350,000 hectares, or 25 percent of the cotton growing area in Uzbekistan), helping to mitigate this risk. Although reliable data are not available, anecdotal evidence has shown instances of internal labor migration of workers from low-yielding regions with low demand for cotton pickers, to more productive regions where there are labor deficits. Furthermore, rapid mechanization of cotton harvesting is unlikely to occur, with relatively low wages for cotton pickers, high capital and machinery investment costs, poor quality of less expensive domestically manufactured harvesters, and the need for substantial investments to change cotton planting techniques that are needed for mechanized harvesting. This is likely to further mitigate risks of rapid labor displacement. Nonetheless, without mitigation measures there is modest risk of increasing poverty among these populations. The Bank is working with the authorities to monitor this situation and support necessary adjustments to social safety nets. In addition, the Government recently adopted additional measures to help address labor market disruptions of all kinds. In October 2020, Parliament approved a new employment law that includes provisions to subsidize the creation of new employment positions, which will defray the costs of hiring an expected 900,000 low-wage workers. The law also includes larger subsidies for businesses hiring people identified as socially vulnerable, including those who have recently lost jobs or are unable to find other work. These programs are expected to mitigate the potential worker displacements in the cotton sector, in addition to existing social assistance programs and the broader safety net.

**121. Low fuel prices will lead to neutral short-term effects from the removal of fuel subsidies.** Petroleum prices have *decreased* by between 10 to 15 percent since the adoption of Prior Action 3, in response to falls in global oil prices. Historically low prevailing unsubsidized prices on petroleum products are expected to mitigate potential negative poverty effects from the removal of fuel subsidies in the short-term. In the medium term, removing state subsidies is expected to generate progressive distributional impacts (as the subsidy is typically distributed regressively). Removal of subsidies creates moderate risks of increased poverty incidence in the medium term through two channels: (i) directly increasing the cost of petroleum use (modest risk due to low consumption amounts among poor and vulnerable; and (ii) indirectly increasing the cost of goods and services (moderate risk). Newly introduced monitoring tools—including both the modernized household budget survey and national consumer price surveys—will improve on the Government’s ability to identify these risks if they materialize. The conventional practice of annually adjusting the value of transfers, the minimum wage, and social benefits to account for the cost of living is expected to provide substantial mitigation. Furthermore, existing government practices to manage inflation through monetary policy channels, which are being significantly improved through financial sector reforms supported under this operation, are also expected to partially mitigate these potential impacts.

**122. Measures to further liberalize internal migration are expected to have large positive social and economic benefits for the poor.** Internal migration is largely rural-to-urban, with Tashkent City the primary destination. This reflects the strength of the labor market in Tashkent, with an employment-to-population ratio of 57 (compared with a national average of 42). About 68 percent of households residing in Tashkent reported higher wage income in the month preceding the L2CU baseline, compared with about 50 percent nationally, and total household income from wages (among those with some wage income) was about 85 percent higher in Tashkent than the



national average. Individuals who recently migrated to Tashkent report higher incomes and better employment outcomes than the national average. Steps taken under these reforms are expected to bring the country significantly close to full and free mobility, and as such are expected to be positive. Further reductions in formal and informal impediments to internal mobility would be expected to lead to even larger reductions in poverty and progressive distributional outcomes. However, these reforms do not occur in isolation from other policy considerations. In the absence of responsive urbanization policy and investments in public services, there are moderate medium-term risks of overcrowding and insufficient social infrastructure to support an influx of domestic migrants in high-demand areas. In the short term, these concerns are moderated by the higher cost of living in Tashkent and other in-demand areas (especially due to housing costs). Recent World Bank research on this subject suggests that policies to expand social services in areas experiencing (or expecting) population growth while allowing the housing supply to respond to demand is likely to mitigate crowding concerns and encourage progressive distributional outcomes.

**123. Measures to improve fiscal transparency, increase equality of opportunities for women, and reduce gender-based violence are expected to have significant positive social effects.** The prior action on fiscal transparency is expected to have positive social effects via increased local participation in budget management and improved improving transparency of public revenues and spending. More than 80 percent of respondents to the L2CU survey respond that “Citizens should have more opportunities to participate in important government decisions.” Measures to strengthen gender equality and reduce gender-based violence are also expected to have strong positive benefits. The establishment of a legal basis to challenge discriminatory practices and strengthening the recourse available to women who are survivors of violence are likely to have significant and immediate social benefits. They are also likely to create far-reaching positive effects on the economic and social welfare, voice, and participation, of future generations, with benefits accruing especially to women.

**124. The expansion of safety nets during the COVID-19 crisis, and the full rollout of the unified social registry are expected have positive poverty, social, and distributional impacts, with some risks to vulnerable people if improperly implemented.** The immediate expansion of safety nets during the COVID-19 crisis has clear positive poverty and distributional impacts via cash transfers to poor and vulnerable households, especially those economically affected by the pandemic. A World Bank review of these programs published in 2019 found them to be highly progressive in distributional terms and effective in reducing poverty among those who receive support. Ongoing World Bank monitoring in 2020 confirms these progressive distributional features remain. The rollout of the unified registry is expected to improve the identification of beneficiaries in the medium term and may reduce exclusion errors due to inadequate information on potential beneficiaries. However, the rapid rollout of the registry before establishing effectiveness (and any improvement it provides in comparison to existing systems) generates risks of inadvertently reducing the efficacy of the social assistance system. The World Bank is an implementing partner for the new system and will work closely with the Government to monitor the quality of implementation, which has been set as an explicit result indicator for this operation to minimize negative poverty or social impact.

**125. Early investments by the Government in managing potential social risks will be critical to 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. A strong legal and



accountability framework combined with a transparent and competitive process are necessary to mitigate the high risk of privatization being compromised by vested interests. Furthermore, extreme caution is necessary to ensure the accurate and open valuation of assets, and to minimize risks of creating private monopolies. The actions supported under this operation are intended to support the Government in setting out a clear strategy for the reform and privatization of SOEs, focusing on the rationale for state ownership and the transparency and competitiveness of privatization processes.

**126. The privatization process supported by this operation focuses largely on small SOEs, consistent with the Government's strategy to first divest smaller enterprises with lower social and fiscal risks.** All 479 SOEs identified for the first phase of sales have an estimated valuation of less than US\$10,000 each, and initial government estimates of total employment in all 479 SOEs range between 2,500 to 4,000 people. The enterprises being sold are in sectors of the economy where a significant private sector presence already exists (e.g., wineries, printing presses, car repair garages). In addition, the new State Tender Commission requires social obligations to be considered and effectively managed by the Government before a sale authorization is granted. These obligations include the settlement of all wage and severance obligations, and any support that displaced workers are entitled to under new employment legislation that has increased amounts payable to unemployed workers.<sup>52</sup> The authorities have reiterated their strong commitment to minimizing any potential labor displacement effects arising from privatization and SOE reform. This is consistent with the Government's overall objectives of ensuring that any major reforms are appropriately assessed for their social and employment impact, and that appropriate mitigation measures are included as part of any approved measures. The World Bank is working with the authorities, through its DPO engagements and via support under the Institutional Building and Strengthening the Social Protection System loans, to strengthen financial and operational transparency, and to improve data quality on SOE employment to better understand the potential impact of SOE privatizations on employment in Uzbekistan. The Government is also working closely with other partners, such as the EBRD and ADB, to strengthen social policy considerations as part of the SOE reform and privatization process. These factors are expected to mitigate the social impact of this first phase of privatization. Lessons from this phase will enable the Government to improve support for displaced workers as it prepares for the privatization of bigger enterprises that employ larger numbers of workers.

**127. It is likely that some loss-making SOEs are effectively subsidizing consumer and producer prices.** Probable instances include in energy, agriculture, and in other sectors with heavy price regulations. SOE reorganizations are likely to entail efficiency measures to achieve cost-recovery and reach profitability. Thus, privatization may generate negative social and poverty-related impacts through rising prices. Furthermore, privatizations that generate private monopolies or the markets with low competition may also generate negative social and poverty related impacts.

## 5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

**128. The existing Environmental Impact Assessment (EIA) and management system in Uzbekistan is robust but requires renewal to ensure it can meet the needs of a transitioning economy.** EIAs are required for activities that are regulated under four categories of incrementally higher environmental risk. EIAs are conducted in either one or two stage processes, depending on the level of environmental risks arising from activities. Higher-risk projects require a two-stage process with draft declarations on environmental impact required at an early stage of the decision-making process, before projects are approved and financed, and a declaration of environmental consequences required after project construction and before commissioning. Since 2018, the State Committee for Ecological and Environmental Protection has also been empowered to require a three-stage EIA process for certain

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<sup>52</sup> The new Employment Law comes into effect on January 1, 2021, before which the commencement of privatizations is not expected.



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, it needs modernization, transparency, and institutional strengthening.

**129. The Government is making efforts to address gaps in the EIA framework.** Improvements that are needed include improved environmental standards, extended time limits to allow for more robust EIAs to be conducted, greater conformity with international conventions relating to EIAs and public participation in environmental matters and expanded scope of EIA coverage to include transboundary contextual assessments. The Government is 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. A new Environmental Code is under development to overhaul and modernize the existing environmental management system.

**130. The Government has significantly strengthened its focus on environmental issues over the past year.** 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.<sup>53</sup> 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.

