Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 10-Apr-2019 | Report No: PIDA26754

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Uzbekistan	P168280	Sustaining Market Reforms in Uzbekistan Development Policy Operation (P168280)	
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
EUROPE AND CENTRAL ASIA	18-Jun-2019	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Republic of Uzbekistan	Ministry of Finance of the Republic of Uzbekistan		

Proposed Development Objective(s)

Sustain Uzbekistan's economic reforms and transition to a market economy by (i) increasing the role of markets and the private sector in the economy; and (ii) enhancing social inclusion.

Financing (in US$, Millions)

SUMMARY

Total Financing	500.00

DETAILS

Total World Bank Group Financing	500.00
World Bank Lending	500.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

Annual real GDP growth remains strong despite a slowdown in recent years. Growth in 2018 was 5.1 percent, up from 4.5 percent in 2017, but lower than recent historical averages. Domestic demand has remained strong on the back of domestic investment from government directed credit to modernize SOE operations. Despite the robust (albeit lower) growth rates, persistently slow employment generation has been a key area of policy concern. The number of new jobs grew at an average rate of just ¾ percent between 2015-2018, leading to an increase in outward labor migration and persistence of unemployment at relatively high levels (8.3 percent in 2018). Fiscal policy has been prudent on balance, although the magnitude of and the lack of transparency around extra-budgetary spending is a key concern. Major improvements in tax administration played an important role in boosting overall tax collection. The overall fiscal balance, including extrabudgetary operations was in deficit by 1.6 percent of GDP in 2018, and is likely to remain at similar levels over the medium term. While external balances have been on a sustainable path, a surge in public investment created an unexpectedly large current account deficit in 2018. A large increase in machinery imports and weaker export growth propelled the current account to a deficit of close to 8 percent of GDP. The deficit was financed by a drawdown on external reserves, which remains at a comfortable level of $27 billion (or 14 months of import cover). Weaknesses in export growth continue to highlight structural constraints in the economy that require policy attention.

Uzbekistan's macroeconomic environment remains supportive of the ongoing reform agenda, but careful economic management will be needed to mitigate potential risks on the horizon. Economic growth is expected to remain robust over the medium term, and low debt levels, fiscal prudence, large international reserve buffers, and sustainable external balances would help to maintain macroeconomic sustainability. While inflation remains elevated, it is expected to gradually moderate over the medium-term. Faster reductions in inflation could be helped through fiscal discipline and an end to the use of directed credit to the economy, and, in the longer term, through stronger transmission channels for the conduct of monetary policy. This outlook, however, is subject to risks, including: external economic shocks such as deterioration in the economic performance of major trading partners, adverse weather conditions, and the occurrence of a major natural disaster[1]. The Government's recent efforts to strengthen revenue and budgetary expenditure discipline and improve fiscal transparency and risk management, and recent public announcements expressing commitments to end directed credit practices, will serve as effective mitigation mechanisms.

Uzbekistan has already taken a series of meaningful initial steps in its transition journey. The reforms were launched with a major decision in September 2017 to liberalize foreign exchange market controls and unify the official and market exchange rates through a 50 percent devaluation of the som against the US dollar. Since then, authorities have undertaken a wide range of other reforms, including an overhaul of the tax system to improve its efficiency and broaden the tax base; the removal of several price, production, and trading controls; an easing of cumbersome bureaucratic processes; significant cuts to import tariffs in preparation for WTO accession; an expansion of social safety nets; and major reforms to simplify visa and visitor registration processes.

However, the long transition process has only just begun, and the challenges are far from over. Job creation has been slow, Uzbekistan's participation in global value chains remains limited, and significant gaps remain in Uzbekistan's social safety net, education and health systems. Moreover, the more visible benefits of market-oriented reforms (for instance, increased participation of private investors) tend to manifest with significant lags and require a strong sequence of complementary reforms. These reforms, such as the restructuring of SOEs and the banking sector, and the development of more accountable public institutions are also likely to be more politically complex to tackle. The situation calls for a patient and resolute approach, backed by targeted and adequate external support

[1] 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.

