Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 11-Nov-2021 | Report No: PIDA33167

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Uzbekistan	P176353	Accelerating Uzbekistan's Transition Development Policy Operation (P176353)	
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
EUROPE AND CENTRAL ASIA	17-Dec-2021	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Ministry of Finance	Ministry of Finance		

Proposed Development Objective(s)

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

Financing (in US$, Millions)

SUMMARY

Total Financing	400.00

DETAILS

Total World Bank Group Financing	400.00
World Bank Lending	400.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

Despite the social adjustment costs from the transition, the reform agenda continues to enjoy broad public and political support. In the latest Listening to Citizens of Uzbekistan report—a nationally representative survey conducted by the World Bank to monitor reform sentiment, over 85 percent of those surveyed believed that the country was headed in the right direction. A strong anti-crisis response has also helped moderate the pandemic's impact on people and the economy and fortified public support. A successor to the 2017-2021 Development Strategy is expected to be announced by the end of 2021 and is expected to be underpinned by a renewed commitment to the reform effort. The reform program also is being supported extensively by bilateral and multilateral development partners.

Over the last five years, Uzbekistan has made solid progress in its market transition. Since late 2016, Uzbekistan has implemented wide-reaching economic and social reforms with remarkable speed. Most prices have been liberalized. Foreign exchange is now fully convertible for current account needs. An overhaul of the tax and regulatory system has substantially lowered barriers that suppressed private sector development in favor of state enterprises. State-directed lending at interest rates below the official monetary policy reference rate has largely ended. Reforms to liberalize horticultural exports and improve cotton and wheat policies have contributed to surges in agricultural output and productivity. These reforms, which have been supported through successive DPOs, contributed to record increases in new business and taxpayer registrations, horticultural exports, and tourist arrivals prior to the pandemic. They also supported Uzbekistan's efforts to weather the COVID-19 crisis and helped maintain positive economic growth in 2020. Crucially, they have led to visible improvements in the lives of the Uzbek citizens: the poverty rates are visibly lower, incomes of the bottom 40 percent considerably higher, and economic freedoms more readily enjoyed, and environmental stresses, such as the impact of climate change, more visibly acknowledged.

Uzbekistan has ambitious aspirations of halving poverty by 2026 and becoming an upper-middle-income country by 2030: achieving these goals will require acceleration of an already bold reform agenda.[1] In order for Uzbekistan to become an upper-middle income economy by 2030, growth will need to average about ten percent annually. To halve poverty, this high growth will have to be accompanied by the creation of more and better jobs that reduce the high unemployment rate (10.5 percent in 2020) and increase incomes for all citizens. These are ambitious goals. But Uzbekistan's strong start to the transition suggests that higher growth rates and faster poverty reduction are achievable. To make meaningful progress toward these, state controls over factor markets and thousands of SOEs will need to be loosened to improve efficiency of resource allocation and prevent crowding out of the private sector, including in sectors where considerable private sector interest exists such as energy, telecommunications, chemicals, and aviation. Greater attention will be needed to the services sector. Uzbekistan's economy has one of the smallest service sectors as a share of GDP—the driver of job creation in successful economic transitions—in the region and in its income group. Public investments will require closer alignment to development and policy priorities and better coordination through a consolidated budget planning and execution process. Greater outward orientation, on the back of stronger trade and FDI linkages, will also be critical for higher GDP growth rates. Policies to support the economic inclusion of women, youth, and the disabled will be important to enhance inclusion.

An adequate macroeconomic policy framework and continued public and political support for the reforms moderate risks to this operation. The country has continued to weather the crisis while maintaining strong fiscal and external buffers. A pandemic-induced higher fiscal deficit is expected to return to more sustainable levels through consolidation of public spending over the medium term. Though the current account deficit is projected to remain

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

elevated over the medium term, external risks are mitigated by high foreign exchange reserves and continued access to concessional and non-concessional financing. Public debt is projected to stabilize at a modest level of about 40 percent of GDP within the next two years. The government has continued to implement effective measures to strengthen the transparency and management of the budget and government debt. Slowing credit growth, improving monetary policy transmission and continued exchange rate flexibility are helping to contain inflation risks. Nevertheless, Uzbekistan still faces risks, including continued global supply chain and border disruptions; further pandemic-induced external shocks impacting domestic economic performance and financial sector stability; and adverse weather conditions that affect agricultural output. With a more complex phase of reforms ahead, the main risks to this operation are likely to emerge from institutional constraints, with Uzbekistan's broad and sweeping reform agenda requiring large amounts of administrative capacity and expertise that is thinly stretched. These risks are being mitigated through strong development partner technical support and through the government's own efforts to procure international technical expertise and advisory services. Although social discontent with reforms remains low and well managed—largely through effective reforms that have increased incomes quickly and mitigated the most adverse price and economic shocks to vulnerable households—they remain an ever-present risk, especially during periods of reform that involve price and employment adjustments. With utility tariffs still below cost recovery levels and with the SOE reform process still at a nascent stage, these risks will continue to require careful monitoring and effective mitigation strategies such as those deployed over the last five years