**131. Most actions supported under this operation have a neutral or positive impact on the environment, but two actions carry potentially negative effects that could be mitigated through better integration of environmental considerations in the policymaking process.** Based on the application of the provisions of the World Bank Toolkit,<sup>54</sup> actions pertaining to cotton, renewable energy PPPs, and SOE reform will require careful integration of

<sup>53</sup> To achieve this goal, an afforestation program has started covering about 700,000 hectares (ha) of dry Aral Seabed with drought-resistant plants, representing a 40 percent increase from the previous year.

<sup>54</sup> “Assessing the Environmental, Forest, and Other Natural Resource Aspects of Development Policy Lending” [http://www.wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2010/08/18/000356161\\_20100818054032/Rendered/PDF/561680WP0Box341IC10WBDPLToolkitCRA1.pdf](http://www.wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2010/08/18/000356161_20100818054032/Rendered/PDF/561680WP0Box341IC10WBDPLToolkitCRA1.pdf)



environmental policy issues to avoid longer-term adverse environmental impacts. While these actions have the potential to generate considerable positive effects, such as strengthening environmentally friendly practices, improved natural resource management, and the use of climate change adaptation technologies, there are also risks of land and biodiversity degradation, soil and water pollution, occupational hazards, and poorly managed legacy environmental liabilities. Negative effects arising from agricultural reforms are sometimes associated with areas considered priorities for agricultural development in Uzbekistan: intensive orchards and/or vineyards expansion, construction and operation of new greenhouses, construction and/or rehabilitation of irrigation schemes, construction, and operation of new agricultural processing enterprises. Although the area of focus under this operation is non-hydro renewable energy, measures adopted through the prior action supported will benefit all infrastructure projects, including potential hydroelectric projects. If increased investments in small hydropower, wind turbines, or biogas production are made without considering environmental requirements, these could also lead to negative environmental and health impacts and risks.

**132. The cotton sector reforms supported in this operation are likely to be positive for the environment but may create risks depending on adopted technologies.** The proposed measure will help address climate related vulnerabilities and help the country strengthen climate resilience of the agriculture sector. It can also support transformational change toward low-carbon growth in the agriculture sector, as the climate-smart agriculture aims to increase productivity while lowering emissions per calorie or unit weight of food produced, where possible. However, depending on adopted technologies, and given capacity constraints, it could also potentially lead to pollution and environmental degradation from fertilizers, pesticide use, inefficient water use, or the poorly planned introduction of new seed varieties. To mitigate these risks, the ongoing implementation of the World Bank's agricultural modernization project is supporting enhanced country frameworks for integrated pest management, improved water management, and the adoption of international best practices for the introduction of new seeds. Simultaneously, the new environmental code and measures to accelerate the green economy are likely to help provide a stronger regulatory environment that promotes environmentally sound practices in agriculture.

**133. Measures to reduce fossil fuel subsidies are likely to have a positive effect on the environment over the medium to long term.** Globally, ending government subsidies of fossil fuels has long been cited as an important way to reduce GHG emissions. Fuel subsidies make energy more affordable and accessible; however, they also create price distortions and structural risks for government budgets, encourage wasteful consumption, and push up emissions in the long run. Canceling the of retail price regulation on petroleum products is expected to have a curbing effect on demand and encourage the use of cleaner alternatives, which will lead to positive environmental impacts including reduced GHG emissions. It could also reduce vehicle usage and growth in the economy. However, there could be unintended consequences that offset some positive effects by a shift to highly polluting substitute fuels like coal or biomass, or to other subsidized fuels such as natural gas, which although cleaner than petroleum, may discourage the adoption of renewable and energy efficient technologies. These risks are likely to be low in Uzbekistan, contingent on the Government's decision to achieve full cost-recovery and end all subsidies in the gas sector. In addition, with global petroleum prices remaining low and expected to stay low for a few years, there is likely to be a delay in emission reductions that would normally accompany the removal of such a price regulation.

**134. Reforms to support increased non-hydroelectric renewable energy investments are likely to be environmentally positive, but the supported measures may also create environmental risks through an increase in hydroelectric generation.** Promoting renewable can have long-term beneficial environmental and climate effects (less emissions and environmental pollution) due to increased proportion of alternative energy and switching from fossil fuels. However, increased investments in hydroelectric power generation can have adverse environmental effects (environmental pollution; land, water, and biodiversity degradation; occupational hazards) in case renewable energy subprojects (for biogas production; construction of small hydropower stations; construction of wind turbines)



are implemented without adequate integration of environmental requirements into the project design. The key mitigation mechanism against this risk is the strengthening of the country's overall environmental assessment and regulatory system. Furthermore, the process of awarding licenses to the private sector, and selecting and appraising specific investments, should include upstream clear guidance on managing environmental and social impacts, especially for hydropower projects where land use and cumulative impacts need to be assessed at the watershed/basin level. The Government is addressing these issues through the new environmental code, with support from the United Nations. The Government is also working with partners to strengthen the quality of oversight over environmental assessment assessments and statements.

**135. As the Government's privatization process expands, legacy environmental issues will constitute an important consideration for the Government in any ownership transition processes.** The SOEs envisaged for privatization under measures supported by this operation are expected to have no major environmental obligations or liabilities. However, as the Government's privatization program expands—especially to companies in the chemicals, manufacturing, and fertilizers sectors—the Government's simultaneous overhaul of the environmental code and privatization legislation is expected to provide more clarity on the requirements for how legacy environmental obligations and liabilities should be treated. The World Bank will support these actions through the on-going efforts to deepen the environmental policy dialogue with the authorities, including through the DPO platform. Environmental considerations linked to these prior actions are also embedded in the World Bank's project engagements in the agriculture sector, in strengthening SOE reform institutions, and in the energy sector.

### 5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

**136. 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.

**137. The Government has taken credible steps to develop and implement an ambitious PFM reform strategy.** This strategy covers a range of measures aimed at strengthening budget preparation and execution, public sector accounting, treasury systems, as well as improving legislative base for PFM reforms. The Treasury Single Account (TSA) has been introduced and made functional. In addition, the Government made a 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.

**138. Progress to strengthen the Chamber of Accounts (CoA), the country's Supreme Audit Institution, is still in the initial phases of its development.** A new law to strengthen the CoA was approved by Parliament in July 2019, which clarifies and expands the institutional mandate of the CoA to go beyond financial and compliance audits to include regular efficiency and performance audits of government agencies. Staffing levels have increased, and the CoA is routinely conducting compliance and financial audits. Limited progress has been made on efficiency and



performance audits, but the more urgent priority is the need for alignment of Uzbekistan's public audit practices with international standards of supreme audit institutions. The Government continues to implement comprehensive reforms to strengthen capacity of CoA staff to enable them to transition from basic financial information validation audits to compliance and performance audits. The Government is also investing in the introduction of the IT-based tools and solutions for strategic and annual audit planning, fieldwork, reporting, monitoring of recommendations, and audit quality control.

**139. The foreign exchange control environment at the Central Bank of Uzbekistan (CBU) is assessed to maintain overall adequate operational control over its exchange reserve management.** The CBU has been audited regularly by internationally recognized audit firms and received satisfactory audit reports. In particular, the 2019 audit of the CBU's consolidated financial statements was conducted by an international audit firm, which issued an unmodified opinion on the financial statements.<sup>55</sup> However, financial statements are not prepared in accordance with IFRS, but rather in accordance with internal accounting and reporting procedures issued by the CBU. The audit was conducted in accordance with International Standards on Auditing (ISA). The audited financial statements of the CBU are not made publicly available and the Audit Report is for restricted official use. The accompanied Management Letter issued by the auditor did not report any internal control issues.

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

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

**142. Parallel financing from the Government of Japan is expected to be approved and disbursed, following Board approval of this proposed operation.** In response to the COVID-19 pandemic, the Japanese government, working through the Japanese International Cooperation Agency (JICA), is working closely alongside the World Bank and the Government to provide additional financial support to help address domestic finance needs while enabling the Government to continue with reform implementation. A notable area of interest for JICA has been in the energy sector, where JICA and the Government are continuing to cooperate and identify new financing opportunities. In

<sup>55</sup> 2019 Audit reviewed on October 19, 2020.



addition to funds in this operation, a further ¥15 billion (about US\$140 million) is expected to be approved and disbursed subject to Board approval of this operation. JICA will rely on the World Bank's assessment of prior actions, as well as its poverty, environmental, and social risk assessments. JICA will also rely on the World Bank's fiduciary assessment of Uzbekistan's PFM systems. JICA will provide approved funding directly to the Government, using its own fiduciary arrangements and requirements, and will rely on the World Bank's completion and evaluation processes to assess the results of its support. The World Bank and JICA have committed to continue working closely to support Uzbekistan's reform program, and to exploring further opportunities to formally collaborate on future operations.

