



**The World Bank**

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

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# Program Information Document (PID)

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Appraisal Stage | Date Prepared/Updated: 02-Nov-2020 | Report No: PIDA30806

**BASIC INFORMATION****A. Basic Project Data**

Country	Project ID	Project Name	Parent Project ID (if any)
Uzbekistan	P171751	Uzbekistan: Supporting a Transparent and Inclusive Market Transition (P171751)	
Region	Estimated Board Date	Practice Area (Lead)	Financing Instrument
EUROPE AND CENTRAL ASIA	16-Dec-2020	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	Implementing Agency		
Ministry of Finance of the Republic of Uzbekistan	Ministry of Finance of the Republic of Uzbekistan		

**Proposed Development Objective(s)**

To (i) improve the efficiency, sustainability, and transparency of resource utilization in the economy; and (ii) enhance economic inclusion and social resilience.

**Financing (in US\$, Millions)****SUMMARY**

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

<b>Total World Bank Group Financing</b>	500.00
World Bank Lending	500.00

**Decision**

The review did authorize the team to appraise and negotiate

**B. Introduction and Context****Country Context**

**The COVID-19 crisis has delivered a sharp blow to an economy that was expanding vigorously from wide-ranging structural reforms.** Real gross domestic product (GDP) growth rose substantially in 2019 and was broad-based, sustaining the reduction in poverty – the result of several reforms enacted since 2017. Unification of the multiple exchange rates and trade liberalization created much needed stability in the foreign exchange market and enabled firms to boost investment with imported machinery and equipment. Ambitious reforms of the tax system and the business regulatory



environment reduced costs and the burden of compliance for the private sector, leading to more business dynamism and buoyant manufacturing and construction activity. Trade liberalization (including restarting of the negotiations for WTO accession and the removal of horticultural export barriers), large increases in farmgate procurement prices of cotton and wheat, and improved reliability of energy supplies and other intermediate inputs led to a surge in trade and transport links with neighbors and was a boon for horticultural exports. A revamp of the visa process contributed to record tourist arrivals. Private consumption picked up through the release of pent-up demand after years of restrictions, supported by substantial increases in wages, a boost to rural incomes from agricultural reforms, and credit expansion. The COVID-19 crisis has extinguished economic growth in 2020, hitting new and promising sectors of opportunity, such as tourism, especially hard. Macro risks have become more elevated due to the pandemic, but internal and external imbalances remain sustainable, benefiting from the strong buffers that were present prior to the crisis.

**Uzbekistan's poverty rate will increase for the first time in over two decades – nearly a million people could fall into poverty.** 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 to pre-crisis projections of 7.4 percent, after falling consistently over the last two decades. As a result, up to 900,000 more people are likely to fall into poverty, with many more at risk of facing considerable hardship. These outcomes could worsen further should there be additional disruptions to economic activity. The incomes of the poor and vulnerable have also suffered from a sharp fall in remittances, reflecting both the economic contractions in Russia and Kazakhstan (the main destinations for Uzbekistani migrants) and travel restrictions that have kept hundreds of thousands of seasonal workers from returning to work.<sup>1</sup>

**The government has provided rapid and sizeable anti-crisis support to save lives and protect the vulnerable.** 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 has spearheaded the government's policy response, with its priorities focused on 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 hiked annual spending by about 4 percent of GDP through targeted and time-bound measures linked to the crisis impact, with emphasis on expanded health services and social protection and financial support to small- and medium-sized businesses. The authorities also provided substantial but temporary tax relief to firms and households, with dividends from sizable gold sales offsetting some of the impact of the economic slowdown and tax relief measures on fiscal revenues.

**The overall risk to the operation is moderate, reflecting steady economic management that has been sustained despite the pandemic – and the high level of political and public support for reforms to continue.** Despite risks and social adjustment costs from the transition, the authorities consider the comprehensive reform program to be essential to the improvement of opportunities for Uzbekistan's citizens. Although the COVID-19 crisis has increased implementation challenges and elevated institutional and macroeconomic risks, a strong anti-crisis response has helped moderate the pandemic's impact on people and the economy. As the government begins the development of the successor to its Development Strategy, risks will be further mitigated by the continuance of a robust reform program to increase private sector investment and growth, and a renewed focus on rebuilding macroeconomic buffers. The Government of Uzbekistan considers the World Bank Group as its lead reform advisor and has requested the resources and analytical support of this proposed operation to continue implementing its ambitious reform agenda. Financing from this operation will also help ensure that public finances remain sustainable amidst the need for a strong anti-crisis fiscal response.