Relationship to CPF

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 is consistent with the first and second focus areas in the revised CPF (supporting a Sustainable Transformation toward a Market Economy and Reforming State Institutions and Citizen Engagement). The second and third pillars of the PDO supports the third CPF focus areas of investing in people. Both the revised focus areas under the PLR, and the pillars of the PDO, are consistent with the findings of the first Systematic Country Diagnostic (SCD), and the findings of the nearly-complete second SCD under preparation.[2]

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 and second PDO pillars support the third and fourth pillars linked to ensuring sustainable business growth and job creation, and on strengthening policies, institutions, and investments for rebuilding better. The third PDO pillar is consistent with the second pillar of the approach paper linked to protecting poor and vulnerable people.

The full span of the WBG's operational, analytical, and policy engagements have contributed to this operation. These include: (i) a forthcoming Country Economic Memorandum and public expenditure reviews; (ii) implementation support for the Agricultural Modernization Project to further deepen the agricultural reform program; (iv) implementation support for the Institutional Building Loan Project to improve fiscal transparency and risk management, and support the SOE reform process; (v) analytical work on citizen engagement, including the Listening to the Citizens of Uzbekistan (L2CU) survey which provide support to improve citizen engagement platforms; (vii) several IFC advisory support programs in the financial sector and to support effective PPP management; and (viii) the IFC Country Private Sector Diagnostic for Uzbekistan, which has underpinned the World Bank's engagement and support for private-sector focused reforms that maximize financing for development.

C. Proposed Development Objective(s)

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

[2] A second Systematic Country Diagnostic is under preparation ahead of a new Country Partnership Framework that will be submitted to the Board in FY22.

Key Results

Measures supported under this operation are likely to support the government's objective of accelerating its economic transition while continuing to strongly emphasize policies that increase economic and social inclusion. Measures under the first pillar of the proposed development objectives are expected to (a) increase the efficiency and value for money of state-owned enterprises, while creating more room for private sector development; and (b) increase the market orientation of the agriculture sector through the removal of mandatory state procurement in the wheat sector. Measures in the second pillar are expected to contribute to greater public spending efficiency and enhanced transparency and effectiveness of public debt management. Measures in the third pillar are expected to (a) improve labor market relations by providing a clearer environment for hiring, contract termination and separation, and increase equal opportunities and equal pay for men and women; (b) accelerate efforts to reduce poverty by better aligning levels of social assistance payments to the needs of the poor; and (c) accelerate the inclusion of people with disabilities into the economy.

D. Project Description

The proposed standalone operation would support the proposed development objectives by helping deepen reforms to strengthen market institutions and improve state enterprise efficiency, increase public sector transparency and accountability, and promote inclusion—especially of women and persons with disabilities. Reforms to liberalize wheat markets are expected to increase farmer incomes and strengthen food security. New SOE corporate governance legislation will strengthen competitive neutrality between SOEs and the private sector and enforce harder budget constraints for SOEs to reduce large quasi-fiscal subsidies (estimated at around six percent of GDP) and improve their operational efficiency. Reforms to the energy sector will unbundle state ownership, increase tariff regulatory autonomy, and establish new wholesale markets. Revisions to the Budget Code will consolidate all on- and off-budget public spending into a single Budget Law that is subject to parliamentary oversight—in 2018 over half of public spending was off-budget and outside the purview of this process. A new labor code will modernize labor relations. The establishment of a new minimum consumption level based on modern practices will enable the government to better identify and target poverty and strengthen its protection of poor and vulnerable citizens. Finally, Uzbekistan's recent decision to ratify the United Nations Convention on the Rights of Persons with Disabilities (CRPD) provides a strong commitment mechanism for the implementation of ambitious disability rights and equal opportunities legislation that was adopted last year.

E. Implementation

Institutional and Implementation Arrangements

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 proposed under this operation.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

The proposed operation is expected to improve the efficient deployment of resources and increase the progressivity of the fiscal and regulatory system. Of eight proposed prior actions, four have clear, significant, and direct poverty and/or distributional implications. Three actions are expected to have positive poverty and or distributional implications. These include the new labor code, the adoption of the new poverty line, and Uzbekistan's ratification of the UN CRPD. Two actions could potentially increase the short-term incidence of poverty and/or entail short-term negative social impacts, while at the same time generating progressive distributional outcomes. These are policy actions to reform the agriculture and energy sector. Where negative effects are present, they are not unprecedented or irreversible, and mitigation measures through the social protection system would moderate the expected poverty impacts relating to these actions.

Environmental, Forests, and Other Natural Resource Aspects

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

G. Risks and Mitigation

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

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APPROVAL

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