**143. 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.

**144. 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

**145. 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).

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

## 6. SUMMARY OF RISKS AND MITIGATION



**147. The overall risk to the operation is moderate as Uzbekistan approaches its fifth year of a strong, sustained, and systematic reform program.** 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. Although the complexity of reforms is increasing, for example in areas such as factor market reforms, SOE privatization, and the liberalization of cotton production, the Government has established a track record of ameliorating negative social impacts, maintaining strong economic management, and strengthening citizen and media engagement processes. Although the COVID-19 crisis is likely to increase implementation challenges for the Government, it has also provided momentum to accelerate change processes in the health and social safety net systems and has created opportunities for the Government to build a more sustainable economy. These changes are likely to further moderate the risk environment in Uzbekistan over the longer-term. Nevertheless, the complexity of the next phase of reforms envisioned by the Government, and the continued management of the COVID-19 crisis, requires careful management of economic and social risks, and a firm commitment to maintaining macroeconomic discipline to rebuild buffers over the medium term. The most significant risks for this operation are institutional capacity, social, and environmental. Other risks are assessed to be moderate or low (Table 6).

**148. Institutional capacity for implementation and sustainability risks are substantial due to the impact of the COVID-19 pandemic, the fast pace of reforms, and the formative stage of many critical government institutions.** The continued high number of COVID-19 cases risks overwhelming administrative capacity, in both the expanded breadth of challenges that the authorities are confronting, as well as infection risks to public officials. Institutions also remain under significant pressure to maintain a strong pace of reforms. The situation is improving, albeit slowly, with an increased number of sector line ministries being tasked with responsibilities to reduce pressures on 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 attract global diaspora talent to return to Uzbekistan for temporary assignments, increasing knowledge and expertise in-house. The Government is well-aware of these risks and is also working closely with the World Bank and other institutions to receive expert assistance and policy advice. The economic council will help improve coordination of this work.

**149. Environmental and social risks remain substantial, largely due to social risks arising from the implementation of more complex reforms.** The ambition and pace of the reforms being implemented will continue to create social risks during the transition. Although popular support for the reforms remains strong, the COVID-19 crisis, and the Government's policy response, especially on the adequacy of social assistance, has generated increased public discussion and criticism.<sup>56</sup> The Government has responded to these criticisms by significantly strengthening audit and anti-corruption oversight of social protection expenditure, and extending anti-crisis support measures beyond their intended expiry dates. Looking ahead, measures to privatize banks and SOEs, and further measures to strengthen utility cost recovery are likely to be the key issues that will require close monitoring. As experiences of other transition economies demonstrate, such complex reforms—if poorly implemented and inadequately socialized—can create social disquiet and threaten the sustainability of the reform agenda. Key risks include land reform and mandatory land acquisition policies, corruption, and capture of state resources by vested interests. These risks are exacerbated by a still weak social accountability framework that could enable the Government to cooperate

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<sup>56</sup> Citizen concerns have centered on coverage gaps, insufficient funding, and sporadic instances of misappropriation by local officials.



with citizens and civil society to more effectively monitor and report on triggers that lead to the materialization of social risks.

**150. The Government is aware of these risks and has taken several positive measures to mitigate social risks.** To minimize social risks, almost all reforms go through a process of public consultation,<sup>63</sup> and reforms with large poverty and social impact are accompanied by analysis-based mitigation measures, such as additional social safety net increases. This approach was used successfully in previous reforms to liberalize bread prices and increase energy tariffs and will be used to mitigate potential social risks in this operation, such as those arising from Prior Action 5 (SOE reform). The Government has also increased its efforts to communicate and disseminate information about progress with reforms more frequently and has become more open to citizen and media engagement and feedback. Greater media scrutiny of government policies and the conduct of public servants has led to several instances where significant policies have been completely overhauled to address weaknesses. In addition, the Government has also prioritized reforms that help deliver quick and visible results to citizens, particularly through reforms in agriculture, improvements in public service delivery and transparency, the removal of *propiska* controls, and the expansion of social safety nets. Prior to the crisis, measures to increase inclusion had already begun to have an effect through higher rural incomes and increased private consumption in the economy, creating strong public support for continued reforms.

**151. Environmental risks are also increasing.** Although measures supported under this proposed operation are not likely to increase environmental risks significantly (as reinforced in the environmental assessment of this proposed operation), environmental risks are likely to increase under this more complex phase of reforms. The Government's eventual privatization and reform of SOEs (the first phase of which is supported by Prior Action 5 in this operation), especially in the chemicals and extractive sectors, will require a sustained engagement from development partners to ensure that appropriate regulations and enforcement is in place to support an environmentally sustainable reform process. To mitigate this risk, the Government has adopted several initial measures to establish environmental principles that will guide the transition process and is in the advanced stages of adopting a modernized environmental code in line with good international practice. Effective implementation of the new code will be critical to minimizing environmental risks. Risks of soil salinity and erosion, land and water pollution, and desertification also pose risks to the ambitious agricultural modernization agenda supported under Prior Action 2 in this operation. These risks are being mitigated by the Government through forestation initiatives, support for investments in improved technologies for land management, improved environmental regulations, and the overhaul of ageing irrigation infrastructure.

**152. Macroeconomic risks are moderate but require close monitoring during the COVID-19 crisis.** Uzbekistan's twin (external and fiscal) deficits remain sustainable, despite the increase in the projected budget deficits in 2020 and 2021 due to anti-crisis spending and weaker revenues. Although public debt will increase more than projected before the crisis, debt sustainability risks are assessed as low, and with about 50 percent of GDP in foreign exchange reserves, Uzbekistan's external buffers remain healthy. The increase in debt to finance the wider deficit will support much needed anti-crisis spending in the economy that will help mitigate the buildup of other social, political, and governance risks, making the use of buffers an entirely appropriate strategy during the crisis. To preserve and rebuild these buffers, the Government is committed to a fiscal consolidation pathway, starting in 2022, to bring the budget closer to balance, and to accelerate efforts—especially in energy, agriculture, and infrastructure—to transfers the costs of investment and modernization from public to the private sector. The SOE reforms supported under this operation will also help the Government better identify and limit fiscal risks, both through stronger corporate governance and oversight, as well as through the privatization of non-performing and non-strategic SOEs. Credit growth in the economy, which was a source of concern between 2017 and 2019, has begun to moderate as state-directed lending, especially on preferential terms, falls. Any reversion to high levels of state-directed credit remains



a risk to financial sector and inflationary risks, but these risks are moderated by significant efforts in recent years to improve capital buffers in the banking system, increase lending rates to reduce market distortions, and reduce the transmission of credit-related risks arising from UFRD lending into the wider financial system.

**Table 6: Summary risk ratings**

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



**ANNEX 1: POLICY AND RESULTS MATRIX**

Prior actions and Triggers	Results		
Prior Actions under this operation	Indicator Name	Baseline	Target
<b>Pillar 1: Improving the efficiency, sustainability, and transparency of resource allocation in the economy</b>			
<p><b>Prior Action 1:</b> To increase the efficiency of financial resource allocation and strengthen transparency in the banking sector in implementation of the Government’s approved banking law and financial sector reform strategy, the Borrower has:</p> <ul style="list-style-type: none"> <li>(i) prohibited all new on-lending to State Owned Enterprises (“SOEs”) by state commercial banks using subsidized funds from the Uzbekistan Fund for Reconstruction and Development (“UFRD”);</li> <li>(ii) required all new commercial bank lending in local currency, from 1 January 2020, to be at interest rates at or above the central bank reference rate, except for government loans for mortgage lending and the production of raw cotton and grains; and</li> <li>(iii) appointed at least one independent director, consistent with requirements in the Banking Law, to each of the boards of at least ten state-owned commercial banks.</li> </ul>	<p><b>Result Indicator 1:</b> The stock of outstanding loans classified as commercial by the Central Bank of Uzbekistan, as a share of the stock of all outstanding banking sector loans.</p>	<p>36 percent (end-2019)</p>	<p>More than 60 percent (end-2021)</p>
	<p><b>Result Indicator 2:</b> Number of state-owned commercial banks boards where the majority comprises independent directors, consistent with requirements in the Banking Law.</p>	<p>Zero (Jan 2020)</p>	<p>At least 5 (end-2021)</p>
<p><b>Prior Action 2:</b> In accordance with the Borrower’s agricultural modernization strategy to increase climate resilience, diversify agriculture, increase the transparency and efficiency of land distribution, and eliminate state agricultural production, the Borrower has abrogated the state cotton order system by removing mandatory cotton production targets and mandatory state procurement of cotton.</p>	<p><b>Result Indicator 3:</b> An increase in cotton growing area with adopted climate-smart farm technologies.</p>	<p>160,000 hectares (end-2019)</p>	<p>300,000 hectares (end-2021)</p>
<p><b>Prior Action 3:</b> To reduce inefficient fossil fuel subsidies, the Borrower has abrogated the State’s regulation of the retail price of AI-80 petroleum, diesel, and ECO diesel.</p>	<p><b>Result Indicator 4:</b> Retail prices of all unleaded petroleum (AI80 and above) and diesel (including ECO Diesel) are determined by the market and free of direct government subsidies.</p>	<p>Retail price set by government decree with provisions for direct subsidies (March 2020)</p>	<p>Retail price determined by commodity exchange trading and is not directly subsidized by any regulatory legal acts (end-2021)</p>