Relationship to CPF

This proposed operation is fully consistent with the World Bank Group's twin goals, and the new focus areas in Uzbekistan following the 2018 Performance and Learning Review (PLR) of the 2016-2020 Country Partnership Framework. Adjustments to the CPF were made following a clear signal from authorities about its intentions to undertake a faster, deeper and broader program of economic and social reform. The overall objective of the operation – to sustain the reform agenda – is consistent with the first pillar of the revised focus areas following the PLR (supporting a Sustainable Transformation towards a Market Economy). The first and second components of the PDO addresses institutional and market constraints to private sector led growth and factor market development – priorities in the first pillar of the revised CPF. The third component of the PDO aims to strengthen the effectiveness of the state and is aligned with the second and third pillars of the revised CPF by supporting reforms of state institutions and investing in people. The focus of this operation remains fully consistent with the findings of the Systematic Country Diagnostic.

C. Proposed Development Objective(s)

Sustain Uzbekistan's economic reforms and transition to a market economy by (i) increasing the role of markets and the private sector in the economy; and (ii) strengthening the inclusivity of the economic transition.

Key Results

Over time and in conjunction with other reforms being implemented by the Government, the actions in this operation are likely to make a significant contribution to Uzbekistan's transition to a sustainable market-let economy. Actions supported in this operation would support increased private-sector led trade, competition, and investment; greater efficiency in factor market allocations (land, labor, capital) towards more productive parts of the economy, improved fiscal transparency and accountability, more effective management of public resources (especially state enterprises), improvements in health and education outcomes for citizens, and stronger safeguards for poor and vulnerable citizens.

D. Project Description

Prior actions in the proposed operation are organized by two pillars, consistent with the PDO of this operation: (i) to increase the role of the market and the private sector in the economy; and (ii) enhancing social inclusion. The first pillar focuses on actions to increase trade and strengthen financial sector oversight. It also focuses on critical institutional reforms that are critical to increasing domestic and foreign private sector investment in the economy. The second pillar focuses on the inclusivity of the reform agenda by actions to address tax, labor mobility and skills constraints to greater formal job growth in the economy, strengthen safety nets, and enhance the voice and participation of citizens in the budget.

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 Tax Committee, the Ministry of Investment and Foreign Trade, the General Directorate of State Inspection for Supervision of Quality of Education, the Ministry of Education, the National Asset Management Agency, the Office of the Cabinet of Ministers of Uzbekistan, 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.

F. Poverty and Social Impacts and Environmental Aspects

Poverty and Social Impacts

Actions in this operation will be evaluated for poverty and social impacts. The anticipated impacts of the actions in this operation are expected to be small, particularly when accounting for mitigation measures taken by the authorities.

Environmental Aspects

Actions in this operation will be evaluated for environmental and climate change impacts. Several prior actions are expected to have a positive impact on the environment and reflect positive efforts by the authorities to mitigate, and adapt to, the effects of climate change. Some actions will require consideration of environmental policy and regulatory issues at an early stage of the transition process to minimize any risks of negative impacts.

G. Risks and Mitigation

The overall risk to the operation is substantial. Uzbekistan's ambitious reform program is now entering a second, and more challenging, phase. The reforms supported through this proposed operation tackle deeper and more complex reform challenges which carry substantial economic, political and social risks. Supporting the effective implementation of reforms in these areas, including the mitigation of social risks, is critical to the sustainability of the reform agenda. The Government recognizes these risks and is working closely with the World Bank and other international development partners to obtain robust analytical advice and implementation guidance before major decisions are taken. The pace and comprehensiveness of the reforms, however, continues continue to generate substantial implementation risks that require careful monitoring. The most relevant risks for this operation are political, sectoral, institutional capacity, and social risks. Other risks are assessed moderate or low.

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APPROVAL

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