<sup>1</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.



## Relationship to CPF

**This proposed operation is fully consistent with the new focus areas of the 2018 Performance and Learning Review (PLR) which adjusted the 2016-2020 Country Partnership Framework (126078-UZ; June 26, 2018).** Adjustments to the CPF were made following a clear signal from authorities about its intentions to undertake a deeper and broader program of economic and social reform (**Figure 7**). The first pillar of the PDO, to increase efficiency, sustainability and transparency of resource utilization 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 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, and the emerging findings of the second Systematic Country Diagnostic under preparation.

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

**The full span of the World Bank Group'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 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; (viii) several IFC advisory support programs in the financial sector and to support effective PPP management, and (ix) the IFC Country Private Sector Diagnostic for Uzbekistan, which has underpinned our 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 Korean Government 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.

**The transformative reform agenda supported under this proposed operation is consistent with priorities for funding under the IDA Scale-Up Facility.** 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 twelve 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

### C. Proposed Development Objective(s)

To (i) improve the efficiency, sustainability, and transparency of resource utilization in the economy; and (ii) enhance economic inclusion and social resilience.

#### Key Results

**Over time, and with other reforms being implemented by the Government, the actions in this operation are likely to help sustain a more inclusive, transparent, and sustainable market transformation.** Actions supported in this operation would support reduced state direction and control of the banking sector, increased agricultural diversification, market-determined retail prices for petroleum products, increased renewable energy generation through private sector investments, an improvement in the transparency of state-owned enterprise operation and the government's divestiture intentions, increased accountability and transparency of the Republican Budget, an increase in internal labor migration, increased personal safety and economic inclusion of women, and more effective social safety nets.

### D. Project Description

**Consistent with the Government's priorities to implement an inclusive and sustainable market transition, the Program Development Objective (PDO) of the proposed operation is to (i) increase the efficiency, sustainability and transparency of resource allocation; and (ii) enhance economic inclusion and social resilience.** The proposed operation substantially deepens the program of reforms supported under the previous DPOs. The first two full DPOs<sup>2</sup>, approved by the World Bank Board in June 2018 and June 2019, focused on a first wave of measures to support price liberalizations, measures to reduce burdensome regulations and increase productivity, increasing the financial transparency and performance of large state-owned enterprises, strengthen the financial sector, and addressing weaknesses in the tax and social safety net systems. Building on these operations, this proposed operation supports the deepening of the reform agenda to address binding constraints to transparent, inclusive, and market-led growth. The first pillar of this proposed operation supports measures to reduce distortions in the banking sector, modernize agriculture by ending state cotton production, reduce highly inefficient fossil fuel subsidies, improve the investment environment for public-private partnerships (PPPs), reform SOEs, and overhaul the budget preparation and accountability process. The second pillar of the PDO, the operation supports the removal of almost all internal migration controls, measures to strengthen the economic inclusion, safety, and well-being of women, and modernize social safety net administration. The development objective of this proposed operation is closely aligned with the Government's focus on accelerating inclusive, sustainable, and market-led growth, and on strengthening public transparency and accountability.

### E. Implementation

#### Institutional and Implementation Arrangements

<sup>2</sup> The Second DPO, approved by the Board in June 2019, was augmented through a Supplementary DPO of US\$200 million in April 2020, in response to unanticipated budget needs arising from the COVID-19 crisis.



**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 Employment and Labor Relations, 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 shown in the monitoring and results framework of the policy matrix (Annex 1).

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

##### Poverty and Social Impacts

**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 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 through relaxed internal mobility constraints, improved social safety nets, improved gender equality and the safety of women, strengthened fiscal transparency and local budget involvement. Two actions, to reform the financial sector and to address agricultural constraints, 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. Where negative effects are present, they are not unprecedented or irreversible, and mitigation measures through the social protection system could moderate the expected poverty impacts relating to these actions.

##### Environmental, Forests, and Other Natural Resource Aspects

**Actions supported by the are largely neutral or positive for the environment, but two actions carry potentially positive and negative effects, and risks that can be mitigated through better integration of environmental considerations in the policymaking process.** Actions to strengthen the agriculture sector, address constraints to increased renewable energy and PPP investments, and the reform of SOEs will require careful integration of environmental policy issues to avoid longer-term adverse environmental impacts. While these areas 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 also 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.

#### G. Risks and Mitigation

**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.

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### APPROVAL

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### Approved By

Country Director:	Lilia Burunciu	02-Nov-2020
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