Prior actions and Triggers	Results		
<p><b>Prior Action 4:</b> To enhance the enabling environment and transparency of public-private partnerships (“PPPs”) in the renewable energy and other infrastructure sectors, the Borrower has submitted legislative draft amendments to the PPP and Currency Regulation Laws, for Parliamentary approval, to:</p> <ul style="list-style-type: none"> <li>(i) allow the Government to enter foreign currency financial commitments in PPP concession agreements and allow financial compensation to be paid to investors against losses which may arise from changes to legislation in force on the date of the partnership agreement; and</li> <li>(ii) strengthen public information disclosure requirements for PPP tenders and PPPs under implementation.</li> </ul>	<p><b>Result Indicator 5:</b> Megawatts of renewable energy generation capacity that have been transparently and competitively tendered as PPPs, consistent with the PPP Law, and whose tender process has been concluded.</p>	<p>100MW (September 2020)</p>	<p>500MW (end-2021)</p>
<p><b>Prior Action 5:</b> To improve the financial transparency and performance of state-owned enterprises (SOEs) and reduce state ownership of assets, the Borrower has:</p> <ul style="list-style-type: none"> <li>(i) required 32 of the largest SOEs by financial valuation to (a) adopt international financial reporting standards, (b) prepare enterprise financial recovery strategies, and (c) obtain international credit ratings starting from 2021; and</li> <li>(ii) approved a list of SOEs that will be divested of government ownership via a competitive process.</li> </ul>	<p><b>Result Indicator 6:</b> An improvement in government institutional arrangements to support a more systematic approach to privatization.</p>	<p>SCTSSP does not exist, and privatizations are approved on a case-by-case basis. (October 2020)</p>	<p>SCTSSP is established and has commenced the valuation and determination of sale methods for SOEs listed for divestiture under the approved Resolution (end-2021)</p>
<p><b>Prior Action 6:</b> To increase fiscal transparency and strengthen public ownership of the State Budget, the Borrower has enacted amendments to the Budget Code of the Republic of Uzbekistan to:</p> <ul style="list-style-type: none"> <li>(i) vest the Parliament, Jokargy Kenes, and regional kengashlar with the responsibility of approving their respective budgets; and</li> <li>(ii) incorporate the income and expenses of the Uzbekistan Fund for Reconstruction and Development in the State Budget Law draft.</li> </ul>	<p><b>Result indicator 7:</b> Increased transparency and accountability of the general government budget.</p>	<p>UFRD income and expenses not included in the consolidated government budget approved by Presidential Decree (2019)</p>	<p>UFRD income and expenses included in the consolidated 2020 and 2021 State Budgets, and all supplementary budgets in those years, that are approved by the Parliament (end-2021).</p>
<b>Pillar 2: Enhancing economic inclusion and social resilience</b>			
<p><b>Prior Action 7:</b> To increase domestic labor mobility, improve access to public services such as health and education, and expand economic opportunities for</p>	<p><b>Result Indicator 8:</b> A decrease in the annual number of peopled</p>	<p>317,088 (2019)</p>	<p>Less than 125,000 (end-2021)</p>



Prior actions and Triggers	Results		
<p>citizens, the Borrower has: (i) reduced restrictions on the issuance of new residency registrations by expanding eligibility criteria for registration in Tashkent and (ii) simplified and digitized residency registration procedures.</p>	<p>fined by the Government for violations of place of registration rules.</p>		
<p><b>Prior Action 8:</b> To reduce barriers limiting the full economic participation and safety of women, the Borrower has issued regulations to further implement legislation: (i) guaranteeing non-discrimination on the basis of sex for employment, electoral candidacy, and for access to state resources; and (ii) for the issuance, enforcement, and monitoring of protection orders for survivors of gender-based violence.</p>	<p><b>Result Indicator 9:</b> The establishment of referral pathways for survivors of gender-based violence.</p>	<p>No legal basis for complaints or referral pathways for survivors of gender-based violence. (June 2019)</p>	<p>Referral pathway for gender-based violence survivors, compliant with WHO standards, has been adopted and disseminated. (end-2021)</p>
<p><b>Prior Action 9:</b> To increase support for vulnerable households during the COVID-19 crisis and to further strengthen the efficiency and transparency of the social safety net system and its responsiveness in targeting people affected by future sources of vulnerability, including climate vulnerable groups, the Borrower has:</p> <ul style="list-style-type: none"> <li>(i) increased by 10 percent the number of beneficiaries receiving low-income family allowances and waived re-registration requirements for existing low-income family allowance recipients, in response to the COVID-19 crisis; and</li> <li>(ii) approved the transition of all regions in the country to using the Single Registry of Social Protection to process applicant registration, beneficiary selection, program enrollment and payment orders.</li> </ul>	<p><b>Result indicator 10:</b> A decreasing share of low-income allowance applications with income below the eligibility threshold that are rejected because of lack of registration with the Employment Service Center.</p>	<p>48 percent covering only the <i>Sirdarya Viloyati</i> pilot region (August 2020)</p>	<p>Less than 30 percent nationwide (end-2021)</p>



ANNEX 2: FUND RELATIONS ANNEX

Republic of Uzbekistan—Assessment Letter for the World Bank  
October 23, 2020

Recent Developments and Outlook

- 1. Uzbekistan, like most other countries, has been hit hard by the COVID-19 pandemic, adversely affecting its people and economy.** The authorities responded quickly and decisively with measures to mitigate the impact of the pandemic, while ensuring macro-economic stability. This included measures to contain the pandemic and to protect people's lives and livelihoods, including through the Anti-Crisis Fund that was set up at the onset of the crisis.
- 2. Economic growth has slowed markedly, although it is still expected to be moderately positive this year.** A fall in trading partner demand and natural gas prices, lower remittances, and lower activity in sectors affected most by the pandemic, particularly tourism and transportation, are weighing on growth. Nonetheless, some sectors, notably construction, are showing strength. Inflation, although still high at just over 11 percent, has gradually come down and with a relatively tight monetary policy stance is expected to decline further toward the Central Bank of Uzbekistan's (CBU) inflation targets. Provided the pandemic gradually abates, growth is expected to pick up to about 5 percent in 2021.
- 3. While the current account deficit in 2020 is projected to remain broadly similar to its 2019 level, at about 6 percent of GDP, trade flows are considerably depressed.**<sup>57</sup> Non-gold exports— notably energy exports and tourism receipts—and remittances are projected to be significantly lower this year, although this is offset by record-high gold prices and much lower imports following the slowdown in domestic activity. The current account deficit is expected to be mostly financed by official financing. International reserves are projected to increase by about US\$3 billion to over US\$32 billion by end-2020 (equivalent to nearly 16 months of imports), largely due to the increase in gold prices.
- 4. The outlook is subject to a high degree of uncertainty and substantial downside risks.** As the pandemic evolves, external risks could arise from a further decline in trading partner demand, a fall in commodity prices—particularly of gold or natural gas—or a further fall in remittances. Domestically, a longer-than-expected duration of the pandemic could result in a further drop in output or a slower recovery.

Economic Policies

- 5. Targeted fiscal support measures have been helpful in mitigating the economic**

<sup>57</sup> At the time of the 2019 Article IV consultation (IMF Country Report No. 19/129), Uzbekistan's external position was assessed as moderately weaker than implied by economic fundamentals and desirable policies.



**impact of the crisis.** This included sizable additional spending on health care and social assistance, and support for small businesses, including tax relief, providing an estimated fiscal impulse of about 4½ percent of GDP. Together with the loss in revenues due to the economic slowdown, this is projected to increase the overall fiscal deficit (including policy lending) from nearly 4 percent of GDP in 2019 to almost 7½ percent of GDP in 2020 (if policy lending is excluded, the fiscal deficit would increase from near balance in 2019 to 4 percent of GDP in 2020). Sizable international support covers a large part of the Government’s financing needs, together with some drawdown of resources from the Fund for Reconstruction and Development. Assuming a gradual economic recovery as the crisis abates, the 2021 budget aims at a gradual fiscal consolidation, while maintaining support to vulnerable households and additional health care spending, aiming to reduce the overall fiscal balance (including policy lending) to about 5½ percent of GDP.

6. **The risk of debt distress is expected to remain low.** With larger deficits in 2020 and 2021 to support people and activity, public debt is projected to increase to about 35 percent of GDP by end-2020, and to peak at just over 40 percent of GDP in 2022. The somewhat higher debt path relative to the last Debt Sustainability Analysis (DSA; see IMF Country Report No. 20/171) could lead to breaches of some DSA thresholds under stress scenarios, suggesting that risks have increased to some extent. The authorities’ commitment, however, to ensure medium term fiscal sustainability and to gradually bring the consolidated deficit back to around 2 percent of GDP in the years ahead provides comfort that public debt will remain manageable. Additionally, existing international reserve buffers and low rollover risk— due to the long-term maturity of debt— mitigate potential distress concerns. Nonetheless, in the aftermath of the pandemic, the authorities should continue to carefully manage external borrowing.

7. **The CBU has lowered its policy rate as inflation has fallen.** Inflation declined from 15.2 percent (year-on-year) at end-2019 to 11.6 percent in September 2020. The CBU lowered its policy rate in two steps from 16 percent to 14 percent in September 2020, thus maintaining a relatively tight stance. With continued strong credit growth, the CBU remains vigilant about a possible resurgence of inflationary pressures. The CBU is aiming to reduce inflation to 10 and 5 percent by end-2021 and 2023, respectively, while allowing the exchange rate to adjust to market conditions. In doing so, the CBU continues a neutral intervention policy, whereby purchases of domestically produced gold are offset by sales of foreign exchange. The UZS/USD exchange rate depreciated by about 8½ percent in the first nine months of 2020, with most of the adjustment taking place during the initial stages of the pandemic.

8. **The CBU has provided ample liquidity to the banking system and encouraged banks to allow firms in affected sectors to defer loan repayments.** Banks are generally liquid and well capitalized, while credit growth remains strong, suggesting that so far banks have been resilient to the effects of the pandemic. Nevertheless, the CBU continues to closely monitor banks’ health, as non- performing loans are likely to increase. Despite the pandemic, financial sector



reforms are moving forward, with a focus on the restructuring of and improving governance at state-owned banks, supported also by International Financial Institutions for some of the main banks. The Ministry of Finance has started to appoint independent supervisory board members at state-owned banks. Looking ahead, the authorities aim to orient state-owned banks more toward commercial lending and to attract strategic investors to support their modernization. Meanwhile, the CBU's efforts will continue to focus on further reducing inflation and safeguarding financial stability.

9. **Although the pace of economic and structural reforms has inevitably slowed reflecting the impact of the pandemic, the authorities remain committed to advancing their reform agenda.** The authorities have continued to strengthen key institutions, including by enhancing capacity at the finance and economy ministries and the CBU, supported by large technical assistance from the IMF and others. They are also improving governance, mainly in state-owned banks and in public financial management, including by increasing coverage of the budget and transparency of crisis spending, and with the establishment of an Anti-Corruption Agency. Progress also continues to be made with tax policy and administration reforms, lifting price controls, including on fuel products, and improving the social safety net. As the pandemic subsides, the authorities are committed to advance further price liberalization, the restructuring and divestiture of state-owned enterprises, and to promote competition and private sector development. This is also needed to help achieve a strong and sustainable economic recovery.

### IMF Relations

10. **Surveillance and financial support.** The IMF Executive Board concluded the 2019 Article IV Consultation on May 9, 2019 (see IMF Country Report No. 19/129). The next Article IV mission is expected to take place in early 2021. In May 2020, the IMF Executive Board approved a disbursement of US\$375 million under the Rapid Credit Facility and Rapid Financing Instrument to support Uzbekistan's response to the COVID-19 pandemic (see IMF Country Report No. 20/171).

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



**ANNEX 3: LETTER OF DEVELOPMENT POLICY**

**O‘ZBEKISTON RESPUBLIKASI**  
**VAZIRLAR MAHKAMASI**



**КАБИНЕТ МИНИСТРОВ**  
**РЕСПУБЛИКИ УЗБЕКИСТАН**

« 09 » November 2020y.

№ 02/1-103-91

Toshkent sh.

**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 envisaged under the Government’s Development Strategy 2017-2021.

**Introduction**

In 2017, as we rapidly mobilized government institutions to prepare for the start of Uzbekistan’s historic economic and social transformation process, I remember reflecting about the significant uncertainties and unknowns that were potentially awaiting us. This January, as the Government once again rapidly mobilized public sector institutions amidst early warnings of an emerging pandemic, I felt a sense of déjà vu, once again reflecting on the unknowns that were potentially awaiting Uzbekistan’s economy. In both cases, despite these uncertainties, the Government’s decision to take bold and decisive action were proven right. As we approach the end of what has been one of the most difficult years in global economic history, I am more confident than ever that the Government, under President Mirziyoyev’s leadership, made the right decision to embark on a path of social and economic reforms. It is a decision that buffered our economy from the worst of the shock, enabled the State to rapidly mobilize and fight the pandemic months before our first case appeared, and helped us save lives, safeguard livelihoods, and preserve the first fruits of nearly four years of sustained reforms. As we look ahead to the fifth and final year of reform implementation under the 2017-2021 Development Strategy, the ravaging effects of the COVID-19 pandemic on our people have only served to harden the Government’s resolve to carry on with the reforms. Going back is not an option. We must move forward, and with the World Bank’s continued support and engagement, I am confident that we will.

In the remainder of this letter, I will outline the Government’s main medium-term reform and policy priorities that form our program with the World Bank. These priorities are organized under three themes.



**Uzbekistan will not be defined by COVID-19.**

**We will defeat the pandemic decisively and emerge from it stronger.**

Since March, when the first case of COVID-19 was detected within our borders, the Government has mounted a swift and decisive anti-crisis response. Following months of institutional mobilization, the Government announced a Republican Anti-Crisis Commission that would lead the anti-crisis response to save lives, safeguard jobs and livelihoods, and maintain reform momentum. This response, which comprises health, social, and economic policy measures backed by a substantial public spending package, has played an important role in containing the worst effects of the pandemic on our society and economy. Many anti-crisis measures, such as the stringent lockdowns imposed in April and May of this year, brought with them heavy economic and social costs, but were necessary to save lives and reduce the pace of viral transmission. To reduce the negative impact of these measures on our most vulnerable citizens, the Government substantially expanded safety nets, provided temporary tax, regulatory, and debt relief measures for affected firms, and maintained state sector employment and salaries. With sustained efforts, the number of cases continues to remain stable, but the Government will not be complacent, and will continue to act decisively to contain and defeat the pandemic.

Over a short period of time, the pandemic has highlighted many challenges that we need to address, such as the need to build a more effective health and pandemic response systems, the need to strengthen and modernize the social safety net system, and the need to have readily accessible fiscal buffers during times of emergency. But these challenges have also created opportunities for the Government to advance reforms that strengthen the resilience and sustainability of our economy and society. The first example of this is the accelerated, nationwide, implementation of a new unified social registry system that was approved last year with support from the last World Bank Development Policy Operation (DPO). The unified registry will not only improve the government's response to the current pandemic as it spills into 2021, but will also create a more robust social safety net system that will better help buffer the most vulnerable to further reforms, and to future economic shocks.

The second example is in fiscal and debt management. Although we have drawn more quickly on our fiscal and debt buffers, we have moved with equal speed to increase the public transparency of government spending and external debt obligations to ensure that people understand where – and to whom – our anti-crisis spending is going, and to maintain a high level of citizen and investor confidence in our economic management. The full 2020 Government Budget has been published for open consultations and feedback, prior to submission to Parliament for approval.



In response to a higher than expected increase in our external debt as a result of COVID-19 financing needs, the government has accelerated the process of preparing and submitting new debt management legislation for Parliamentary approval, which will increase our debt discipline and public accountability, and codify the significant improvements we have made in the transparency of our external debt information. We expect to submit this legislation to parliament in the first half of next year, alongside the adoption of a new medium-term strategic approach to debt management.

A third example of how the pandemic has created opportunities for a better future is in reducing fossil fuel subsidies. With global oil and gas prices at historic lows, and with prices projected to stay low over the medium-term, the government moved quickly to remove all petroleum retail price fossil fuel regulations that have previously been used to subsidize fuel. Instead, we will allow petroleum products to be freely traded and priced by the market and will instead rely on our social safety nets to buffer any future shocks that rising prices may create for our poorest citizens. It is my expectation that we would have eliminated most direct fossil fuel subsidies – through further reforms to reach cost-recovery of energy utility prices once the pandemic has subsided – within a few short years.

**The private sector must become Uzbekistan’s engine of growth.  
The State should be an effective partner, and not a competitor.**

Under the 2017-2021 Development Strategy, one of the highest economic reform priorities has been to reduce the role of the State in the economy. The State’s presence in the economy takes many forms – through ownership of factors of production, through its sizeable ownership of state-owned enterprises (SOEs), and through the many regulations and bureaucratic processes that impose transaction costs on the private sector, and create preferences for SOEs. With this approach having served as the engine of Uzbekistan’s growth over the last two decades, our process to unwind this has naturally been understandably gradual and in a way that minimizes adjustment costs on vulnerable citizens. Under a first preparatory phase of reforms between 2017 and 2020, the government focused on reforms to improve the private sector environment. The transfer from state to private sector cannot happen in a void and following over two decades of burdensome regulations and restrictions, Uzbekistan’s private sector needed room to breathe. To create space for the private sector to emerge, the government took measures to liberalize foreign exchange markets, remove most domestic price regulations, and reform market trading.



Simultaneously, it overhauled the tax system to make it more equitable and efficient; strengthened banking sector capital buffers and prudential oversight to minimize financial sector risks; severely curtailed state-directed lending at subsidized interest rates; removed burdensome business regulations; and liberalized trading and export regulations. In individual sectors where private sector growth has been constrained by dominant or monopoly SOEs, the government has unbundled vertically integrated SOEs that were previously responsible for sector operations as well as government policymaking. Vertically integrated SOEs have been dismantled in the aviation, energy, and road transportation sectors, and new government agencies have been established, separate to the SOEs, to regulate and create effective policies to develop these sectors. These measures are already yielding results in the energy sector, with the conclusion of several private investments, including most notably one of the lowest price-per-kilowatt bids ever received under the World Bank Group's Scaling Solar project. In the aviation sector, the government is moving ahead to concession domestic airports under Public Private Partnership arrangements – a process that is likely to accelerate in 2021.

As the implementation of reforms enters the fifth year, we believe that the time has come to accelerate the process of transformation from a state to private sector economy. There are three major areas where we will focus our efforts over the medium-term.

### ***Agriculture***

We must move faster to unleash agriculture's potential to create prosperity, end poverty, and improve Uzbekistan's connections with the global economy. We are confident that once the discerning global consumer has savored her first taste of Uzbekistan's famous melons, she will never again buy from anywhere else. In October 2019, the Government approved the 2020-2030 Agricultural Modernization Strategy, which sets out a systematic framework for the transfer of the agriculture sector from being largely state controlled, to being developed based on market principles. The approved Strategy explicitly acknowledges the importance of ending state production in cotton and wheat, reforming land tenure and security, reducing water consumption in the sector to increase sustainability, and increasing the diversification of agriculture.

Measures have already been taken to implement this strategy, first through the removal of mandatory state cotton production targets and procurement quotas, and more recently through reforms to enable farmers – especially the most productive *dehkhans* – to sublease land plots. The government has also announced the end, from 2021, of mandatory state wheat production targets and procurement quotas. With this measure, the State would have transformed its role from being the collector of production compulsorily surrendered by



farmers at fixed prices, to a market agent that procures competitively to meet food security requirements. With the removal of these last vestiges of the old state agricultural model, I am confident that we will no longer refer to Uzbekistan's elimination of systematic forced labor, but instead refer to our eradication of this scourge. While it may seem as if we are coming to the end of a significant period of transformation in the agricultural sector, and while this is indeed the case, our work to truly empower agriculture has only just begun. The immense opportunities that agriculture offers Uzbekistan, and the significant potential for this sector to lift the incomes of our rural citizens, who are often among the poorest citizens, is yet untapped. The government will continue to prioritize agricultural development, including through measures to expand private sector led horticultural and livestock production, improved logistics and research, and strengthened connections to regional and global value chains.

### ***Financial sector***

Under the status-quo of the old system, almost all banking sector assets were held by the government, almost all large lending was to the government, and most lending was at pre-determinedly low prices that neutered the effectiveness of monetary policy and forced banks to recover costs through substantially higher pricing to private borrowers. This system is not fit to serve the new Uzbekistan, and it is time to create a real financial sector. Our vision is for the best entrepreneurs with the most promising or valuable ideas, to access enough of the most appropriate types of financing, at competitive market prices, in a manner that preserves the safety of the financial system. To accelerate the achievement of this vision, the government approved, in May this year, a transformative financial sector reform strategy, with a commitment to privatize 10 out of 13 State Owned Banks over the medium-term, reduce market distortions created by state-directed lending, and enable the banking sector to be run commercially. As part of the implementation of this strategy, almost all preferential lending has been curtailed this year, with exceptions only for cotton and grain financing (to smoothen the agricultural transition process) and for social housing projects (to support decent housing for our most vulnerable citizens).

We have moved quickly to establish a new banking reform unit in the Ministry of Finance, which is working with all banks to prepare restructuring strategies and asset quality reviews. Over 20 independent directors have been appointed to the Boards of 10 commercial banks, and one bank's Board now has a majority of independent directors and an independent Board chair.



From next year, interest-rate setting by banks will be fully liberalized to allow banks to make commercial decisions, and where the government chooses to subsidize lending, it will be in the form of explicit on-budget subsidies that are transparent and allow interest rates to be market determined.

The strategy also contains measures, that are already being implemented, to strengthen the financial transparency and corporate governance of all State banks. Notwithstanding the eventual privatization process, it is our commitment even in the interim to rapidly professionalize and commercialize State bank operations, subject them to independent Board oversight and high quality prudential supervisory standards. To advance the privatization process, which will be done transparently and competitively with high standards for potential investors, all State banks have already begun preparing corporate restructuring plans and independent Asset Quality Reviews to enhance transparency regarding bank exposures and the adequacy of their valuations and provisions. The results of these exercises, which has already become available for a few banks, will help guide the privatization plan for each State bank. In the next few years, and with continued support from the World Bank and other partners, our intention is to transform the banking sector from being a vassal to the state's directed lending policies, to an engine of efficient resource allocation elevating the best and brightest ideas and growth opportunities in the economy.

#### ***State-Owned Enterprise reform and privatization***

Close to 3,000 state-owned enterprises continue to delay Uzbekistan's market transition, hindering the creation of new ideas, the adoption of new and innovative technologies, greater productivity and efficiency in the economy, and most importantly the creation of more and better-paid jobs. Although there are valid reasons for State Enterprises to operate in an economy, it has become clear to the Government that most of Uzbekistan's SOEs do not satisfy those reasons. For those that do, the Government has no appetite to expend valuable resources on these SOEs through preferences, subsidies, and protections. Our vision is not just for a radically smaller number of SOEs in the economy over the medium-term, but for each and every SOE – no matter how large or systemically important – to be corporatized, well-governed, and delivering on its profitmaking and social obligations at maximum efficiency.

To accelerate the reduction of the state's footprint in the economy, the government approved, this October, an ambitious SOE reform and privatization program aimed at transforming the operational efficiency, transparency, and oversight of the largest SOEs in the economy, and initiating a privatization process covering about one-fifth of all SOEs in the economy.



As part of this program, and for the largest SOEs, the government has begun to implement reforms to (i) improve financial transparency through the use of IFRS accounting standards; (ii) transform and restructure these large SOEs to improve operational efficiency and minimize fiscal risks; (iii) develop financial recovery plans to strengthen the financial performance of SOEs and their potential sale value should the government ever decide in the future to privatize these enterprises; and (iv) identify and remove benefits and preferences granted to SOEs that undermine competitive neutrality and a level playing field with the private sector. The program also covers the reform and transformation of SOEs in critical sectors of growth, including telecommunications, chemicals, and aviation. The measures to transform these sector SOEs and increase competitive neutrality represent tangible steps towards a comprehensive sector reform agenda in areas of high potential.

To accelerate the privatization process, especially the privatization of smaller businesses that can be readily absorbed by the existing private sector, the Government has identified about one-fifth of all SOEs for privatization. A small number of these SOEs will first be subject to a pre-privatization process to strengthen the value of the company and its investor attractiveness. The bulk of SOEs being privatized, however, are small or unprofitable businesses that can be readily absorbed by the existing private sector. All enterprises approved for privatization will first be subject to a final valuation and clearance process by a special tender commission chaired by the Prime Minister. Once approved, and investment conditions permitting, they will be competitively and transparently divested of government ownership over the course of 2021 and 2022. To accompany this SOE reform and privatization program, the government will adopt several measures within the next few months to strengthen the strategic framework for SOE reform and submit new privatization legislation for Parliamentary approval.

I wish to stress to you that we are ambitious to advance this work quickly, but also that we will not be so hurried as to risk doing it badly or non-transparently. Our intention is to have a competitive and high-quality process, supported extensively by the World Bank and other development partners, that serves as an exemplar to attract the most reputable investors to Uzbekistan, especially for when the time comes to privatize bigger SOEs.

There is also a risk that the continued effects of the pandemic may create unfavorable market conditions for privatization. While this may delay our ability to privatize, it does not mean that we will remain idle and allow the pandemic to stop our progress. Instead, we will carefully monitor the situation, work closely with the World Bank and other partners, and be ready to adapt our reform program as needed, for example by accelerating corporate governance reforms while waiting for market conditions to improve.



Our success will be measured by the growth of a vibrant private sector that takes the place of the State and the creation of more and better-paid jobs. At the same time, our success will also depend critically on the transparency of our processes, the level of public support, and the strength of our safety nets and labor market policies to buffer the negative costs on those most vulnerable to this process. I wish to assure you that these measures of success are constantly in focus for the Government. I am confident that we will eventually create a brighter and more sustainable future through this process, and deliver jobs, prosperity, and well-being for all citizens.

**We will prioritize reforms that put people first.  
Ensuring a broad-based and highly inclusive transition is our  
highest priority.**

During a speech in October 2016 outlining the main priorities for the government, the President of Uzbekistan, turning to his vision for how government agencies and activities would be organized, said, Uzbekistan is not reforming to reform. Instead, there is only one purpose to each reform we undertake: to improve the lives of all citizens. The reforms being implemented by the Government would serve no purpose without ensuring that tangible benefits are accessible to all citizens, and that adequate protections and safety nets are within easy reach of our most vulnerable populations. From the start in 2017, we are proud that in almost equal proportion, each of our major economic reforms has been accompanied by equally important social reforms. The strength of the social reform agenda has been essential to maintaining high levels of public support for the reforms. Large safety net expansions have helped us buffer our most vulnerable citizens from high adjustment costs that have repeatedly led to failed reform programs in other transitioning economies. They have also accelerated our ability to advance difficult economic reforms, such as the increase in utility tariffs and the liberalization of most market prices, that took other countries much longer to achieve. Our early focus on social reforms also left us in a position of strength to respond decisively to the COVID-19 crisis, enabling a rapid increase in health and safety net spending during the worst of the lockdowns.

Since the approval of the last DPO, the government has also accelerated other social reforms, the most notable of which was the removal this year of the propiska (internal passport) system, a policy inherited from Soviet times. The abolition of the propiska system has the potential to truly transform the lives of our citizens, by delivering substantial benefits through increased opportunities for citizens, better access to public services, and increased availability of talent for the private sector.



The removal of this deeply unpopular policy has immense symbolic value to our citizens. Under the former system, citizens faced substantial financial and legal risks, and exclusion from access to basic public services such as health and education, without a valid propiska. In his state-of-the-nation speech to Parliament this January, our President noted, of propiska, that “we have shackled our citizens and failed to solve this problem for 30 years”. Through the determined leadership of our President to overcome opposing views, and with analytical support and policy engagement from the World Bank, this “shackle” was removed earlier this year. In its place is a new and streamlined residential registration system can be easily completed and obtained electronically. The registration system will be used to better understand where public service delivery pressures may be building and allow the government to make early investments to expand the availability of public services and infrastructure in high-demand areas. It can only be denied to citizens under exceptional circumstances, and even then, such denials are subject to a robust appeals process.

The removal of propiska has received substantial public praise and support, which in turn will serve to inspire the Government to continue addressing other constraints to internal labor mobility, such as the high costs of housing, public service delivery constraints, and labor market policies. As part of the approved measures removing propiska, work is already under way to identify ways of expanding public services in areas expected to see increased internal migration. The government is also reducing labor market frictions through new employment legislation that was recently adopted, and through a complete overhaul of Uzbekistan’s dated labor code, which will be finalized in the coming months. To address high costs of housing, the government is working closely with development partners to identify market-based mechanisms to provide decent and affordable housing and access to mortgage financing. I am confident that these measures will continue to improve the efficiency of Uzbekistan’s labor market.

We will not succeed with our reforms if people are excluded from them. The longer we wait to implement inclusive reforms, the more difficult it becomes for those who are excluded to catch-up with the wider population that has prospered from the reform process. Core to our reform strategy is to invest decisively in maximizing social inclusion as early as possible in our transition.

The approval of new laws in 2019 to guarantee equal opportunities for women and men, and to address gender-based violence, were important steps as part of a systematic effort to increase the participation of all citizens in the economy.



The government continues to make good progress in implementing requirements in the laws, including through measures supported in this DPO. The government, with support from the Parliament, has committed extensive resources to identify barriers limiting the participation of women in the economy, and has created new review mechanisms to regularly assess the level of inclusion that is taking place. This October, the government expanded its focus to include people with disabilities, with the passage of historic legislation guaranteeing the rights of people with disabilities. This legislation, prepared with active participation from disabled people, guarantees non-discrimination based on disability and the right to an inclusive education from preschool to postgraduate level for disabled people. Further regulatory and legislative work to implement this new law will be done in 2021.

While these reforms constitute a substantial social reform agenda, they are not enough. A truly inclusive transformation that puts people first cannot occur without confronting and defeating the scourge of poverty. This year, and for the first time in Uzbekistan's history, the Government publicly declared its determination to reduce poverty. With support from the World Bank and other partners, the Government is developing a new poverty reduction strategy, the first for Uzbekistan, which will serve as the framework guiding the Government's medium-term work program of measures to systematically target and eliminate poverty in Uzbekistan. Our intention is to achieve this ambitious goal through programs that grow and nourish entrepreneurship in the economy, address weaknesses in the private sector business environment that constrain job creation, improve labor market policies, and provide better targeted social assistance to those most in need. To improve the effectiveness and targeting of our strategies, the Government is also working closely with the World Bank to modernize the approach and methodology used in measuring and tracking poverty. Just like the abolition of propiska, the radical shift in the government's attitude towards poverty carries profound symbolism for our people and helps strengthen public support for the reforms.

### **Conclusion**

I hope that through this brief glimpse into our reform program, I have been able to show you the immense breadth of our ongoing transformation, and of the government's resolute commitment to delivering better outcomes for our people.

Although I have chosen to showcase three specific themes from our reform program, we continue to make substantial progress in other important areas such as improving our macroeconomic coordination and management, enhancing fiscal transparency and budget accountability, reducing subsidies and



preferences, improving tax administration, increasing regional and global trade integration, expanding public infrastructure, and strengthening the reliability and availability of energy. In each of these areas, the government is working closely with the World Bank and other partners to continue the implementation of reforms, and we expect to continue these reforms at a strong pace. Even these additional reforms that I have outlined represent only a small fraction of a much larger transformation that is under way in Uzbekistan. From newly established regional bodies that are directly elected by the people to strengthen public accountability, to expanded personal and religious freedoms, to a more open media, it is a transformation that touches upon every aspect of the economy, society, and polity of Uzbekistan. And it is a transformation that we are proud to work alongside the World Bank with.

Uzbekistan's collective resolve to undertake these reforms, and in more recent times to overcome the pandemic, has elevated the best of our country's spirit. Time and time again, this has been demonstrated by the strong collaboration between government, the private sector, communities, during the most difficult periods we have faced over these last few years, including most notably the health containment measures earlier this year. Any successes we have achieved have been built on the hard work of our people and the steadfast support of our people. During this pandemic, we have seen their spirit and resolve shine bright, from our heroic and tireless health workers and volunteers, to our public institutions that have responded and mobilized quickly to buffer the unavoidable economic and social costs that have emerged this year. The COVID-19 pandemic is testing Uzbekistan's resolve at every opportunity, but I am afraid that the pandemic does not seem to understand the message we are sending in response: it will never succeed in shaking our resolve. In response to each challenge the pandemic creates for us, our economy and society will emerge stronger, more open, more resilient, and more sustainable. Looking ahead, I am brimming with optimism that Uzbekistan will use its strengths to overcome its weaknesses. We will confront, weaken, and eventually defeat this pandemic. We will emerge stronger, more resilient, and better prepared. This fight will not be easy, nor will it be without costs, but by maintaining our common purpose and sustaining the implementation of reforms, I am confident that Uzbekistan will rapidly converge back to its immense and growing potential.

Although we may feel like we have accomplished a considerable amount in these last four years, I believe that Uzbekistan's reform program is something that is continuous, like a story with no ending. This is because the status-quo will never be acceptable to our citizens, or to the Government. We will always and continuously strive to do more. And the World Bank's steadfast support to the Government's reform program, especially during these unprecedented times of heightened risks and challenges, makes me even more certain that you and your team understand Uzbekistan's resolve in the same way.



On behalf of the government, I thank you and your team for your support, and for the strong friendship, each of you has built with our people. As we look ahead to a new and bolder Country Partnership Framework to guide our relationship, I am pleased that we will continue to work together to harness Uzbekistan's bright future.

Sincerely,

A handwritten signature in black ink, appearing to read 'Djamshid Kuchkarov', written in a cursive style.

Djamshid Kuchkarov  
Deputy Prime Minister  
Minister of Economic Development and Poverty Reduction  
and WBG Governor



**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
<b>Pillar 1: Improving the efficiency, sustainability, and transparency of resource allocation in the economy</b>		
<p><b>Prior Action 1:</b> To increase the efficiency of financial resource allocation and strengthen transparency in the banking sector in implementation of the Government’s approved banking law and financial sector reform strategy, the Borrower has:</p> <ul style="list-style-type: none"> <li>(i) prohibited all new on-lending to State Owned Enterprises (“SOEs”) by state commercial banks using subsidized funds from the Uzbekistan Fund for Reconstruction and Development (“UFRD”);</li> <li>(ii) required all new commercial bank lending in local currency, from 1 January 2020, to be at interest rates at or above the central bank reference rate, except for government loans for mortgage lending and the production of raw cotton and grains; and</li> <li>(iii) appointed at least one independent director, consistent with requirements in the Banking Law, to each of the boards of at least ten state-owned commercial banks.</li> </ul>	<b>Neutral measure</b>	<b>Potentially negative</b> poverty effects
<p><b>Prior Action 2:</b> In accordance with the Borrower’s agricultural modernization strategy to increase climate resilience, diversify agriculture, increase the transparency and efficiency of land distribution, and eliminate state agricultural production, the Borrower has abrogated the state cotton order system by removing mandatory cotton production targets and mandatory state procurement of cotton.</p>	<p><b>Positive</b> (arising from adoption of climate smart technologies, lower water consumption) and <b>potentially negative</b> (from land/soil degradation and pollution and pesticide use).</p>	<p><b>Positive</b> distributional social and poverty-related effects, <b>potential negative</b> impact on vulnerable groups, such as voluntary low-income workers, especially women, in marginal growing areas.</p>



<p><b>Prior Action 3:</b> To reduce inefficient fossil fuel subsidies, the Borrower has abrogated the State’s regulation of the retail price of AI-80 petroleum, diesel, and ECO diesel.</p>	<p><b>Positive</b> by curbing fuel consumption, with benefits accruing over time as fuel prices increase, and assuming limited switching to other subsidized or less clean fuel technologies.</p>	<p><b>Neutral short-term effect</b> given low fuel prices, <b>positive distributional effects over medium term, moderate risks of increased poverty</b> through direct and indirect price effects.</p>
<p><b>Prior Action 4:</b> To enhance the enabling environment and transparency of public-private partnerships (“PPPs”) in the renewable energy and other infrastructure sectors, the Borrower has submitted legislative draft amendments to the PPP and Currency Regulation Laws, for Parliamentary approval, to:</p> <ul style="list-style-type: none"> <li>(i) allow the Government to enter foreign currency financial commitments in PPP concession agreements and allow financial compensation to be paid to investors against losses which may arise from changes to legislation in force on the date of the partnership agreement; and</li> <li>(ii) strengthen public information disclosure requirements for PPP tenders and PPPs under implementation.</li> </ul>	<p><b>Potential positive</b> (through less GHG emissions and environmental pollution) <b>and negative</b> (biodiversity degradation, land pollution, insufficient guidance to investors).</p>	<p><b>Neutral measure</b></p>
<p><b>Prior Action 5:</b> To improve the financial transparency and performance of state-owned enterprises (SOEs) and reduce state ownership of assets, the Borrower has:</p> <ul style="list-style-type: none"> <li>(i) required 32 of the largest SOEs by financial valuation to (a) adopt international financial reporting standards, (b) prepare enterprise financial recovery strategies, and (c) obtain international credit ratings starting from 2021; and</li> <li>(ii) approved a list of SOEs that will be divested of government ownership via a competitive process.</li> </ul>	<p><b>Potential positive</b> (through increased resource efficiency) <b>and negative</b> (environmental liabilities and responsibilities of new owners)</p>	<p><b>Neutral</b> poverty implications from measures supported at this stage of SOE reform process. However, negative poverty and social implications may arise later during the privatization process requiring early investments in mitigation measures.</p>
<p><b>Prior Action 6:</b> To increase fiscal transparency and strengthen public ownership of the State Budget, the Borrower has enacted amendments to the Budget Code of the Republic of Uzbekistan to:</p> <ul style="list-style-type: none"> <li>(i) vest the Parliament, Jokargy Kenes, and regional kengashlar with the responsibility of approving their respective budgets; and</li> <li>(ii) incorporate the income and expenses of the Uzbekistan Fund for Reconstruction</li> </ul>	<p><b>Neutral measure</b></p>	<p><b>Positive</b> social effects.</p>



and Development in the State Budget Law draft.		
<b>Pillar 2: Enhancing economic inclusion and social resilience</b>		
<p><b>Prior Action 7:</b> To increase domestic labor mobility, improve access to public services such as health and education, and expand economic opportunities for citizens, the Borrower has: (i) reduced restrictions on the issuance of new residency registrations by expanding eligibility criteria for registration in Tashkent and (ii) simplified and digitized residency registration procedures.</p>	<b>Neutral measure</b>	<b>Positive</b> social and poverty effects.
<p><b>Prior Action 8:</b> To reduce barriers limiting the full economic participation and safety of women, the Borrower has issued regulations to further implement legislation: (i) guaranteeing non-discrimination on the basis of sex for employment, electoral candidacy, and for access to state resources; and (ii) for the issuance, enforcement, and monitoring of protection orders for survivors of gender-based violence.</p>	<b>Neutral measure</b>	<b>Positive</b> social effects.
<p><b>Prior Action 9:</b> To increase support for vulnerable households during the COVID-19 crisis and to further strengthen the efficiency and transparency of the social safety net system and its responsiveness in targeting people affected by future sources of vulnerability, including climate vulnerable groups, the Borrower has:</p> <ul style="list-style-type: none"> <li>(i) increased by 10 percent the number of beneficiaries receiving low-income family allowances and waived re-registration requirements for existing low-income family allowance recipients, in response to the COVID-19 crisis; and</li> <li>(ii) approved the transition of all regions in the country to using the Single Registry of Social Protection to process applicant registration, beneficiary selection, program enrollment and payment orders.</li> </ul>	<b>Neutral measure</b>	<b>Positive</b> social and distributional effects, with <b>some risks of negative effects</b> for vulnerable people if improperly implemented.



**ANNEX 5: OVERVIEW OF DPO REFORMS AND RESULTS SINCE 2017**

Sector	Reforms supported in the first two DPO engagements	Reforms the Government has completed in this DPO	Major results
<b>Areas of support across all DPOs since 2017</b>			
<b>Agriculture</b>	<ul style="list-style-type: none"> <li>• Large reduction in cotton/wheat growing areas</li> <li>• Increase in wheat and cotton farmgate prices to equalize with international benchmarks</li> <li>• Removal of almost all horticulture export barriers</li> <li>• Liberalization of bread prices</li> </ul>	<ul style="list-style-type: none"> <li>• Ending mandatory cotton production targets for farmers, and all mandatory state cotton production surrender requirements</li> </ul>	<ul style="list-style-type: none"> <li>• A revival of agriculture growth and record horticultural exports</li> <li>• Up to 1.2 percent of GDP increase in rural incomes from higher farmgate prices for cotton and wheat production</li> <li>• End of systematic forced and child labor</li> </ul>
<b>Energy</b>	<ul style="list-style-type: none"> <li>• New renewable energy legal and institutional framework</li> <li>• New energy tariff policy and methodology, and the establishment of a new tariff commission to improve independence of tariff-setting</li> <li>• Electricity and gas tariff reforms to strengthen cost-recovery</li> <li>• IFRS accounts and audits of main energy and gas SOEs</li> </ul>	<ul style="list-style-type: none"> <li>• Ending all retail petroleum price controls (and subsidies)</li> <li>• Removing constraints to increased private sector investments in energy generation PPPs</li> </ul>	<ul style="list-style-type: none"> <li>• Unbundling of vertical gas and electricity SOEs, separation of policy/regulation to new Ministry of Energy</li> <li>• Electricity cost recovery from 70 to 92 percent within 2 years.</li> <li>• First competitive and transparent private investments in power generation in Uzbekistan's history</li> </ul>
<b>Financial Sector</b>	<ul style="list-style-type: none"> <li>• Strengthened prudential requirements to comply with Basel Core Principles, and stress testing requirements</li> <li>• Modernization of banking legislation</li> </ul>	<ul style="list-style-type: none"> <li>• Stopping UFRD on-lending via commercial banks</li> <li>• Ending almost all preferential lending by state banks</li> <li>• Strengthening independent governance of Bank boards</li> </ul>	<ul style="list-style-type: none"> <li>• Substantial improvement in capital and liquidity buffers</li> <li>• Sharp slowdown in preferential lending and credit growth from state-directed lending</li> </ul>
<b>SOE Reform</b>	<ul style="list-style-type: none"> <li>• Creation of SOE reform agencies</li> <li>• Unbundling of vertically integrated national airline SOE</li> <li>• Increased financial transparency of energy SOEs</li> </ul>	<ul style="list-style-type: none"> <li>• SOE reform framework to improve the performance of the largest SOEs</li> <li>• Identification of at least 15 percent of all SOEs to be fully privatized via a competitive process</li> </ul>	<ul style="list-style-type: none"> <li>• Identification and transfer of all SOE shares to new agency and initiation of privatization process.</li> <li>• Forthcoming PPP of domestic airports</li> </ul>
<b>Fiscal transparency</b>	<ul style="list-style-type: none"> <li>• Full disclosure of budget information to public</li> </ul>	<ul style="list-style-type: none"> <li>• Integration of UFRD revenue/expenditure into</li> </ul>	<ul style="list-style-type: none"> <li>• The full 2021 Budget will be publicly consulted before</li> </ul>



	<ul style="list-style-type: none"> <li>• Preparation of citizen budgets to explain public spending.</li> <li>• Fiscal consolidation to close and consolidate off-budget accounts</li> <li>• New community-level budgets where citizens can determine how spending occurs</li> </ul>	<p>State budget (4% of GDP of off-budget spending now on-budget)</p> <ul style="list-style-type: none"> <li>• Transfer of budget approval and accountability from Cabinet/President to Parliament and regional parliaments</li> </ul>	<p>submission to Parliament, the first time in Uzbekistan’s history</p> <ul style="list-style-type: none"> <li>• Substantial reduction in off-budget spending, from over 6 percent of GDP to an estimated 1.5-2 percent of GDP</li> </ul>
<b>Social protection and labor</b>	<ul style="list-style-type: none"> <li>• Ending systematic forced and child labor by the state</li> <li>• 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)</li> <li>• Creation of a unified social registry</li> <li>• Improved seasonal contractual conditions and obligations.</li> <li>• Tax reforms to address disproportionate labor taxes discouraging formal employment</li> </ul>	<ul style="list-style-type: none"> <li>• Removal of almost all internal migration controls</li> <li>• 10% increase in low-income allowance beneficiaries for COVID</li> <li>• Countrywide rollout of a new unified social registry to consolidate and improve safety net coverage and amounts</li> </ul>	<ul style="list-style-type: none"> <li>• Largest social assistance beneficiary expansions since independence</li> <li>• Complete transformation of safety net system with single registry, with transparent data on applications and decisions</li> </ul>
<b>Other Reforms Supported in Previous DPOs.</b>			
<b>Liberalization of business and trading environment</b>	<ul style="list-style-type: none"> <li>• Unification of exchange rate through an unannounced 50 percent overnight devaluation of the som against the US dollar</li> <li>• The removal of all current account foreign exchange restrictions and export earnings surrender requirements</li> <li>• Removal of onerous domestic trading licensing regulations and firm-to-firm advance prepayment requirements</li> <li>• Price liberalization and removal of trading restrictions to allow market-based formation of prices</li> <li>• Reduction in average import tariffs</li> </ul>		<ul style="list-style-type: none"> <li>• Average import tariffs fell from 13 to 8 percent</li> <li>• Foreign exchange access, once the biggest firm constraint, is no longer a problem</li> <li>• Record increases in 2019 and first three quarters of 2020 in domestic trading businesses</li> <li>• Average tariffs have fallen from 13 to 7.9 percent</li> </ul>